OPPORTUNITIES IN PRIVATIZATION

OF STATE OWNED ENTERPRISES AND PRIVATE SECTOR DEVELOPMENT

KIRIBATI

REPORT BY

Rifat Barokas & Steven Rubin

CENTER FOR PRIVATIZATION
2000 Pennsylvania Avenue, N.W. - Washington, D.C.

Project No. 57

January 1988

Prepared for the
BUREAU FOR PRIVATE ENTERPRISE
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

CENTER FOR PRIVATIZATION

The Center for Privatization was established in 1985 to provide expert advisory services to developing countries and their indigenous private sectors in planning and implementing programs to divest and privatize their state-owned or controlled enterprises and activities. The Center is fully funded under a major contract between Analysis Group, Inc. and the Agency for International Development. Participating subcontractor companies include:

Arthur Young & Co.
Equity Expansion International
Ferris & Company, Inc.
International Phoenix Corporation
Public Administration Service

The Center draws upon its consortium of six companies, and others when appropriate, to provide a wide range of qualified specialists in fields from agriculture, industry, financial and other services, transportation and utilities with experience in areas related to privatization, such as:

- Corporate Restructuring
- Employee Stock Ownership
- Equity Placement
- Financial Analysis and Valuation
- Labor Relations
- Legal and Regulatory Studies
- Macro/Micro Economic Analyses
- Marketing and Market Research
- Project Design and Evaluation
- Strategic Planning
- Taxation

2000 PENNSYLVANIA AVENUE, N.W. ······· WASHINGTON, D.C. 20006

**This Report was prepared under
AID Contract No. DPE-0008-C-00-5850-00
between the Agency for International Development
and Analysis Group, Inc.**

Dr. Rifat Barokas *has 23 years of experience in international development and management. He has worked on numerous short and long-term agricultural. transportation. sanitation and other assignments funded by the U.S. Agency for International Development. the Organization of American States. Inter-American Development Bank and other multilateral donor agencies. Dr. Barokas speaks fluent Spanish. French and Turkish.*

Steven Rubin *has over seven years professional experience as an attorney and consultant, specializing in international development projects in Latin American and the Caribbean. Mr. Rubin's most recent work concentrated on policy analysis and formulation. export and trade promotion . foreign investment, financial market and credit analysis. private sector development and project design and evaluation. He also writes regularly for professional periodicals and academic journals and speaks fluent French.*

OPPORTUNITIES IN PRIVATIZATION

OF STATE OWNED ENTERPRISES AND PRIVATE SECTOR DEVELOPMENT

KIRIBATI

REPORT BY

Rifat Barokas & Steven Rubin

CENTER FOR PRIVATIZATION
2000 Pennsylvania Avenue, N.W. - Washington, D.C.

Project No. 57 January 1988

Prepared for the
BUREAU FOR PRIVATE ENTERPRISE
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

TABLE OF CONTENTS

CHAPTER I:	EXECUTIVE SUMMARY	3
CHAPTER II:	INTRODUCTION	6
CHAPTER III:	THE ROLE OF THE PUBLIC AND PRIVATE SECTORS IN THE ECONOMY	9
CHAPTER IV:	THE NEED FOR PLANNED PRIVATIZATION: STRATEGY AND POLICY OPTIONS FOR GOVERNMENT OF KIRIBATI CONSIDERATION	26
CHAPTER V:	LEGAL FRAMEWORK	37
CHAPTER VI:	FINANCIAL RESOURCES FOR PRIVATIZATION	57
CHAPTER VII:	MANPOWER AND INSTITUTIONAL RESOURCES FOR PRIVATIZATION	60
CHAPTER VIII:	ANALYSIS OF SELECT STATE ENTERPRISES	65
CHAPTER IX:	RECOMMENDATIONS FOR THE IMPLEMENTATION OF A PHASED PRIVATIZATION PROGRAM	89
CHAPTER X:	CONCLUSIONS AND RECOMMENDATIONS	99

APPENDICES*

APPENDIX I:	Country Profile
APPENDIX II:	Country and Enterprise Checklists and Financial Reports
APPENDIX III:	Sample Agreements
APPENDIX IV:	Letters of Transmittal
APPENDIX V:	Individuals Met
APPENDIX VI:	Bibliography and References

* Appendices are a separate volume, available upon request.

REPUBLIC OF KIRIBATI
REPORT ON OPPORTUNITIES IN PRIVATIZATION OF STATE OWNED ENTERPRISES AND PRIVATE SECTOR DEVELOPMENT.

TE KATEI NI KIRIBATI

CHAPTER 1: EXECUTIVE SUMMARY

1. The GOK submitted a request for privatization assistance to the USAID regional office in Suva which resulted in a task assignment approved by AID/PRE. A two-person team fielded by the Center for Privatization through International Phoenix Corporation departed for Kiribati via Suva on September 7, 1987. The task assignment called for the team to assess prospects for privatization of a list of 12 state owned enterprises, during a two week period.

1.2. The Republic of Kiribati, formerly Gilbert Islands, is a group of 33 islands, totalling 260 square miles in area, spread over some two million square miles of Pacific Ocean, forty percent (25,000) of the Kiribati population live in the capital city of Tarawa. The remainder of the total 60,000 people mostly operate within a subsistence economy, living primarily on food from the sea and a small range of plants. Kiribati attained independence from Britain in 1979, when exports of phosphates, up to 45 percent of GDP in prior years, stopped due to depletion.

1.3. In the British colonial administration from 1892 to 1979 government monopolies together with administratively sanctioned private sector oligopolies dominated economic activities. The British Phosphate Commission in particular dominated the nation's economy. Since independence in 1979 the GOK, in order to ensure long term capital formation, and an orderly supply of goods and services, established a large number of state owned entities, some of which were modified versions of pre-independence entities.

1.4. The GOK has expressed considerable interest in divesting state-owned enterprises and in creating a vigorous private sector. GOK interest in privatization is closely related to budgetary and fiscal constraints. As expressed in the 1987 - 91 National Development Plan, the loss of receipts from phosphate taxes transformed the Government recurrent budget from substantial surpluses to a deficit which had to be financed by budgetary aid. Deficits in current account were partly avoided by extra budgetary support only until 1985. Thus, the country faces an insufficiency of internal domestic revenue to finance the recurrent budget. Furthermore, a phasing out of extra-budgetary support has placed an additional burden on the GOK to reduce public spending. Finally, the reduction in extra-budgetary support and fall in internal sources of revenue, coupled with an on-going policy of expenditure restraint, exert a dampening effect on taxable activities and employment. In view of these factors, the GOK has decided to reduce government expenditures and create new private enterprises, incomes and tax revenues through a program of privatization.

1.5. The mission was requested to rank a select group of 12 state owned enterprises identified by the GOK. Our prioritization was based on two broad criteria: first, we considered the GOK's interest in reducing public spending and creating new private sector activities eventually leading to increases in taxable revenues; second, we considered the technical feasibility of privatization from a standpoint of legal, financial/economic, commercial and political constraints. Moreover, some enterprises, due to juridical organization, constraints of is finances, and commercial character, can be more easily and quickly divested than others. A full analysis appears in Chapter 8. We determined that Priority One Group enterprises can be privatized within an operational period of less than one year: Priority Two Group enterprises within one to two years;: Priority Three Group enterprises within two to four years; and Priority Four Group enterprises within a long term period of four to eight years. In instances where divestiture is inappropriate, other approaches are recommended. The Ranking of these 12 enterprises is as follows:

I. <u>Priority One Group</u>

<u>DBK</u>
1. Abamakoro Trading Company, Ltd.
2. Atoll Motor and Marine Services, Ltd.
3. Otintaai Hotel

<u>Ministry of Finance</u>
4. Government Supply Division

<u>Ministry of Transport and Communications</u>
5. Government Philatelic Bureau

<u>Ministry of Home Affairs and Decentralization</u>
6. Government Printing Office

II. <u>Priority Two Group</u>
<u>Ministry of Works and Energy</u>
7. Government Plant and Vehicle Unit
<u>Ministry of Transport and Communications</u>
8. Shipyard

III. Priority Three Group
Ministry of Works and Energy
9. Public Works Department
Ministry of Finance
10. Kiribati Insurance Corporation

IV. Priority Four Group
Ministry of Transport and Communications
11. Shipping Corporation of Kiribati
Ministry of Works and Energy
12. Public Utilities Board

The GOK has expressed keen interest in the privatization assessment and prioritization of enterprises (see Appendix 4).

1.6. To carry out a privatization program encompassing these and other state owned enterprises in Kiribati; it will be necessary to establish strategies, polices and an institutional framework for privatization, viz., a Bureau for Privatization and Private Sector Promotion (BPAPSP) under the office of the President of the Republic. The initial stage in the establishment of a Bureau would be formation of a Presidential Task Force. The Task Force should be Chaired by the Minister of Finance and Vice President. The Task Force would consist of two units, one unit would be staffed by a full-time I-Kiribati professional and a secretary. The professional would be assisted by one long term expatriate advisor, and occasional short term advisors. The second unit would be an advisory Board made up of other ministers or designees, the managers of the DBK, the Bank of Kiribati and The Attorney General. The Presidential Task Force would undertake three parallel activities at its inception: (1) Generate local and donor support for the task force to be transformed into a permanent Bureau as part of the President's Office; (2) Prepare a policy document (based in part on this report) to establish the Government strategy, priorities, and an implementation program for specific enterprises; (3) study the feasibility of creating a small securities exchange in Kiribati

The Presidential Task Force established in January 1988 would become the Bureau for Privatization and Private Sector Promotion by June 1988 at which time it would be fully operational with adequate professional staff, accommodations and fixtures.

CHAPTER II: INTRODUCTION

2.1. Mission Background

The Center for Privatization was established under a USAID contract awarded on September 30, 1985. One of its objectives is the promotion and organization of regional privatization conferences to encourage government leaders from several countries in specific regions to give serious consideration to divestiture of state owned enterprises. The initial seeds for the activities which this report covers were sown during such a regional conference in early 1987.

The Pacific Conference on Privatization and Investment was sponsored by USAID and US Department of the Interior, hosted by USAID/South Pacific Regional Development Office in Suva, Fiji and held in the Fijian Hotel, Sigatoka, Fiji on February; 2-8, 1987.

A review of attendants, workshops, moderators and lecturers indicated that a substantial amount of interest was generated on the subject. Four individuals from the Government of The Republic of Kiribati (GOK) attended the conference. They were:

Mr. Ben Tinga
Permanent Secretary of Finance
Ministry of Finance

Mr. T. Kairoro
Assistant Secretary
of Trade

Mrs. K. Taoaba
Planning Officer
Ministry of Finance

Mr. Enora Isopo
Chief Accountant
Ministry of Finance

Upon return to Tarawa Mr. Ben Tinga briefed the Minister of Finance and other members of the Government which culminated in a request to the USAID regional office in Suva for short term technical assistance. The first request was transmitted in March 1987. After a number of reiterations, this task assignment was approved by AID/PRE and initiated on Friday, September 4, 1987. The following Monday, Labor Day, September 7th the two person team fielded by International Phoenix Corporation departed for Fiji arriving there on Wednesday September 8th. Barokas and Rubin were briefed by program officer Louis Kuhn and DCM/Charge D'Affaires. Prior to proceeding to Kiribati the CFP/IPC team interviewed Messrs Peter J.S. Elvey, Senior Trade Officer and Mr. Tinian from SPEC., The Southern Pacific Bureau for Economic Cooperation. Mr. Tinian is a technician from Kiribati, scheduled to leave Fiji in the near future to continue graduate studies in Australia. Subsequently the team met with Gerald Burke UNDP Resident Representative and - Deputy Resident Representative. UNDP staff in Fiji showed great interest both in the economic development of Kiribati and the USAID financed privatization activity in this country. In addition to the limited documents provided by SPEC, UNDP, the team purchased whatever was available on Kiribati from the University of The South Pacific bookstore. The evening before departing Suva, the team had a long discussion with Mr. Richard Elsy, of Pacific Business Associates Limited an independent consultant from the U.K. who has done a number of studies for SPEC and governments of the island republics in the region.

Several months before this assignment took place the Center for Privatization had forwarded the country and enterprise checklists which were circulated among the government owned enterprises and departments. This proved highly useful. The Ministry of Finance assigned Mr. Simon Koomar, a chartered accountant provided by the U.K. Commonwealth Technical Assistance to organize the preparation of responses to enterprise checklists. The country check list, enterprise checklists and financial reports are given in Appendix Two.

Our methodology in-country was to read all documents made available to us in Kiribati, interview government and business leaders including the managements of the currently state owned entities and departments. A broad cross section of the private sector leaders was also interviewed. These interviews were followed by visits to the enterprises to inspect their physical plant and facilities and review their operations. Our in-country work concluded with visits to the Cabinet Secretary, (an equivalent of Prime Minister) and the President of the country. The Beretitenti as the President is called in I- Kiribati, (an expression which means both the language and a cultural tradition) graciously provided an hour of his time emphasizing his interest in privatization and private sector development. At the same time he reiterated his concern of following a developmental path which allows the preservation of the Kiribati way of life which also contains the Kiribati way of doing things viz., Te Katei Ni Kiribati.

The team prepared a draft outline of the report in-country and used it as a debriefing document with Mr. Ben Tinga as well as the President and Cabinet Secretary. Although the team met upon arrival, with the Finance Minister, Vice President, and the Chief Planning Officer of Ministry of Finance, an expatriate U.K. economist, these two individuals left for Washington D.C. for the annual IMF/World Bank meetings and were not seen by the team prior to departure.

The team provided exit briefings with the Mission Director Bill Paupe, Program Officer Louis Kuhn and Private Sector Advisor John Howard.

The team wishes to emphasize that all of this occurred within the framework of a two week in-country mission. Accordingly, the report below is intended to identify and discuss the principal considerations involved in a privatization program in Kiribati and to detail the further efforts required to design and implement a privatization program. It does not purport to be a final rendering of a program for privatization in the country.

2.2 REPORT FORMAT

This report consists of ten chapters and six appendices. Chapters I, Executive Summary and Chapter X, Conclusions and Recommendations, as the first and last chapters of the report provide a quick look opportunity to the hurried reader. After a brief introduction in this chapter the essence of the report is presented in Chapters III through IX. An analysis of the role of the privat. and public sectors in the Kiribati economy in Chapter III is followed by strategy and policy options in Chapter IV. In Chapter V a detailed analysis of the legal aspects of privatization in Kiribati is followed by a review of financial resources available for privatization in Chapter VI. Institutional and manpower resources are discussed in Chapter VII followed by an analysis of a selective group of enterprises in chapter VIII. An eleven phase privatization program and illustrative examples of specific tasks to be undertaken in these phases is provided in Chapter IX. Appendix one titled Country Profile, provides background information on the Geography, History, Economy, Political Framework and Culture of Kiribati. Appendix Two contains the Country and Enterprise checklists and detailed financial data on individual companies. In Appendix Three we present copies of sample work agreements and in Appendix Four the letter of transmittal to Mr. Ben Tinga by the team and his letter of acknowledgement to Louis Kuhn and a draft report outline used for pre-departure briefing purposes in Kiribati and Fiji. In appendix five a list of the individuals met in Kiribati and Fiji are provided. Appendix seven lists a selected bibliography for this report.

CHAPTER III: THE POLE OF THE PUBLIC AND PRIVATE SECTORS IN THE ECONOMY

3.1 Past and Present Public Sector Involvement in the Economy.

The Public Sector has dominated the economy of the country up to the present day. We can look at three periods of Kiribati history to make some general observations on this matter: Public sector involvement in traditional times, under colonial rule and the post-independence period.

Although available information is very limited traditional Kiribati society seemed to respect a division of individual and communal economic activities where Utu and Kainga leaders and family members engaged in activities to feed other family members subject to established rules and regulations monitored by the Unimane and the Maneaba. Individual families developed and maintained specific skills in addition to fishing and fighting. Warriors over a certain age became Unimane. The Unimane/Maneaba played a surrogate public sector role primarily in the distribution of rights to use existing resources. [1]

3.1.1 COLONIAL ADMINISTRATION

The period from 1892 to 1979 under British rule first attempted and succeeded in putting an end to civil wars, some of which determined land ownership and control over fishing rights and coconut groves. The British brought in laws which in some cases took into consideration traditional customs and practices and introduced western patterns in health, education, trade, manufacturing, and peace keeping.

The early stages of the colonial administration focused on the production and export of phosphate which was the most important revenue generator. While phosphate mining and exports were in the hands of a private company - The Pacific Phosphate Company- from 1892 to 1920, the British Phosphate Commission bought out the PPC. BPC, a trading partnership of the governments of Great Britain, New Zealand and Australia, proceeded to dominate the Colony's economy for the next 59 years. Nevertheless, shipping and trading did remain in private hands. Various taxes, fines and licensing fees collected by the government were initially absorbed by the Island Fund and subsequently the Protectorate Fund. BPC polices speeded development in Banaba where phosphate was mined and shipped to Australia and New Zealand at the lowest possible prices. These polices slowed growth in all the other

---

[1] See Appendix One for definition, description and Analysis of the I-Kiribati Terminology Utilized.

islands and delayed their entry into a monetized economy. During this period BPC was a major employer and generator of revenues.

A handful of trading companies dominated the export of copra and import of basic consumer necessities. Fishing, production and sale of vegetables, construction materials and sale of canoes remained in the small informal and artisanal sectors.

During subsequent decades the colonial administration recruited a disproportionate number of Ellice Islanders (later Tuvalu) over Gilbertese. This employment policy and differnence in cultures in large measure led to the separation of Ellice as a country at independence.

In summary, during colonial times either a government monopoly or an administratively sanctioned oligopolistic private sector dominated economic activities.

3.1.2 Kiribati Since Independence

As in most developing countries moving into independence with or without a colonial heritage, two important events mark the initial post independence years:

1. Most pre-independence government institutions are kept and modified. Those entities also maintain established economic and/or political controls.

2. In the absence of a domestically owned, controlled and operated private sector, the government is involved in many economic activities which are in the private sector of developed countries.

Consequently, the social objectives of the Government of Kiribati at independence had a paternalistic attitude justified by its proponents, for public sector entities to respond to the needs of its citizenry. The government first and foremost established a policy of self reliance and self sufficiency to protect its citizenry from a downward fluctuating standard of living. The governments insistence on cultural preservation has an important economic dimension. Given the loss of phosphate revenues, the end of British budgetary assistance and deep cuts in other foreign assistance, capital formation in the economy has been hindered. In the absence of rapid capital formation, reliance on a subsistance economy provides a protective cushion in case of future natural or other adversities. Domestic capital formation by the public sector is still dominant although available resources have been decreasing.

In order to ensure long term capital formation in the economy and an orderly supply of goods and services the GOK established a large number of institutions some of which were modified versions of pre-independence entities. These institutions at present operate under three distinct types of juridical and organizational characteristics.

1. Division/Departments of a Government Ministry:

The activity undertaken by such an entity does not determine its relationship with the organization of which it is a part. The entity in its full sense is part of a government organization selling goods and/or services either to the public and/or to other government agencies, public and private companies. The operating manager of such an entity is responsible to the Minister or his designee who is the nominal Chief Executive Officer. An entity which operates as a division of a government has limited options as far as privatization is concerned. It can liquidate and sell its assets or it can go through a fairly complex series of procedures before it can operate as a truly private entity. Very briefly, if the latter course is followed, the entity first has to be converted into a registered company with a separate and specific legal personality but still owned by the government through the Ministry which spun it off. Once converted to a registered company, the procedures for transferring ownership of the registered company are fairly simple. Another option which should not be considered is that of converting a government division or department to a statutory law company. This would substantially delay the privatization process since a statutory law company requires special legislation to move from public to private hands.

In summary, government divisions under consideration for privatization in Kiribati will need to be either liquidated or transformed to registered companies. A more detailed discussion on the legal aspects of this conversion is given in Chapter V: Legal Framework, of this report.

2. Registered Companies

The government of Kiribati has a company ordinance law under which certain types of companies are required to register with a Government Registrar - these companies once established and registered can be owned either by the government, a body representing groups of individuals such as an Island Council, a Town Council or a village, or one or more private individuals. Thus, a registered company can be owned publicly - owned by the government and not by a large segment of the general public as the terminology is used in the United States - or it can be owned privately, by associations of people or private individuals. However, the ownership described above does not mean that a registered company can be called a private registered company or a public registered company due to ownership. The company ordnance law defines a "Private" registered company and a "Public" registered company not in terms of ownership but in terms of what the company can and cannot do with reference to number of shareholders, and procedures on sale or transfer of shares and convertibility of warrants and debentures.

Thus if we accept the ordinary usage of "Public" and "Private" registered companies the decision whether a government division should be transformed into a "Public" registered company or a "Private" registered company requires additional study before a decision is reached by a specific Minister who has jurisdiction over the division which will eventually be privatized. A more detailed analysis of the legal aspects of "Public" and "Private" registered companies is given in Chapter V of this report.

Statutory Law Companies.

These are exclusively government owned companies established under specific legislation by the Maneaba Ni Maungatabu - The National Parliament. The legislation provides both for the legal and organizational structure as well as the purpose and types of activities which can be undertaken by such companies.

Normally the transformation of a statutory company for divestiture purpose has the following options:

1.	Liquidation:	Not too probable, since the government had initially decided that the activity undertaken by an SLC was sufficiently important to the country to set up such a corporation under special enabling legislation.
2.	Lease/Management Contract:	This may be a feasible alternative for some SLC's depending on the products and services they provide, the state of their finances and the political rationale.
3.	Transformation To A Registered Company:	Under normal circumstances a statutory law company would need to be converted to a registered company ("Private" or "Public" in the company ordinance sense) before it could be privatized by selling shares. As an SLC was established by a specific piece of legislation it would need new legislation which would allow this transformation from an SLC to an RC.
4.	Direct Privatization of an SLC.	This is not possible under most privatization circumstance unless the charter of a company allows for divestiture of shares directly to the

public under its enabling legislation. An SLC which is given the authority and responsibility to set up new registered companies and eventually divest the SLC held shares in these RCs may be an important exception to the rule. Such an exception does exist with reference to the Development Bank of Kiribati and is discussed in more detail in chapter five and six of this report.

The public sector of Kiribati at present consists of two general types of institutions. The first type of institution is the Central Government and ten Ministries whose expenditures are paid by the national budget. The second type of institutions are 19 organizations which include self financing agencies and public corporations.

The Seven Public Corporations are:

1. Plant and Vehicle Unit
2. Public Utilities Board
3. Kiribati Housing Corporation
4. Kiribati Insurance Corporation
5. The Broadcasting and Publications Authority
6. The Shipping Corporation of Kiribati
7. Air Tungaru

The Four Public Companies are:

1. Te Mautari Limited
2. Abamakoro Trading Co.
3. Atoll Auto Stores
4. The Otietai Hotel

The Seven Self Financing Agencies are:

1. Philatelic Bureau
2. National Provident Fund
3. Motor Agency
4. Supplies
5. Telecom
6. The Shipyard
7. Captain Cook Hotel

It is important to note that the total gross expenditures of the central government is half of the expenditures of the 19 institutions listed above.

The Government has tried very hard to restrain the growth of total public expenditures in order to avoid the burden of increased taxation. The generally low level of incomes and high tax rates starting at low income levels limits the governments capability of increasing taxes in the short and medium term.

Government expenditures are accounted for under two separate budgets. The development budget includes all capital investments and a substantial amount of current expenditures. The recurrent budgets reflects total government expenditures. The recurrent budget is met from local funds while the development budget is met from foreign assistance funds. This indicates that current government spending can not be met from current revenues creating a reliance and dependency on foreign assistance funds to meet the shortfall. The government is well aware of the danger in this dependency not being able to ensure a reliable and continuous flow of foreign assistance funds in the medium term. It is this awareness which has led to emphasize self reliance as a major government objective for the current plan period. Future decreases in foreign financial assistance - primarily on a grant basis and some soft loans - will have serious effect both on capital outlays and current expenditures. Decreases of capital outlays will lead to the deterioration of the social and economic infrastructure and hinder future economic growth. Decreases in current expenditures will hinder the governments ability to provide goods and services leading to an immediate decrease in the standard of living and welfare of the population.

The above is not intended as the drawing of a pessimistic picture and an inability to avoid the horns of a dilemma. The country needs a continuous flow of foreign financial assistance to further generate its internal ability to cope with future economic growth. At the same time it needs to unleash a private sector which can develop further and contribute to the governments objective of self reliance.

3.2 The Emerging Private Sector

Considering the last two hundred years as the modern period of Kiribati history, the private sector has always had an important role in the economic evolution of the country. The problem has been that this private sector whose influence has increased and then decreased over time has been foreign owned. Companies such as Burns Philip, On Chong, Nanyo Boyeri and the Pacific Phosphate Company were involved in the import, wholesale and retail at different times of diverse consumer items, equipment and even alcohol and firearms until they were prohibited to do so.

3.2.1 Past Developments

As the old trading habits disappeared they were taken over by either government owned statutory law companies or cooperatives. The cooperative movement which started in Vaitupu, Tuvalu (formerly Ellice) in the 1920's spread out throughout the Islands especially through informal groups called Mronrons who operated the retail stores. Initially cooperative organizations such as Tangitang worked only on the retail end and later went into wholesaling and importing directly from overseas. After WWII the Wholesale Society which was established by the colonial administration was combined with other government departments forming first the Gilbert and Ellice Development Authority then Gilbert Islands Development Authority, (GIDA). GIDA was then split into several statutory law companies one of which was a subsidiary of GIDA called ATOLL Products Limited whose assets were in turn taken over by Abemakoro Trading Company (ATC) ATC is one of the prime candidates for privatization.

3.2.2 Current Entrepreneurial Activities

There is an interesting array of entrepreneurial activity in the subsistence sector, cooperative sector and small business sector. In the subsistence sector its manifestation is usually in activities that benefit a whole family, village or island activity. Such leaders mobilize community resources to resolve a specific problem such as transportation of goods and passengers on a regular basis. In another instance an island community leased land and built a Maneaba in Betio to have a place to sleep meet friends and transact business.

The cooperative sector, represented by KWCS - Kiribati Wholesale Cooperative Society, after going through a growth period and becoming one of the major import, wholesale and retail organizations has entered a state of slow decline, loss in market share to Abemakoro Trading Company and about half a dozen other private companies who have been entering the market primarily on the import and wholesale channels in the past five years.

3.2.3 Private Sector Perception of GOK Policies

Interviews with over a dozen businessmen indicated that the majority of the local entrepreneurs and managers believe the government wishes to continue its dominance and control over the economy. We also observed a deep seated suspicion of the government's intent to allow further private sector development. Some business persons however, did point out the ambivalence displayed by the government by announcing encouragement of private sector and then turning around and making entry difficult for the activity which it initially encouraged private participation.

Most of the businessmen interviewed emphasized the lack of incentives provided by the government in ways of tax, credit and technical assistance to truly help the development of the private sector. Tax rates increase rapidly at low levels of income, credit sources are limited and its cost perceived as high while sources of technical assistance to the profit oriented private sector are practically non-existent.

3.2.4 Constraints to Private Sector Development

There are a number of important constraints to private sector development and by extension to privatization in Kiribati which will necessitate a better and closer working relationship between government, private sector, religious and traditional leaders. This relationship will need to evolve according to a well thought out and conceived plan whose preparation should include the same leaders who would be implementing it.

Cultural Dicnotomy

When an individual in Kiribati society is successful financially as a result of hard work, ingenuity, leveraging meager resources or whatever other legal means are available to him, there are a number of social reactions which are inimical to his further growth. These are:

1. Relatives and friends arriving to live with his family, borrow money, food or other items which they may need and the businessman has.

2. Society around him develops a negative attitude about him because he is now different. He stands out by having been successful and relatively wealthy.

3. His success elicits cut throat competition by a few other individuals who enter the field with the belief that the successful individual in no way could be better than them and eventually drive everyone out of business.

4. The government displays an ambivalence in helping further an individual who has displayed a measure of success. Government offices may delay processing of paper work, try to encourage others to enter the field.

The above points out to a cultural dichotomy and clash in values which impact entrepreneurial behavior. Part of the cultural tradition which the government wishes to preserve is inimical to private sector development. Nevertheless, in absence of open and forced restrictions and prohibitions, a small entrepreneurial pool has developed. Its composition interestingly enough is dominated by native Kiribati citizens who have Chinese, British and other foreign ancestors somewhere in their genealogy going back about 200 years at most. These entrepreneurs, despite the social and governmental real and perceived obstacles, are still forging ahead: opening new hotels, manufacturing soap and perfume products based on coconut and expanding their food and consumer imports, wholesaling and retailing.

Resource Limitations:

The entrepreneurial and business managers interviewed displayed a need for improved management skills for themselves as well as more skilled staff. They have an acute awareness of the limitations of two out of three factors of production; land and capital. Although in a sense there is no shortage of unskilled or semi skilled labor, there is a shortage of skilled labor and individuals with supervisory and managerial skills. The shortage of land is not only related to that for agricultural production, but also for residential and business/industrial use. Lease price of this type of land and its conditions will slowly place a financial constraint on small businessmen and residents of Tarawa.

Market Limitations

Markets are limited for imports, exports, processing local products, and finishing semi - finished imports. Rapid migration to Tarawa in search of jobs - primarily in the public sector- and improvement in the standards of living has exerted a critical pressure on existing infrastructure. However, this process has also increased the demand for food, construction materials for new housing and additions to existing housing and durables. This demand pull has led to the establishment of many small operations retailing a limited assortment of goods. Market conditions have also led small businessmen to enter the food import and wholesale business which is perceived and in reality is a profitable endeavour.

Natural Resources

If a thousand tons of Pacific Ocean water would yield an ounce of gold or silver, Kiribati would be a wealthy country, instead, Kiribati is trying to dry the water and export the salt to increase export earnings! Fisheries is a critical resource in two interesting aspects. The men in Kiribati express an ease and a liking for moving between the subsistence and cash economy. That is, a family can still be fed with fish caught in the lagoon or the ocean, coconut products, breadfruit and local vegetables if opportunities in the money economy dry up. Thus, although shortage of drinking water is a serious problem, starvation is not. Also, although malnutrition is prevalent among children, it does not seem to be so among adults.

Fisneries is also a critical national natural resource which needs careful husbandry. In the long run, instead of licensing fees or creating its own government owned fleet it may choose to give appropriate incentives to joint ventures between Kiribati and foreign businesses.

In summary, the constraints to private sector development are difficult but not insurmountable. A number of families in

Kiribati have acquired funds over years which can be invested in new enterprises or expansion of current businesses. Some of these funds are deposited/invested overseas. Credit conditions although tight may loosen with both Westpac and Development Bank of Kiribati expanding their portfolios.

3.3 Institutional and Policy Framework for Privatization and Private Sector Development

The government of Kiribati needs to consider and establish an institutional and policy framework to promote privatization and private sector development not only in Tarawa but throughout the country. There are three ministries which should participate in the design and implementation of a strategy to promote such a development. This participation should include members of the private sector in a way which will increase the credibility of the new policy and change the perception held by the public of the governments anti-private sector attitudes.

The institutions which need to participate in such a framework are:

1. Ministry of Finance and Planning
   - A. National Planning Office
   - B. Development Bank of Kiribati
   - C. Bank of Kiribati
   - D. Kiribati Provident Fund
   - E. Special Funds
   - F. Department of Audit
2. Ministry of Trade Industry and Labor
3. Ministry of Natural Resources
4. Other Ministries and Agencies as Appropriate

The Finance Portfolio is an important Ministry in Kiribati Cabinet. In some ways this is a legacy from pre-independence days. The Minister of Finance is first among equals in the Cabinet (with the exception of the foreign affairs portfolio held by the President) which is attested by his also being the Vice President. There are six institutions that in varying degrees have close relationships with the Ministry of Finance.

The National Planning Office with substantial presence of foreign technical assistance, undertakes medium term macro socio-economic planning. Given the limited resources available, The National Planning Office of the Ministry of Finance needs to be aware of the source, quantity and purpose of local and foreign resources directed to private sector development and privatization.

The Development Bank of Kiribati is in the middle of a reorganization which involves changing the legal status and financial structure of a number of registered companies and former subsidiaries of Statutory Law Companies. The DBK will become the most important development financial institution and one of two primary credit sources after its reorganization. Privatization of the companies under its umbrella will bring in much needed resources. Furthermore, loans and guarantees from the Asian Development Bank and USAID will strengthen DBK to take a major role both in privatization of SOE's and promote small and medium size businesses in the country. The Bank of Kiribati is a joint venture of the Government of Kiribati (51%) and Westpac (49%) an Australia based commercial bank. It is the Ministry of Finance which represents the government's share in this venture. The Ministry of Finance as representative of GOK can play an important role in encouraging BOK to take a more active role in financing viable ventures by the private sector.

Kiribati Provident Fund is a depository of funds from all public and private sector employers. It can be a financing source to promote privatization and private sector growth in the future.

The Special Funds are surplus funds of specific organizations within the government with specific restrictions of their use. Both the Kiribati Provident Fund and the Special Funds are deposited in the Bank of Kiribati which, in turn, invests these funds in Australia.

The Department of Audit is an important component of the Ministry of Finance which has an especially important role in reviewing the financial statements of Government owned corporations.
The Ministry of Trade, Industry and Labor is important for two different reasons: First this Ministry has a number of registered and statutory law companies which, subject to government approval, are privatization candidates. Secondly, the SOE's to be privatized will have a number of labor issues which will need resolution.

The Ministry of Natural Resources is another Ministry with dual importance. Although natural resources are limited in type they are extremely important in planning the generation of revenues both for the government and the private sector. Fisheries and ocean mining are two specific areas where the government expects substantial future revenues. On the other hand this Ministry is in the process of actively privatizing small scale agriculture, and incubating small enterprises.

Our observations have indicated that there is a need to coordinate the privatization and private sector promotion activities of the three ministries mentioned above, i.e. Finance and Planning; Trade, Industry and Labor; and Natural Resources.

Finally, there may be other ministries and agencies which the government deems important and necessary to participate in a new institutional framework. The institutional framework recommended is the creation of the Bureau of Privatization and Private Sector

Promotion under the Beretitentis Office, (BPAPSP). Establishment of this bureau at such a high level will signify the importance attached by the government and its leadership moving towards a new policy stance. The Beretinenti is recommended to appoint a qualified and respected individual to work full time in the new bureau. The Presidents advisor in Privatization and Private Sector Development (PAP) will be assisted by a revolving group of advisors initially from three ministries: FAP, TIL and NR. This working group meeting monthly would advise the PAP and assist him in the design and implementation of a new strategy. Once a state owned enterprise is given the official sanction for privatization, the PAP would be responsible in guiding the SOE through the problems until ownership has been transferred to the private sector.

The BPAPSP in its initial status will consist of the PAP, one secretary, a board of advisors called The Privatization Task Force from the three Ministries and foreign technical assistance provided by bilateral and multilateral donors.

The four initial functions of this new Bureau will be:

1. To expand on the Governments objectives to privatize and promote private sector development, outline of which is given in the next section of this chapter below.

2. To finalize the strategy provided in chapter IV of this report and, submit it to the Beretitenti for his approval and Cabinets recommendation for legislative adoption to the Maneabe Ni Mangetabu.

3. Once approved by the Maneaba implement the strategy and proceed with the programs and projects identified.

4. Carry out privatizations to their successful conclusion and indicate a responsiveness by the government to the needs and programs of the emerging private sector in Kiribati.

3.4 Government Objectives for Privatization

A review of the 1983 - 1986 Kiribati National Development Plan found no mention of privatization and scant reference to the private sector as a participant in national economic activities. The only specific reference was, "Certainly there <u>is</u> business enterprise in Kiribati, particularly on South Tarawa, but it is largely involved in the distributive service sector (shops, garages, bus lines; etc), rather than in manufacturing - with construction a secondary business activity". a/

---

a/ Kiribati National Development Plan 1983-1986, pp.91

Chapter 3: Page 13

A number of reasons are offered in the plan for the lack of manufacturing enterprises in the 1983 - 86 plan. Since they apply to other types of private sector activities to a certain degree these are quoted below:

"Lack of management skill and entrepreneurial flair
Small size of local markets;
High cost of imported materials;
Lack of technological expertise;
Lack of finance;
Inadequate shipping and communication facilities". 3/

It is possible to take issue with the constraints listed above. First, the emphasis on manufacturing is biased. The absence of entrepreneurial activity may also be due to government restrictions and discouragement and/or the lack of sufficient profits due to one or more of the constraints listed above.

A marked change in the government's policy is exhibited in the Kiribati Sixth National Development Plan of 1987 - 1991 Te Kanriki N Toronibabwai, emphasizing self reliance. In the Objectives, Polices and Strategies chapter of this document there is one section of one paragraph titled "Expansion of Private Enterprise and Gradual Commercialization of Some Public Sector Activities" quoted below: 4/

> "The development of private enterprise will actively be encouraged. The expertise and capital are not readily available, but the establishment of joint venture schemes will be accommodated in our plans. Potential exports that may be wholly or partially privatized have been identified, such as handicrafts, stamps, seaweed, marine resources, solar salt, coconut timber, millionaire's salad and tourism. In addition the financial machinery for providing working capital for small local businesses will be expanded to facilitate the development of a cadre of local entrepreneurs. Training will be provided for our people and assistance provided to aid the establishment of viable business ventures. This will especially be provided for people on the outer islands, to participate in small scale cottage industries. Already the machinery has been set in motion with the establishment of the National Development Bank".

The government's enunciated policy to privatize and promote private sector development is clearly stated as can be seen from

---

3/ IBD

4/ Kiribati Sixth National Development Plan 1987-1991, pp.2.3-2.4

the above excerpt. There is no doubt that this policy requires and indeed, deserves active encouragement from bilateral and multilateral donors who profess friendship and support of the young Republic's effort at economic development. In the absence of such support there is a danger that the policy remains simply in written words in a planning document. New policies expressed in planning documents are meaningless without programs and projects and especially without the financial and manpower resources to implement them.

The 1987 - 1991 National Plan is a more comprehensive document and the authors are well aware of the difficulties involved both in planning and carrying out economic development as indicated in the last paragraph of the second chapter of this plan titled Objectives, Policies and Strategies.[8]/

> "Development planning will not be fruitful without adequate provision for the implementation and execution of policies, strategies and projects. Plan implementation is as complex and difficult as plan preparation. The lack of adequate institutional, administrative and economic policy arragements necessary for successful plan implementation has often been the reason for the failure in the realization of planned objectives. Appropriate measures for the implementation of policies, programmes and projects will be constructed in the sectoral plans. The framework for revising the medium term plan objectives, and targets will also be established, and the improved system of aid and project coordination and monitoring, developed between 1983 and 1986, will continue to be improved during the Plan period. Development planning is a continuous process which does not terminate with the adoption and publication of the document. It is essential that a systematic and continuous follow-up and evaluation of plan implementation be organized earlier on in the exercise. To this end the National Planning Office will keep in constant contact with implementing Ministries and Divisions".

The majority of the government owned enterprises are concentrated in 10 square miles and are in South Tarawa. There are no secrets in such close quarters. The government leadership is well aware of the problems created by the inefficient operations of these parastatals. Based on the interviews the team conducted together with our synthesized observations, the government's objectives for privatization can be listed as follows.

1. State owned enterprises create barriers to market entry.

---

[8]/ Ibid, p.2.6

Chapter 3: Page 15

At the time of their establishment SOE's may have performed an important social and economic function. However, these enterprises over time have become monopolies and oligopolies which have discouraged competition, especially when the market size has remained relatively small. The government is aware that their mere existence, regardless of their efficiency, is a barrier to entry for the private sector and is interested in removing these barriers.

2. Reduction of budget deficits and subsidies.

Budget deficits have been avoided through government restraint, through freezing levels of public employment, stabilization of public services and other expenditures, and the use of RERF invistment income replacing decreasing external assistance and exploring ways to reduce subsidies.

The largest recipient of government subsidies during 1979-85 was Air Tungaru, however, these subsidies were reduced in 1985 and subsequent years. Air Tungaru and the Public Utilities Board accounted for more than 60% of all government subsides up to 1984 according to the 1987-91 National Plan. Subsequently, the majority of subsidies went into Telecommunications. Public Utilities Board and the Housing Corporation as shown in figure 1 below.

Source: Kiribati Sixth National Devel. Plan 87-91 p.5.8

The government's policy in earlier years was to get the country on a sound economic development path before allowing the private sector to fully participate in the national economy. However, the difficulties encountered in recent years have created an alternative: resolve budgetary problems and reduce subsidies by including the private sector; increase domestic employment and investment through the mobilization of local savings.

The privatization program recommended in this report will positively affect the budget by reducing recurrent expenditures and also by reducing subsidies in the short and medium term.

The government will achieve an improved resource allocation as the privatization program is successfully implemented. Both government leadership and the management of SOE's are aware of the waste of resources in inventories of items which are not sold, and subsidized operations which do not provide the goods and services demanded by users either in the public or private sectors. Transfer of these entities to the private sector will force the owners and managers to include the profit motive in their decision making. The transfer in itself will bring additional financial resources to the government and will also enable the government to save that portion of expenditures which were formerly allocated to SOE's.

The transfer of SOE's to the private sector will also introduce a large measure of labor and capital productivity. Payments to labor will be a function of their performance and contribution to revenue and profits. Payments to labor working in a state owned enterprise is often for presence on the job rather than for productive performance. Capital productivity will also increase because of the risk of loss to the private investor. The concept of loss through risk and productive performance is different for a manager of a state owned enterprise than a private owner/manager. The SOE manager is more interested in job security and maintenance of a social, political, and economic power base. Losses by an SOE are made up through subsidies which in a way rewards inefficient operations and less than optimal use of labor and capital resources. Furthermore, much of the capital provided to SOE's do not carry appropriate charges for interest. Private ownership/management is much more sensitive to the risk factor and low levels of productivity.

Privatization of state owned enterprises is expected to have a marked effect on the pricing of goods and services provided by these entities. There may also be negative effects of higher prices if a particular good or service is highly subsidized and high cost of operations are inherent in the provision of that good or service.

In summary, the objectives of the government in moving towards the privatization of SOE's and using this as one of the vehicles the privatization of SOE's and using this as one of the vehicles to increase private sector involvement in the national economy is to increase social and economic benefits to the population at a lower real cost than to the central government. Since the government has found out that increasing costs of providing these goods and services are not justifying the benefits (because of sub-optimal use of the factors of production) it expects that the entry of the private sector will increase social and economic benefits to Kiribati society by optimizing the factors of production at prices determined by market forces.

CHAPTER IV: THE NEED FOR PLANNED PRIVATIZATION: STRATEGY AND POLICY OPTIONS FOR GOVERNMENT OF KIRIBATI CONSIDERATION.

4.1 Strategy

Privatization of state owned enterprises is primarily a political process with profound social and economic implications. Its success depends on creating a political environment supportive of the changes that are planned. Government leadership will need to be joined by the leadership of institutions and organizations outside the government and the general public. Furthermore, the government support for privatization has to be expressed not only by new policies but by specific actions and provision of frameworks and resources to ensure that it unfolds to the benefit of society as a whole.

The strategy described in the first section of this chapter is based on 5 specific actions. They are: 1) Demonstrate, by government leadership, a commitment to privatization of state owned enterprises. 2) Initiation of a public education campaign to mobilize the support of the population and a variety of institutions. 3) Establish an institutional framework to carry out privatization. 4) Provide the new entity to carry out privatization with manpower and financial resources. 5) Study carefully the options suitable for privatization.

In the second section of this chapter we deal with the policy framework which is necessary to translate the strategy into action and results. The policy options are briefly reviewed with due consideration given to government sensitivities on the ways which privatization might deflect Kiribati culture.

4.1.1 Political Commitment to Privatization

It would be advisable for the government to schedule the delivery of a dozen speeches by its top leadership over a period of three months in early 1988 to express its concern on the economic and financial consequences of inefficient parastatals on the budget and on goods and services provided by these entities. The speeches by the President and Cabinet members would present a balanced view and analysis of the pros and cons of privatization. Painting a completely rosy picture is not advisable: first, because this is not true, and second, a balanced presentation would reinforce the credibility of the governments' position vis a vis the public.

Parallel to the speeches, the publication of articles and short papers on the subject and their wide dissemination in all the inhabited islands would generate interest and discussion among institutions and the general public as a preliminary step to increasing public support.

The government should encourage the organization of workshops and seminars by Ministries as well as outside organizations. For example the extension of the University of the South Pacific can be asked to organize such workshops for government managers of state owned enterprises, private sector and union leaders, religious leadership and selected Unimane from each island. Seminars involving donor representatives would be useful to bring them on board at the earliest stages to ensure their financial support at later stages.

Discussions in cabinet meetings which would not necessarily be made public would ensure reducing any threatening perceptions of privatization to individual cabinet members and would hopefully create a closer and mutually supportive working relationship between ministries who will be affected by privatization. Government agencies are sellers and buyers of each others goods and services and will be affected by the process. The important point is to emphasize and expand on the positive aspects of the changes proposed. For example some of the services provided by the government printery are free or charged at subsidized rates to other government agencies. Privatization will mean incurring a higher cost to an agency which need say 100 copies of a document. However, at present, substantial delays and faulty quality lead to desperation by buyers who, it seemed to us, are more than glad to pay a higher price to get a quality product on time.

The President and cabinet members should encourage discussions of the advantages and disadvantages of privatization in the Maneaba Ni Maungatabu. The members of parliament as representatives of the people will be sensitive to potential changes which privatization will bring about to their constituents interests. There is no doubt that initially there may be opposition by some parliament members. This opposition may be based purely on political reasons or real economic and financial issues. It is important that they are dealt with properly and adequately before they swell into a solid block of opposition tying the governments hand in proceeding with privatization.

The various island and village Maneabas as well as island and town councils are important foci of local government and political power base of the government. It is important that their leaders as well as members are encouraged to discuss and support privatization.

4.1.2 Public Education

In the absence of television (which is a strong medium for carrying both good and bad messages to the public) the government should consider four other channels available for dissemination of information on privatization. Radio is an important medium in Kiribati. News reports and interviews are two means through which privatization can be brought to the public's attention. The newspaper is the second medium in which occasional articles not only on privatization in general but divestiture of specific enterprises would influence forming public opinion. The third medium is education: the specialized vocational training schools, the system of secondary education and the extension operations of the University of the South Pacific. Finally, presentations by knowledgeable individuals in the Maneabas throughout the islands, business groups and religious organizations would ensure an educational process which would lead to the formation of a positive public opinion.

4.1.3. Establishment of an Institutional Framework for Privatization.

In chapter three of this report we discussed the establishment of a Bureau for Privatization and Private Sector Promotion (BPAPSP) under the office of the President of the Republic. It is important that such a new legal entity be established to convince Ministry and SOE staff, as well as the private sector and the general public that the government is taking privatization and the further development of the private sector very seriously. The initial stage of establishing such a bureau would be the announcement of the formation of a Presidential Task Force. This Task Force would be under the Chairmanship of the Minister of Finance and Vice President. The Task Force would consist of two bodies, one body would be staffed by a full time I-Kiribati professional and a secretary. The professional would be a Presidential Privatization and Private Sector Development Advisor and would be assisted by one long term expatriate advisor and occasional short term expatriate advisors depending on specific needs and the level of donor support. The second body would be an advisory board made up of other ministers or designees, the Managers of The Development Bank of Kiribati, Bank of Kiribati and the Attorney General. This Presidential Task Force would undertake two parallel activities at its inception: 1) Generate local and donor support for the task force to be transformed into a permanent Bureau as part of the President's Office; 2) study the feasibility of a small stock exchange which would market the shares of state-owned enterprises.

The Presidential Task Force established in January, 1988 would become the Bureau for Privatization and Private Sector Promotion by June, 1988, at which time it would be fully operational with full and part time professional and part time staff, adequate space, equipment, fixtures and furniture. Doubtless to say, it would also have a budget and source of funding to ensure its continuance and ability to perform its functions.

4.1.5 Privatization Options Suitable for State Owned Enterprises in Kiribati.

One of the first assignments to be undertaken by the Presidential Task Force is to prepare a document which establishes the GOK strategy, policies, objectives, implementation program and specific projects involving the privatization of specific entities. The privatization options are discussed in this section only as far as they relate to the strategy recommended to the Government for adoption and further study.

Immediate to Short Term Liquidation.

If liquidation in a given case does not require recourse to the Maneaba for legal empowerment, and if such recourse would otherwise be necessary as in conversion to registered company, then it may prove a useful strategy. For example, the Government Supply Division might be closed, liquidated, and its assets sold. In addition, in the case of AMMS, Ltd., which holds large liabilities, liquidation and disposition of assets may possibly be warranted. This assessment will have to be made on a case-by-case basis. Chapter 5 specifically considers liquidation from a legal standpoint.

Immediate Full Divestiture.

There are two types of immediate full divestiture recommended for government consideration. The first is 100% divestiture of all government shares in a particular SOE during the next 12 months. The second type is the selling of 51% or more of shares immediately and remaining 49% or less in the term of two years. Immediate full divestiture within the new strategy being formulated is being recommended as an option for the entities in Priority One Group - discussed in more detail in Chapter VIII. The strategy emphasizes the full and immediate privatization of those entities which require minimum effort compared with other entities. Their privatization would also encounter the minimum number of obstacles and objections by those directly involved in their operation and affected by the process of full divestiture.

Divestiture in the Medium Term

This applies primarily to government divisions and departments which do not have a self accounting status at present. It is hoped that within a year of the governments announcement of its intent to privatize, these department/division entities would first be transformed into a self accounting status and in turn converted into a registered company. It would probably take at least one more year to valuate the new company and determine the best way to privatize it.

Divestiture in the medium term also implies that some SOE's could be split up into different components. Some of these components which would be sold off immediately, while the others would need additional restructuring, valuation, decisions on handling liabilities, market conditions and labor issues. This latter group would then be privatized in the medium term.

Divestiture in the Long Term

The entities in this category fall into two groups. The first is composed of entities which due to reasons which are explained in more detail in chapter VIII cannot be easily privatized fully or in part immediately or in the medium term. The second group consists of those entities which although could not be privatized immediately or in the medium term, they are candidates to either the leasing of their operations as a preparatory stage to divestiture or letting out management contracts with or without equity options.

The strategy of the Government would be to consider leasing or management contracts as an intermediary stage to full privatization. Under leasing contracts the Government would want to ensure that the lessor does not cause an undue deterioration of its assets in the course of operation. The lease charges should not be too high, which could lead to asset deterioration. It should not be too low which would make the Government a target of criticism.

Leasing contracts may have a buy-out option. The conditions of such an option can be established either at the time the operation is being leased out for the first time or at a time when lease renewal is being negotiated. The Government should consider its options on a case-by-case basis taking into consideration both the public interest and the sustainability of the operation by the lessee.

Management contracts also may come in two types, with or without equity options. A management contract does not normally provide control of the assets of the owner. It is usually tied to three types of performance. 1) Total revenues. 2) Total profits. 3) Productivity and efficiency of the resources provided by the owner and operated by the management contractor. Increases in all three types of performance should be part and parcel of the management contract between the owner, in this case the Government of Kiribati and a private company.

4.2 Policy

The Policy framework suggested for the Government's consideration is consistent with the Sixth National Plan, by focusing on the following priorities;

1) Increase self reliance
2) Maintain public interest
3) Open the national economy to private sector
4) Regularize donor assistance fund flows
5) Maintain Kiribati culture
6)Choose among alternative investment options for rapid and appropriate privatization.

4.2.1 Increase Self Reliance

Increasing self reliance can be approached as a long term process in which the present critical need for foreign assistance decreases over the next several decades. This definition also encompassas the expansion of the non-Government productive sector which would contribute to expansion of employment and incomes through private domestic and foreign investment. The Government will continue to explore the potential of diversifying and increasing its exports and stabilizing its imports. In fact, increasing self reliance is more than just a government policy. It seems it is a credo which the Government would like to be adopted by Kiribati society. Preservation of the local culture to the maximum extent is the cornerstone of the self reliance policy.

Privatization of state owned enterprises can be made an important component of self reliance. Encouraging the development of an ever increasing pool of local entrepreneurs who take over the ownership and management of SOE's and also create new enterprises with the National interest in mind would gain the Government an important partner instead of a suspicious bystander which the private sector seems to be at present.

Self reliance, thus, becomes an important component of the privatization policy framework emerging from the strategy and leading to programs and projects which strengthen the national economy by strengthening the private sector.

4.2.2 Maintenance of Public Interest

Maintenance of the public interest is a major part of the social contract entered between a government and society. The regulatory activities of the government prevents anarchy and allows a harmonious development of social, economic and political activities in society. In Kiribati the conceptual framework of public interest emanates from two sources. The first is traditional culture with the responsibility of the elders as watchdogs and arbitrators of social norms. The second is the British influence wielded over a long period of colonial relationship. The overlay of these two influences has led to the governments present role in the economy.

The definition of the public interest is also shaped by the political system of society it chooses. A government may choose development of heavy industry at the expense of all other sections and may justify the curtailing of individual freedoms in the name of public interest as defined by that particular government. A democratic government respectful of individual and property rights defines public interest differently than authoritarian governments. While the public and its organizations can contribute to a changing concept of public interest under a democratic form of government this is not easily possible under an authoritarian government.

Enforcement of public interest is accomplished through laws, regulations, organizations and people to ensure that no particular individual or organization is unduly favored or unduly discriminated against.

The maintenance of the public interest is an important component of the privatization policy framework. The critical question which would need either resolution or compromise is whether the Government is the only and the best judge in providing a good or a service considered in the public interest or whether other organizations in society can be given this responsibility with the Government maintaining regulatory powers.

The Government of Kiribati is aware of the monopolistic or oligopolistic position of some of the SOE's in operation at present given the small size of the market and limited number of people which can purchase and hold shares. It is justifiably concerned about the creation of private monopolies replacing public monopolies. We do not believe that such a problem presents itself for the first two groups of companies. However, such concerns can be alleviated by the regulatory powers of the Government in curbing either exclusive domination over the market by a specific firm or any predatory policies against competitors or exploitation of buyers of the goods and services provided by a single or leading firm.

The salutary effects of competition and operation of free market forces have a number of assumptions which do not easily lend themselves to Kiribati. The country cannot support large numbers of small entities in any particular sector. However, in the absence of government restrictions the market is large enough to allow the degree of competition beneficial to the economy. Competition accompanied by government regulatory powers will ensure both maintenance and enhancement of the public interest.

4.2.3 Opening the National Economy to the Private Sector.

Conversations with some government officials as well as review of national plans indicates the government may prefer to improve the operations of SOE's rather than to transfer ownership. Parallel to the expression of this preference was the idea of SOE's entering into joint ventures with foreign private corporations. Furthermore, there is a persistent belief that the private sector is too small, too inexperienced and too weak. However, the inability of the government to continue operation of some of the SOE's is also admitted during these discussions. The ambivalence of the government needs to be resolved by adopting a policy of opening up the national economy to the private sector, both domestic and foreign. Such an opening means furnishing licenses and enabling new operations to start with minimum bureaucratic impediments. A number of ministries have undertaken the incubation of small enterprises. However, these efforts are not initiated to help a local entrepreneur. They are started with the intent of maintaining the operation and ownership in the public sector either as an extension of an existing SOE or a new business undertaking by the public sector.

The addition of a policy opening the national economy to the private sector is necessary for the successful implementation of a privatization program. Government employees with an entrepreneurial bent may be given some assistance to leave the government and establish a new enterprise rather than starting one with government resources.

4.2.4 Regularize Donor Assistance Fund Flows

The government consistent with the self reliance framework adopted a policy to reduce and eliminate British budgetary assistance. Although it is difficult for bilateral and multilateral donors to commit and disburse funds consistent with the recipient's development goals and objectives, the government may still adopt such a policy and push for its gradual acceptance by donors. Recipient's perception often may not coincide with donor's perception of developmental needs and priorities. Recipient's policies on political and technical levels may provide somo regularization of donor assistance fund flows consistent with governments objectives over the long run.

4.2.5 Maintenance of Te Katei Ni Kiribati

Government's adoption of a privatization policy may have an impact on its efforts to preserve the Kiribati Way. Consequently, an important component of this policy needs a compromise on the potential changes, whether and how they should be encouraged or discouraged.

Privatization will make private sector owner/manager more prominent and different from others. Small share holders will also be differentiated at a later stage if it was found that investing in stocks of a privatized entity was a wise financial move. Divestiture of government assets throughout the economy will create changes in employment by continuing to attract wage labor from the subsistence sector. Preference for urban over rural housing will continue to grow exacerbating the current housing shortage. At present, urban houses are as sparsely furnished as rural houses. In some interesting aspects Kiribati society has maintained a minimalist attitude towards household and personal effects. The changes brought about by a money economy and job opportunities in the public sector after independence may increase with privatization by introducing the desirability of acquiring material goods.

One of the important changes privatization will contribute is the way in which perception of status is transformed. Privatization will contribute to increase in prominence through acquisition of wealth and demonstration thereof, of prestige and power. The egalitarian nature of Kiribati culture will need to be sufficiently resilient to adapt to these changes.

Traditionally, education was provided to children by the immediate and extended family members and to some extent by the community. However, much of the education was treated as privileged information between father and son. As the demand for skills and knowledge changes, those provided exclusively in the traditional manner through the family are insufficient to survive or thrive in a money economy. Thus, reliance on new educational institutions and the learning and application of this knowledge weakens the traditional educational function of the family.

The changes in education also lead to changes in politics and formation of new political relations. Educated young people do not easily go along with the decision making process of the elders. Begrudgingly the Unimane observe the shifting of political power to a younger generation, primarily because the Unimane themselves realize that they do not have the knowledge or skills required to respond to problems or situations of modern daily life.

Privatization policy needs to guide changes in education and politics. Short of Kiribati closing itself to the outside world like Japan before the Meiji restoration, it can not stop the changes. Privatization will impact the intensity and direction of these changes. The government's policy would be to decide on an appropriate compromise between the traditional and modern way in each step of privatization.

4.2.6 Alternative Investment Policies

Privatization of SOE's can occur in the total absence of organized capital markets in the sense they operate in industrialized countries. Most developing countries which can benefit from immediate privatization of some of their enterprises can not afford to wait for the development of financial markets to undertake privatization. The cost of establishing organized financial markets in the short run may not justify the benefits to be derived since in each country there has existed informal financial markets since the beginning of time. This, however, does not mean that a privatization program does not provide the opportunity to initiate a small stock exchange which is nurtured in its early stages, primarily through the sale of shares of companies being privatized. In Kiribati, such an opportunity exists which can enable a privatization program to incubate (in a manner of speaking), the birth of a very small, very limited capital market.[1]

Some of the current SOE's can probably be sold in their entirety to either a single individual, a family unit or a moderately large number of shareholders, say 100 to 500 people. The GOK will be interested in a wider distribution of ownership rather than its being concentrated in a few hands. Encouraging maximum participation by current employees in the purchase of shares is one approach. A second approach would be to make shares part of a severance or early retirement package for employees who leave the SOE during the process of its privatization.

The policy of the government so far has been to establish share prices on the basis of book value. We recommend that a valuation study be undertaken for each SOE to be privatized since book value may not represent market value or what an investor would be willing to pay for a share. The new privatization policy would enable the establishment of conditions which would dispose of shares rather than holding them for a year or more because prices based on book value do not reflect value as perceived by investors.

General government funds supplemented by foreign assistance funds can finance a study on the feasibility of establishing a small stock exchange. Some of the resources of the Special and Provident Funds can be lent to the employees for the purchase of shares.

The Development Bank of Kiribati can provide matching equity capital loans to principal investors taking part of the shares as collateral while the Bank of Kiribati can provide operating capital loans based on assets or factoring of receivables. Funds received by the government from the sale of shares of a specific

---

[1] For a discussion of successful privatization with an undeveloped capital market see: Roger S. Leeds; Privatization of the National Bank of Jamaica: A Case Study Research in progress Center for Business and Government, Weil Hall, John F. Kennedy School of Governemnt, Harvard University, Cambridge, Mass., September 1987.

SOE could be lent to employees over time to increase their share of ownership.

From a Privatization Policy Framework point of view, the government is advised to consider alternative approaches to divestiture and establish credible polices consistent with its other development priorities and objectives.

CHAPTER V: LEGAL FRAMEWORK

This chapter relates to legal authority to divest state owned enterprises, applicable procedures under law for offers of securities, labor aspects of privatization, Native Lands Act provisions, foreign investment legislation and selected individual and corporate income tax provisions.

5.1 Legal Power and Authority to Privatize

By way of introduction to this subject, section 3.1.2 should be carefully read for background on 3 principal types of government owned entities in Kiribati: (1) Division/Departments of a Government Ministry; (2) Registered companies under the commercial company act; and (3) Statutory law corporations. Section 3.1.2 is a necessary foundation for an understanding of the more technical, functional analysis that follows.

The major inquiry in this section concerns whether specific legislation is required in the case of a given type of entity in order to divest it. Moroover, in some cases it will be necessary to specifically seek such authority from the Maneaba (or Parliament). In other cases such authority will already have been granted pursuant to existing legislation.

Enacting legislation is a complex and time-consuming process. The Maneaba convenes 3 times per year, every four months. A bill requires a simple majority of the 38 members to be enacted. A bill is generally "read" into the Maneaba over 2 sessions, to allow about eight months consideration before enactment. However, the process can be shortened. If a bill is deemed "urgent", it can be considered in one session or reading.

For entities that already have authority in one form or another from the Maneaba to be divested, there is less risk that a political objection will be raised to block the process. In addition, since the legislative gauntlet will not have to be run, the process will be expedited by some 4 to 8 months or more. Accordingly, the analysis below focuses on <u>when specific authority from the Maneaba exists to allow divestiture, and when and under what circumstances such authority must be sought because it is not present.</u> This knowledge is critical to privatization prioritization and planning.

Some precedent exists in Kiribati on questions of legal authority to privatize. Such precedent does not exist in the form of published legal decisions (in Kiribati) or explicit administrative rulings or regulations. However, certain government approvals have been granted and other pending actions undertaken on advice from the Attorney General that these areappropriate. This precedent of guidance on the requirements government approvals have been granted and other pending actions undertaken on advice from the Attorney General that these are appropriate. This precedent of guidance on the requirements of the law is considered below.

5.1.2 Ministry Division into Registered Company

The Attorney General has observed in conversations sustained on the subject that an act of the Maneaba is required to authorize the transformation of a government ministry division into a government ministry owned company. We are informed that the Maneaba is enacting laws authorizing the Shipyard (a division of the Ministry of Transport and Communications) and the Mobil Oil Agency (a part of the Ministry of Works and Energy) to be reconstituted as government owned companies registered under the Companies Ordinance. These entities have not yet been registered as companies under the Company Ordinance but are reportedly being reorganized for this purpose. Moreover, these government divisions would be legally restructured to have a separate juridical identity as registered companies, with respective boards of directors, officers, and the ministries as shareholders (i.e., the Minister of Transport will control a Shipyard Corporation).

5.1.3 Government Owned Registered Companies into Private Hands

Reconstituting a ministry division into a registered company is significant, not only from a standpoint of management and organization, but also with respect to future sale or disposition: according to conversations sustained with the Attorney General, registered companies can be sold to private shareholders without further Congressional authorization. The controlling ministry through its Board of Directors would be responsible for making such a decision. Thus, in Kiribati, authorization of the Maneaba is required to convert one form of ministry ownership (a division or self-accounting unit) into another form (a registered company under the Company Ordinance, wholly owned by the government per its representative, the ministry). However, once a government-owned entity has achieved registered company status, it needs no further authorization from the Maneaba to transfer ownership into private hands. According to the Attorney General, such authority is implicit in the authorization for registration as a company under the Companies Ordinance.

5.1.4 Statutory Law Corporations and Private Ownership

It is important to distinguish companies registered under the general Companies Ordinance on the one hand, which may be publicly or privately owned, and on the other hand the companies created pursuant to a specific enabling statute, the so-called "statutory law corporations", which are always government-owned companies with a specific mandate established by act of Congress. Examples of statutory law corporations in Kiribati include the Kiribati Insurance Corporation, Air Tungaru Corporation, and the Shipping Corporation, to name only a few.

The Attorney General has observed that an act of Congress would be required to revoke enabling legislation establishing such corporations in order to authorize their conversion into registered companies under the Company Ordinance and sale into private hands.

An important exception would be an instance where the enabling legislation creating the statutory corporation authorized it to divest shares into private ownership. This appears to be the case in respect to the Development Bank of Kiribati, (DBK) which is authorized, among other things,:

(a) to buy, sell or invest moneys held by the Bank in shares, stocks, bonds or debentures, Treasury Bills, and other capital interest or securities of body corporates incorporated in or outside Kiribati;
(b) to form, acquire, or promote subsidiaries and body corporates in the manner permitted by law;....
(c) to take such steps as may be necessary to protect or recover its financial interest in any enterprise;....
(d) to do anything incidental or conducive to the better exercise of its powers and functions under this Act....

The Attorney General has expressed his view that the Development Bank of Kiribati is authorized to divest its subsidiaries registered under the Companies Ordinance without further congressional authorization. There is already some precedent for this. Recently, the DBK, with the approval of the Registrar of Corporations, offered to the general public in a secondary market sale its share holdings in the Abamakoro Trading Company, which is already about 15 percent privately owned.

5.1.5 Privatization Short of Divestiture

The above analysis demonstrates when Congressional authorization is needed for the power to divest government owned companies. Insofar as authority to contract management or lease properties is concerned, it appears within the discretion of the respective ministers to make such arrangements as are reasonable with respect to government divisions or units of statutory law companies, so long as any revenues generated are repatriated to the General Consolidated Fund, or otherwise allocated as prescribed by law. For example, the Ministry of Transport and Communications contracted out management of the Philatelic Bureau, a self-accounting unit within the Ministry. Nevertheless, if contracting or leasing is envisioned as a step in the road to divestiture, then it would be sensible to limit it to situations where a registered company (capable of sale to private ownership) was planned or in existence. Similarly, most ministries will have authority to partially liquidate their assets in the ordinary course of their activities. Whether a division of government or a statutory law company, a reorganization that would eliminate certain activities and assets would probably be within the discretion of most ministers, so long as any funds realized were fully accounted for and repatriated into the General Consolidated Fund used to finance all government activities. However, closure of an entity and cessation of its activities together with complete liquidation of its assets would in many instances require authority from the Maneaba, depending on the juridical character of the entity and the provisions of any pertinent enabling legislation.

5.1.6 Application of Above Analysis to Entities Reviewed in this Assignment

5.1.6.1 The DBK and its Registered Company Holdings

Under this analysis, the easiest companies to divest, strictly from a standpoint of existing legal authority, would be the holdings of the Development Bank of Kiribati, both because the DBK appears authorized to divest its holdings, without further recourse to the Maneaba and these holdings are either already established as registered companies under the Companies Ordinance or in the process of being so established. These include: the Abamakoro Trading Company, Ltd; the Otintai Hotel; and Atoll Motor and Marine Services. In sum, it is very likely that no further Congressional authorization would be required insofar as the power to divest these entities into private hands is concerned.

5.1.6.2 Government Divisions

The Government divisions would indeed require an act(s) of Congress to be converted into companies registered under the Companies Ordinance, even if the respective Ministry retained full ownership and control. Accordingly, Congressional authorization would be needed for the Ministry of Transport and Communications to convert the Government Philatelic Bureau, and/or the Shipyard into a registered company (ie); for the Ministry of Works and Energy to convert the Plant and Vehicles Unit, and/or the Public Works Department into a registered company(ie); for the Ministry of Home Affairs and Decentralization to convert the Government Printing Office into a registered company; for the Ministry of Finance to convert the Government Supply Division into a registered company.

An alternative approach with respect to these divisions would be to simply terminate their operations, redeploy or terminate personnel, and liquidate assets. A possible advantage to this approach would be that no recourse to the Maneaba would be required for authorization, since the Minister in charge would already possess such authority in respect to his ministry's activities. The purchaser of such assets could then register a new company, and use same for an existing company. On the other hand, since this type of decision (e.g., closure of Government Supply Division) would have an impact well beyond the respective Ministry involved, it may be that under Kiribati law recourse would have to be made to the Maneaba for such authority. In this event their would be no legal advantage to liquidation. Further, a sale of assets will likely bring less revenue to the GOK than a sale of a going concern. The question of legal authority to liquidate needs to be examined with the respective ministry and office of the Attorney General on a case by case basis.

5.1.6.3 Statutory Law Corporations

As indicated by the Attorney General, the statutory law corporations could not be divested except upon specific authority in enabling legislation (as in the case of the Development Bank of Kiribati) or legislative act of the Maneaba. The statutory corporations included among the entities analyzed in this assignment include: the Shipping Corporation, the Kiribati Insurance Corporation, and the Public Utility Board.

5.1.7 Cautionary Note

The activities of the Government of Kiribati support the above analysis, insofar as the Registrar of Corporations appeared to have ratified the authority of the Development Bank of Kiribati to make a public offering of its shares on the secondary market; and insofar as the Shipyard and the Mobil Oil Agency are seeking under authority of the Maneaba to become registered companies under the Company Ordinance. However, these are incipient activities. The "opinions" of the Attorney General referred to throughout here are utterances made in conversation based on his sense of the law with respect to the necessarily hypothetical questions posed. This essay is intended as a guide to the direction in which the law is evolving; not an "opinion letter" certifying what the law will hold in a given circumstance. As planned privatization activities become more concrete, and hypothetical questions become genuine, authoritative GOK legal opinions can be requested and obtained.

5.2 Offers of Securities

The paragraphs below offer some guidance on rules relating to securities offerings. The rules should not be dismissed as technicalities. It is useful to focus on the rules as an opportunity for the Government to, first, articulate and implement its objectives in the case of each divestiture by giving specific shape to its offer; and, second, earn goodwill and achieve consensus by following transparant and orderly procedures that can be appreciated as fair by the public at should be used by the Government to carefully formulate public offerings that meet its objectives. As made clear below, there appears to be substantial discretion for the Registrar of Corporations to certify procedures appropriate for each respective sale of securities.

It should be borne in mind that the Office of the Attorney General consists of basically two lawyers, the Attorney General himself and another expatriate lawyer (who acts as Registrar of Corporations, among other things). Insofar as we were able to determine, there are no private attorneys practicing in Kiribati. Notwithstanding these limited legal institutional resources, the legal regime inherited from Britain is exacting, creating an impressive array of rights, obligations, and potential liabilities in the share offering process. In essence, this means that activities such as structuring, writing and reviewing prospectuses will have to be carried out with expatriate technical assistance. Expatriate assistance will be necessary both to protect the rights of the public, and also to help shield the government from litigation that could arise from failure to comply with the technical requirements set forth in the Company Ordinance.

5.2.1. Private and Public Companies

As with the prior section, this section assumes the reader has already reviewed section 3.1.2, which introduces the concept of "public and private" companies as defined in the Registered Company Ordinance.

Before discussing public share offerings, it is useful by way of background to review here these two basic forms of company organization Under the Ordinance, a "private" company is not simply a company whose shares are held in private hands. Rather, a private company is a term of art. To qualify as a "private company" the company Rules must specify:

(1) that it is "private", and the company must satisfy these conditions:

(a) its Rules restrict the right of a member to transfer its shares;

(b) the number of its members is not more than 25, and where 2 or more persons hold 1 or more shares jointly they shall be treated as a single member;

(2) A private company shall not be entitled to make any invitation to the public to acquire any of its shares or debentures;

(3) A private company may not issue bearer shares or share warrants in bearer form or convertible debentures.

Companies not so restricted are generally regarded as "public" companies. "Public" companies are generally subject to more stringent oversight and exacting regulation than "private" companies. For example, rules on annual general meetings (Sec. 62

companies are more relaxed.

In addition, the prospectus requirement reviewed below pertains only to public companies. While in theory this is logical since by definition only public companies would be making offers of securities to the public, in practice the Registrar appears to have some considerable discretion to determine that an offer that might otherwise appear to constitute a public offering is technically not so. Therefore, it might be possible to utilize certain provisions in the law to escape the technical requirements that apply to "public" companies and "public" share offerings.

5.2.2 Private Placements versus Public Offerings

For example, it might be possible to organize as a "private" company to reenforce the notion that a share offer is not "public" within the meaning of the Ordinance, and to gain the approval of the Registrar of Corporations in this respect. That would insulate an offer from all the requirements that attend a "public" offer of securities. While such a strategy might be useful in some instances, this type of "private placement" might have drawbacks in terms of perceived fairness. As stated at the outset of this section, the technical requirements will in most cases prove useful inasmuch as they compel the government to carefully formulate its offer, create transparency and even-handedness in the process, and give the impression of fairness to the general public.

Even where the Registrar determines that a "public offering" of securities will not take place for one reason or another, he is still empowered to place restrictions on such offerings to achieve fairness (and equally importantly a perception of fairness among the general public). This will permit the Registrar to formulate and follow whatever procedures are appropriate in respect to each enterprise. Given the fact that the enterprises range from a trading company to a public utilities board, it is very likely that the terms of sale of each would differ, and that the procedures attached to such securities offerings would reflect such differences, as spelled out in Chapter IX, section 9.2.

The Companies Ordinance contains detailed provisions relating to the offers of securities to the public. Section 61 defines a "public" offering very broadly to include just about any offer except offers to existing share or debenture holders. As indicated above, there remains, however, a considerable discretionary loophole, as it were, inasmuch as an offer is not a "public offer" if it is "certified in writing by the Registrar to be an offer which the Registrar considers as not being calculated to result, directly or indirectly, in the shares or debentures becoming available to more than 20 persons or to persons other be an offer which the Registrar considers as not being calculated to result, directly or indirectly, in the shares or debentures becoming available to more than 20 persons or to persons other than those to whom the offer is made and which the Registrar considers as being a domestic concern of the persons making and receiving the offer...." (Sec.61 (3)) and meets other related requirements. This exception may be quite wide. For example, the Registrar may have discretion to regard 3000 individual people constituting one Island Council as a "person", if the public offer is made to various Island Councils as such. As just noted, this leaves open the possibility of having a share offering certified not a public offer, and thus being exempted from the many requirements that pertain thereto.

Apart from the stated technical requirements that pertain to a public share offering, it must receive the discretionary approval of the Registrar of Corporations, "who in granting such consent may impose such conditions or restrictions as he may think proper." (Sec. 61 (2)). Moreover, just as the Registrar may tailor private placement requirements on a case-by-case basis, this provision furnishes similar authority in the case of public offerings.

5.2.3 Public Offers of Securities

Among the principal explicit technical requirements attaching to a public offer of securities are the following:

Sec.61 (1) provides that it "shall not be lawful for a public company to allot or agree to allot any shares or debentures of the company unless the person to whom the shares or debentures are allotted has had delivered to him a copy of a prospectus which has been duly registered with the Registrar not earlier than 3 months before the date of such allotment or agreement to allot." The section provides further that, "no form of application for shares or debentures of a public company shall be issued unless it be accompanied by a copy of a prospectus which has been so duly registered...." (Sec. 61).

The Registrar of Corporation is accorded wide discretion in approving the form and content of a prospectus submitted to him for his approval as required by Sec.61 (5) of the Ordinance. The prospectus must be submitted at least 14 days prior to date of intended issue and cannot issue in the absence of a certificate of registration is delivered from the Registrar to the petitioning company. (Sec. 61 (5)). The prospectus must bear the date on which the Registrar certified registration.(Sec.61 (6)).

Section 61 (7) provides that no "prospectus shall be issued more than 3 months after the date of the registration of the prospectus with the Registrar and if a prospectus is so issued it shall be deemed a prospectus which has not been registered."

Section 61(9) provides that no "company shall within 1 year after the date of registration of a prospectus vary or agree to the variation of any of the terms of any contract referred to in the prospectus unless the variation in specific terms is authorized by the class consent of the holders of shares or debentures of the class comprised in the prospectus." (Sec. 61 (10)).

Section 61 (10-(14)) imposes civil liability on certain persons (experts, officers, and others, probably including the Government of Kiribati unless otherwise protected by a provision conferring sovereign immunity) connected with an offer of sale of securities of a public company to compensate injured purchasers who acquire shares or debentures of such company as a result of an "untrue statement of material fact (whether innocently or fraudulently) in a prospectus published in relation to such shares....". The section also contains provisions allowing for defenses to such allegations. Nevertheless, in view of these provisions, that make an innocent misstatement of a material fact subject to liability, great care must be extended in the preparation of a prospectus.

The Government must carefully consider its liability, and the potential liability of the different juridical personalities and entities it holds. If exposure exists, the Government must take such steps as are necessary to protect itself from undue exposure. For example, if the government or its commercial entities do not benefit from sovereign immunity automatically, the Government may wish, as permitted by law, to include a disclaimer of liability or warranties in connection with prospectuses issued, even through every effort would be made to provide true and accurate information timely disclosed. While Kiribati is not an especially litigious environment, there have been some acrimonious lawsuits filed against the Government by private litigants in contentious circumstances-- and divestment of government ownership can be expected to generate intense scrutiny and acrimony even if handled through fair and transparent mechanisms.

Applying these rules to the specific enterprises at hand will require close collaboration with the Office of the Attorney General. For example, in the case of the companies registered under the Companies Ordinance, securities have already been issued to the controlling Ministry or other government entity involved. Should this mean that they would be exempt from the rules in Section 61 governing public offers since they could be construed as secondary market sales? Or would this be exalting form over substance since the securities have not in reality ever been offered to the public as such? What about the case of Abamakoro Trading Company where some securities have indeed been offered and sold to the public in the past and offered to the public recently without any apparent issuance of a new prospectus (none was brought to our attention in conversations on the subject with DBK and the relevant authorities)?

In the case of Kiribati, the legal universe is sufficiently small and self-contained so that these and other questions can be answered by the Registrar of Corporations neatly and cleanly with appropriate case-by-case procedural rules and safeguards formulated. The essential point is that each enterprise work closely with the Office of the Attorney General to raise and answer such questions, comply with any applicable existing legal requirements, and where discretion exists, to fashion rules and procedures that make sense for each type of enterprise divestiture process planned. Whether characterized as a private placement or public offering, securities sales should be made transparently with full regard for a perception of fairness. Valuations should be certified by independent outside experts credible to the community at large.

5.3 Labor Laws and Regulations

Initially, it should be underscored that we are dealing with relatively small enterprises in Kiribati and that employee dislocations will not likely be of a large magnitude. Indeed, it is probable that any dislocations involved in the priority group of enterprises can be arranged among involved parties without a contentious recourse to legal instruments, since in general they are likely to involve relatively small numbers (e.g. under a dozen) of employees.

Nevertheless, it is useful to consider the legal framework for a consideration of issues involved. There are three sets of employment relationships of interest from a standpoint of privatization. First, it is useful to determine what the rules and regulations controlling government employees in government ministries are, particularly their rights and the government's obligation on dismissal for redundancy. Second, it is useful to know whether these also apply to government companies registered under the Company Act, or whether and to what extent these are different, so as to determine when and in what forms the redundancy obligations may arise. Third, from a standpoint of assessing nature of the employment relationship and the operational efficiency of a private company, it is useful to consider the rules governing private employment relationships.

5.3.1 National Conditions of Service Governing Public Employment

5.3.1.1 Scope of Application

According to section A of the National Conditions of Service (NCS), they apply:
(a) ...to employees of the Government, Statutory Bodies, and Government owned companies of Kiribati...except where:
(i) the contrary intention appears in the National Conditions;
(ii) alternative provision is made for any particular employee in any Ordinance or in any regulation, rule, by-law, or order made

Provision (iii) just cited appears to relate to employees hired into the Government of Kiribati under a contractual "Agreement of Service" as opposed to "appointment to the permanent establishment" of a government ministry. The terms and conditions of employment of these employees are set forth in an Agreement of Service (Contract), an example of which is set forth in Appendix Three. These terms are likely to closely track those of permanent employees and in cases where the contract does not speak the NCS is construed to apply.

Provision (ii) above appears to open the way for government owned companies pursuant to the Company Act and their respective by-laws to set out the terms and conditions of employment of their workers. Thus, they may either adhere to the NCS as written or use the NCS as a guide shape their own terms and conditions. We were informed that the Ministers have this discretion. The correspondence in Appendix Two between the Attorney General and the Ministry of Industry and Trade in respect to the terms and conditions of employment of the Otintaai Hotel demonstrates how this process works.

5.3.1.2 Terminations and Indemnities for NCS Covered Employees and for Non-NCS Government Employees (in government owned companies).

NCS covered employees are subject to the following provisions:
C.1 The appointment of a permanent employee may be terminated at any time by giving him two months' notice in writing or by paying him one months' salary in lieu.
C.2 Unless the agreement otherwise provides, the appointment of an employee on contract may be terminated at any time by giving him one months' notice in writing or paying one month's salary in lieu.

While these provisions may appear to allow the Government liberal allowance to dismiss, in reality this is not the case, since for all employees occupying posts at level 14 and above approval of the Public Service Commission is needed to complete a dismissal (There are about 19 pay levels with 1 ranking as the highest and 19 as the lowest).

In addition, special provisions appear to apply to "redundancy" terminations. Moreover, under the heading "Termination on the Grounds of Redundancy" the NCS point to an appendix containing an agreement on redundancy terminations between the Government of Kiribati and the PKATM Union. This agreement is set forth in our Appendix Three.

It is to be emphasized that the terms and conditions on redundancy in he union agreement under the NCS and the Otintaai hotel agreement appear substantially similar, even though

<u>It is to be emphasized that the terms and conditions on redundancy in the union agreement under the NCS and the Otintaai hotel agreement appear substantially similar, even though Otintaai was established independently of the NCS. Several lessons can be drawn from a consideration of these examples.</u>

<u>5.3.1.3 Guidelines on Terminations and Indemnities for Redundancy</u>

Whether a redundancy termination occurs within the framework of a government entity subject to NCS or otherwise is not as important as the question of whether a union contract exists. If a union contract exists then its terms will control. Even if a union does not exist, the substantive terms will probably be the same or similar. In this connection it should be observed that the Otintaai Hotel provisions on redundancy and indemnification closely track the NCS referenced union agreement. Among other things these call for payment of 2 weeks basic wage or salary for each completed period of 12 months service. Thus, these probably represent norms of fairness in Kiribati. In addition, it is to be pointed out that even contracts among private employers and workers are subject to attestation of the Commissioner of Labor--so that the redundancy terms and conditions cited may even be required to apply (implicitly) to private sector agreements in the form of a severance pay.

Notwithstanding the likely uniformity of terms and conditions in NCS and non-NCS governed employee relationships, there are two significant advantages to encouraging government owned corporations to establish their own terms and conditions independent of the NCS pursuant to their by-laws prior to privatization. First, procedurally the company will have more autonomy since its employee decisions will not be subject to review by the Public Service Commission. Second, for this same reason it will be able to act more swiftly and flexibly to arrive at a settlement with employees or their union prior to divestiture.

Moreover, as indicated above, it is to be expected that in most cases, given the relatively small numbers of employees likely involved, the Government will be able to help any "redundant" employees to find comparable alternative employment in the government or private sector, so that "redundancy" payments as such will not be required. <u>Redeployment of any redundant workers should be a principal focus of privatization planning, for the protection and welfare of the families involved, and also to ensure that the Government of Kiribati is not burdened by the social-welfare and political problems associated with idle workers.</u>

5.3.2 <u>The Employment Ordinance Confers Broad Powers on the</u>

Government To Set Terms and Conditions of Private Employment

Private employment in Kiribati is governed by the Employment Ordinance which is administered by the Commissioner of Labor. The ordinance reflects the interest of the Government of Kiribati in protecting the rights of large parts of the population which are uneducated and possibly subject to abuse or exploitation. Indeed, provisions in the labor code appear to address employment circumstances that we in the United States would associate with migrant farm labor in the Southwest. For example, the Ordinance proscribes payment of wages in any form but legal tender; proscribes payment made "at or within any shop or store" or "at any place or premises where intoxicating liquors are sold" (Sec. 15). The Ordinance limits the liability of workers for advances and loans made by an employer (Sec.9), presumably to prevent a form of indentured servitude from arising.

The paternalism is reflected not only in such specific provisions but in the very wide discretionary powers of the Commissioner to determine working conditions, wages, hours and terms of employment and to investigate and remedy same. Among other things, section 5 of the Ordinance provides that the Commissioner is empowered to:

(1)...enter at all times upon any place which he has reasonable cause to believe is a place of employment ....and put questions...concerning the workers to the employer or to any person who may be in charge of the workers....

(3) [when reasonable grounds for suspecting that any offence has been committed against a worker or when any complaint is made] the Commissioner...may forthwith remove, or cause to be removed, such worker from the place of employment...for further enquiry into the matter.

(4)... may by order in writing require any employer to take within such reasonable time as the Commissioner may determine such steps as he considers necessary with a view to remedying defects observed in plant, layout, working methods, supervision, medical or sanitary provisions or other matters at any place of employment....

Moreover, the Commissioner is empowered to request information returns "in such form or forms as shall be prescribed"; to "call for and examine all contracts, registers, books of account and other documents concerning any worker...."(Sec. 6). Any person who "hinders or obstructs the Commissioner" is subject to fines or imprisonment for 6 months. (Sec. 8).

5.3.2 Wages, Hours, Contracts and Terminations

Section 10 of the Ordinance provides that "the Commissioner may by order specify the days and hours of work for such workers (in any particular industry, occupation or area) and the rates at which they shall be paid for any work in excess of that specified."

Section 27 provides that "the Beretitenti acting in a cord with the advice of the Cabinet may by order fix minimum rates of wages for workers in any class or grade of occupation in Kiribati, either generally or in any specified area or district, in any case in which the Cabinet is satisfied that the minimum rate of wages being paid to any persons...is unreasonably low." Employers failing to pay such wages are subject to fines and civil liability suits for recovery of wages.

Section 55 requires generally (with some limited exceptions) that employment relationships exceeding 1 month must be reduced to written contract. The Ordinance sets out the "form and particulars" that each contract shall cover (sec. 56), and further that "every contract shall be presented to the Commissioner for attestation", which the Commissioner may refuse, if he is not satisfied that the employee understood the contract and that all of its terms are in compliance with law.

Section 63(5) states that a contract "may be terminated by either party giving to the other notice of such termination in accordance with the terms of the contract, the minimum requirements of which shall be:
(a) where the duration is for more than 1 month the period of notice shall be not less than 14 days and may be given only after the expiry of the first month of employment....
Provided that an equitable settlement of monetary and other conditions including the question of repatriation shall be agreed upon between the worker and employer, and in default of such agreement either party may refer the matter to the Commissioner, who shall make such order...as may be just and reasonable." Once again, the Commissioner of Labor is by law placed at the center of any action relating to employment.

5.4 Native Lands

In Kiribati as in other island nations in the South Pacific and around the world the scarcity of land has endowed it with a special significance which is expressed in the laws arising to protect national control of it. The Native Lands Ordinance in Kiribati is intended to ensure that only aboriginal inhabitants of Kiribati and their descendants control the nation's land resources.

Section 5 (1) provides that "...native land shall not be alienated, whether by sale, gift, lease or otherwise, to a person who is not a native." The term "native" is defined to mean "any aboriginal inhabitant of the Islands and a descendant of any aboriginal inhabitant, whether wholly or partly of aboriginal descent, who has not acquired non-native status under the Native Status Ordinance. Thus, the qualification is not one of citizenship but rather "native" status.

In essence, the only way a foreign investor can conduct a business in Kiribati that involves the use of land is to lease or sublease the land through a native or to act through a native spouse or businesse associate. Any lease or sub-lease arrangement will require approval by the Minister of Home Affairs, and will be limited in duration as per below.

The controls placed on leasing are as follows. Section 9 provides that "No lease or sub-lease of any native land shall be valid until it has been approved and registered in accordance with the (applicable provisions). Section 10 declares that, "A lease or sub-lease, other than a native lease (native to native for not more than 21 years and 5 acres), shall require the approval of the Minister (of Home Affairs).

Section 10(2) implicitly recognizes the right of non-natives to lease lands. It declares that "any native or non-native who desires to obtain a lease of native land, other than a native lease, shall submit such lease for the inspection of the court of the district or island in which the land the subject of the lease is situate." The Minister is empowered to register the lease upon confirmation of several basic factors relating to the lease.

In all events, however, transfer and duration of the leasehold estate are strictly limited by law. Section 13 provides, "No lease or sublease granted under the provisions of this Ordinance, other than a native lease, shall be assigned or transferred without the approval of the Minister in the case of leases or subleases granted under section 12." Section 12 provides that, "No lease or sub-lease shall be granted for a longer period than 99 years or of any parcel of land of greater extent than 10 acres without the approval of the Minister."

It is worth noting in passing that at present Kiribati is not well equipped to legally document the increasing number of commercial lease transactions that are occurring as the economy opens to private investment. Moreover, this mission to Kiribati was not made aware of any private attorneys practicing in Tarawa to represent the interests of private citizens.

5.5 Foreign Investment Legislation

The Foreign Investment Act of 1985 was promulgated to "provide for the supervision and control of foreign investment in Kiribati".

5.5.1 Approvals

The Act provides that, "Except with the approval of the Commission or of Cabinet, no foreign enterprise not lawfully carrying on a business at the commencement of this Act shall commence or carry on business in Kiribati." For purposes of the Act, a "foreign enterprise" in the case of a company means a corporation in which 30% or more of the voting shares or power of the corporation is held or controlled by persons who are not local persons, where "local persons" are defined as citizens of Kiribati. It also refers to a situation in which 30% of the value or shares are beneficially owned by non-local persons; and finally to any corporation established under the laws outside Kiribati. For other forms of business organization, a foreign enterprise is an enterprise where one third or more of the members (or beneficial owners) or partners are not local persons; and an enterprise that is a person other than a local person.

The Act establishes a Foreign Investment Commission consisting of the respective Secretaries of Trade and Industry; Natural Resources; Finance; Home Affairs; and the Senior State Advocate. Four members constitutes a quorum and the Commission meets whenever the Chairman directs being not less than once every two months. The Commission may approve applications for foreign investment up to A 250,000, providing the Minister of Trade and Industry has not directed that the Cabinet so decide. The Cabinet considers investments in excess of this amount. The Commission may set conditions on approval of investments (and makes recommendations to the Cabinet in cases where the Cabinet decides) registers, supervises, and monitors foreign investment. Approval is based on the usual factors: employment, foreign exchange generation, technology transfer.

The Act appears to guarantee the right to remit earnings and capital overseas, although it is not clear whether this can be limited in some fashion by the Commission or Cabinet as a condition to approval. Regulations issued in 1986 set out the form and contents of an application for approval of foreign investment.

Apart from the national approval and registration, a license is issued by the Commission in subrogation of any local government licensing authority involved. Moreover, the Commission is authorized to make local approvals where the general application has been approved in order to prevent an investment from collapsing due solely to denial by a local government council.

5.5.2 Incentives

While there is likely to be some interest among foreign investors in Kiribati it is important to keep this in perspective. Kiribati is a poor isolated country of only 66,000 inhabitants. Its internal market is not large; its isolation does not recommend it as a export platform. Most likaly, a foreign investor would have some tie to the commerce of the island. For example, an Australian supplier of the trading company Abamakoro has expressed interest in acquiring its shares.

Kiribati has enacted an incentives program in Section 10 of its Income Tax Ordinance that allows "pioneer" companies up to 5 years exemption from income tax; the tax exemption is passed through to the shareholders of the company pursuant to a "special dividend" which "shall be exempt from tax in the hands of those shareholders."

Section 10(4) refers to manufacturing and production and may limit the exemption to such industrial enterprises. Under the Foreign Investment Act of 1985 the Cabinet or the Commission as the case may be is empowered to grant or deny application for pioneer tax status. The specific provisions of pioneer tax relief are set forth in Schedule 3 to the Tax Ordinance.

The Commission and/or Cabinet is accorded wide latitude to grant or deny such applications based on "the economic and other benefits likely to accrue to Kiribati". While the desire for wide discretion is understandable, the case-by-case discretionary approach to the incentive can easily cause acrimony and inspire mistrust among entrepreneurs in the private sector, who will tend to believe grants and denials are based on inappropriate factors. To protect the appearance of fairness, therefore, it would be useful to instill a higher degree of automaticity and uniformity in the process, declaring, for example, that any new import substitution or export industries approved by the Commission automatically qualify for the 5 year exemption program.

It is not clear whether a government business acquired by private interests would constitute "new" business qualified to receive pioneer benefits. The government may hold out this possibility to make purchase of selected government owned businesses more attractive.

5.6 Tax Rates in Kiribati and Privatization

Tax rates in Kiribati are as follows. Individuals are taxed at a graduated rate of 10 percent on their first A1000 up to 50 percent on each dollar exceeding A8000 in income. Persons other than individuals (e.g. corporations) are taxed at a rate of 25% on their first A25,000 and 35% on every dollar exceeding A 50,000. Resident corporations are provided relief from double taxation.

The Pioneer Relief Program, the principal investment incentive and exemption from both individual and corporate taxes, is above described. Particularly the high level of individual income taxation demonstrates the Kiribati cultural tendency toward social levelling. As part of an effort to stimulate a more dynamic private sector, it is advisable to lower these rates of taxation. At a minimum, this level of taxation argues in favor of liberal granting of Pioneer Relief to entrepreneurs willing to assume risks to develop new businesses and sources of employment in the islands.

VI. Financial Resources for Privatization

Resources are limited but adequate for the first priority companies. Resources arise from sevoral sources, surveyed below.

6.1.0 The Development Bank of Kiribati

Since the Development Bank of Kiribati has recently been reorganized pursuant to technical assistance provided by the Asian Development Bank in order to make the Kiribati institution a suitable channel for development funds, it is reasonable to assume that the DBK will receive additional resources from the ADB in the future. Indeed, the reorganization of the DBK is continuing with on-going assistance from the ADB. The DBK was newly established in November 1986 and effective upon the dissolution, and transfer to the Bank of the assets and liabilities and officers and employees of its predecessor, the National Loans Board.

As noted earlier, the first priority divestiture candidates that we identified are companies currently owned and operated by the DBK --which the DBK has already manifested an interest in divesting as part of its reorganization activities. These include the Abamakoro Trading Company, the Otintaai Hotel and the Atoll Motor and Marine Services Company (The DBK has actually offered shares of the Abamakoro Trading Company for sale).

At the time of this mission to Kiribati (9/87), the DBK held about A 400,000 in net loanable funds and some A 600,000 in loanable assets (e.g., the building, equipment and furnishings of the Otintaai Hotel). Its officers were expecting an additional U.S. 500,000 in loanable resources through the ADB in 1988. Since the DBK has been a prime mover in the reorganization of the institutions, it appears reasonable to expect the ADB to play a continuing role.

In the period the mission visited Kiribati, the Atoll Motor and Marine Services "Division" had not yet been transferred to a corporate shell created and registered under the Companies Ordinance, viz. AMMS, Ltd. This appears to be at this stage simply an administrative oversight easily rectified by completing a filing with the Registrar of Corporations. The major problem AMMS experiences, and the DBK as a consequence, is its apparent A 904,000 debt to the Government Supplies Division. The DBK officers with whom we spoke expect the Maneaba to restructure its balance sheet and forgive these debts pursuant to a parliamentary act. This process should be followed closely and the DBK should be directly contacted on this issue as part of any privatization follow-up effort.

Similarly, the Otintaai Hotel remains a division of the National Loans Board, although a corporate shell has been created pursuant to the Companies Ordinance in the name of Otintaai Hotel Ltd. A simple filing with the registrar of Corporations is required to transfer assets and liabilities to the registered company. This should be completed at once.

6.1.1 The Bank of Kiribati

This is a joint venture between the Government of Kiribati and Westpack Banking Corporation (Australia). According to the Bank Manager (an expatriate), the Bank holds A 30 million in deposits with some A 28 million overseas, A 1.5 in its Kiribati loan portfolio, and about A 500,000 in cash. Since this is a joint venture, with Government of Kiribati officials sitting on the Board of Directors and with the Government far and away the largest depositor, and since the venture enjoys "pioneer" tax exempt status over a reportedly extended duration, it is conceivable that this Bank would make funds available for privatization on the basis of criteria somewhat more relaxed than a traditional wholly privately-owned banking institution, taking due regard for the solvency and integrity of its finances.

In addition, USAID is reportedly making available to Westpac Banking Corporation a regional loan guarantee facility of U.S.$2,800,000 to share up to 30 percent of the risk for up to the local currency equivalent of U.S. $6,000,000 in small business lending. The Bank will seek to foster the economic development of the independent development of the independent developing countries of the South Pacific through the provision of finance and related management services. The loan guarantee facility will be retired 6 years and 120 days from date of disbursement. The project is intended to demonstrate "the commercial and financial viability of profit-driven private enterprise debt and equity investment in the South Pacific. This facility, once operational, ought to be of high relevance to privatization in Kiribati; the Bank of Kiribati, as part of a privatization planning process, should begin discussions on use of the facility in connection with a proposed program of privatization.

6.1.2 Government Special Funds

Section 107 (2) of the Constitution of Kiribati provides for the establishment of Government controlled Special Funds. Section 13 of the Public Finance Law provides that the Chief Accountant shall establish such funds to which moneys appropriated shall be credited and from which moneys may be expended solely for the purposes for which the Special Funds were established. In essence, this provides that certain government entities may create reserves inaccessible to the rest of the government, notwithstanding any other priorities the government may have. As indicated in Chapter 8, the Government Plant and Vehicle Unit and the Government Supply Division have created Special Funds that constitute an inefficient use of government revenues. If these Government Special Funds were eliminated, it is likely that considerable discretionary funds would be available for privatization activities, if so assigned, even after taking into account reserves in the General Consolidated Fund for replacement of equipment and other such "Special Fund" purposes.

6.1.3 Kiribati Provident Fund

This fund was established in July 1977 under the Kiribati Provident Fund Ordinance to provide a social security scheme for all I-Kiribati employees in the country. It replaced the Pension and Guaranty scheme operated by government prior to that date. In 1985 the fund held U.S.$7.4 million investment in foreign countries, including $5,421,284 held by James Capel & Co., in quoted government stocks, some $912,214 in short term deposits with James Capel & Co., and U.S.$1,093,690 in long term deposits in Westpac in Sydney. Short term deposits in the Bank of Kiribati totalled $2.3 million.

In the medium to long term future, the Government may wish to consider the possibility of using some small part of this fund to develop private capital markets in Kiribati.

6.1.4 Other Capital Resources

There are about a dozen entrepreneurs in South Tarawa who own and operate such enterprises as automobile import and repair facilities, wholesale food distributors and retail grocery outlets, and hotel and restaurant facilities. Whether acting together or even alone, these entrepreneurs control assets and cash resources that would likely enable them to qualify for loans for viable privatization acquisitions, from the above-described institutions.

The people of Kiribati cooperate in groups to mobilize sufficient economic resources for large purchases they deem important. For example, it is reported that the members of the Betio Catholic Church mobilized some A 1 million to construct a new church. As coordinated by the Island Council, some 3000 people of Abaiang commissioned and paid for a catamaran with motor and sail costing about A 40,000. Similarly, the 2000 people of the island of Marakei reportedly built a meeting house in Betio at a cost of about A 80,000.

CHAPTER VI: FINANCIAL RESOURCES FOR PRIVATIZATION

Resources are limited but adequate for the first priority companies. Resources arise from several sources, surveyed below.

6.1.0 The Development Bank of Kiribati

Since the Development Bank of Kiribati has recently been reorganized pursuant to technical assistance provided by the Asian Development Bank in order to make the Kiribati institution a suitable channel for development funds, it is reasonable to assume that the DBK will receive additional resources from the ADB in the future. Indeed, the reorganization of the DBK is continuing with on-going assistance from the ADB. The DBK was newly established in November 1986 and effective upon the dissolution, and transfer to the Bank of the assets and liabilities and officers and employees of its predecessor, the National Loans Board.

As noted earlier, the first priority divestiture candidates that we identified are companies currently owned and operated by the DBK --which the DBK has already manifested an interest in divesting as part of its reorganization activities. These include the Abamakoro Trading Company, the Otintaai Hotel and the Atoll Motor and Marine Services Company (The DBK has actually offered shares of the Abamakoro Trading Company for sale).

At the time of this mission to Kiribati (9/87), the DBK held about A 400,000 in net loanable funds and some A 600,000 in loanable assets (e.g., the building, equipment and furnishings of the Otintaai Hotel). Its officers were expecting an additional U.S. 500,000 in loanable resources through the ADB in 1988. Since the DBK has been a prime mover in the reorganization of the institutions, it appears reasonable to expect the ADB to play a continuing role.

In the period the mission visited Kiribati, the Atoll Motor and Marine Services "Division" had not yet been transferred to a corporate shell created and registered under the Companies Ordinance, viz. AMMS, Ltd. This appears to be at this stage simply an administrative oversight easily rectified by completing a filing with the Registrar of Corporations. The major problem AMMS experiences, and the DBK as a consequence, is its apparent A 904,000 debt to the Government Supplies Division. The DBK officers with whom we spoke expect the Maneaba to restructure its balance sheet and forgive these debts pursuant to a parliamentary act. This process should be followed closely and the DBK should be directly contacted on this issue as part of any privatization follow-up effort.

Similarly, the Otintaai Hotel remains a division of the National Loans Board, although a corporate shell has been created pursuant to the Companies Ordinance in the name of Otintaai Hotel Ltd. A simple filing with the registrar of Corporations is required to transfer assets and liabilities to the registered company. This should be completed at once.

6.1.1 The Bank of Kiribati

This is a joint venture between the Government of Kiribati and Westpac Banking Corporation (Australia). According to the Bank Manager (an expatriate), the Bank holds A 30 million in deposits with some A 28 million overseas, A 1.5 in its Kiribati loan portfolio, and about A 500,000 in cash. Since this is a joint venture, with Government of Kiribati officials sitting on the Board of Directors and with the Government far and away the largest depositor, and since the venture enjoys "pioneer" tax exempt status over a reportedly extended duration, it is conceivable that this Bank would make funds available for privatization on the basis of criteria somewhat more relaxed than a traditional wholly privately-owned banking institution, taking due regard for the solvency and integrity of its finances.

In addition, USAID is reportedly making available to Westpac Banking Corporation a regional loan guarantee facility of U.S.$2,800,000 to share up to 30 percent of the risk for up to the local currency equivalent of U.S. $6,000,000 in small business lending. The Bank will seek to foster the economic development of the independent development of the independent developing countries of the South Pacific through the provision of finance and related management services. The loan guarantee facility will be retired 6 years and 120 days from date of disbursement. The project is intended to demonstrate "the commercial and financial viability of profit-driven private enterprise debt and equity investment in the South Pacific. This facility, once operational, ought to be of high relevance to privatization in Kiribati; the Bank of Kiribati, as part of a privatization planning process, should begin discussions on use of the facility in connection with a proposed program of privatization.

6.1.2 Government Special Funds

Section 107 (2) of the Constitution of Kiribati provides for the establishment of Government controlled Special Funds. Section 13 of the Public Finance Law provides that the Chief Accountant shall establish such funds to which moneys appropriated shall be credited and from which moneys may be expended solely for the purposes for which the Special Funds were established. In essence, this provides that certain government entities may create reserves inaccessible to the rest of the government, notwithstanding any other priorities the government may have. As indicated in Chapter 8, the Government Plant and Vehicle Unit and the Government Supply Division have created Special Funds that constitute an inefficient use of government revenues. If these Government Special Funds were eliminated, it is likely that considerable discretionary funds would be available for privatization activities, if so assigned, even after taking into account reserves in the General Consolidated Fund for replacement of equipment and other such "Special Fund" purposes.

6.1.3 Kiribati Provident Fund

This fund was established in July 1977 under the Kiribati Provident Fund Ordinance to provide a social security scheme for all I-Kiribati employees in the country. It replaced the Pension and Guaranty scheme operated by government prior to that date. In 1985 the fund held U.S.$7.4 million investment in foreign countries, including $5,421,284 held by James Capel & Co., in quoted government stocks, some $912,214 in short term deposits with James Capel & Co., and U.S.$1,093,690 in long term deposits in Westpac in Sydney. Short term deposits in the Bank of Kiribati totalled $2.3 million.

In the medium to long term future, the Government may wish to consider the possibility of using some small part of this fund to develop private capital markets in Kiribati.

6.1.4 Other Capital Resources

There are about a dozen entrepreneurs in South Tarawa who own and operate such enterprises as automobile import and repair facilities, wholesale food distributors and retail grocery outlets, and hotel and restaurant facilities. Whether acting together or even alone, these entrepreneurs control assets and cash resources that would likely enable them to qualify for loans for viable privatization acquisitions, from the above-described institutions.

The people of Kiribati cooperate in groups to mobilize sufficient economic resources for large purchases they deem important. For example, it is reported that the members of the Betio Catholic Church mobilized some A 1 million to construct a new church. As coordinated by the Island Council, some 3000 people of Abaiang commissioned and paid for a catamaran with motor and sail costing about A 40,000. Similarly, the 2000 people of the island of Marakei reportedly built a meeting house in Betio at a cost of about A 80,000.

ChAPTER VII. MANPOWER AND INSTITUTIONAL RESOURCES FOR PRIVATIZATION.

7.1. Manpower Resources

The Government has a finite, indeed, very limited amount of skilled manpower to run the administration, leave alone for privatization. This is a serious bottleneck which is only partially met by expatriate technical assistance from the UK, Australia, New Zealand, Commonwealth and UNDP.

In order for privatization to be successfully implemented and take hold in Kiribati, foreign technical assistance needs to be provided by a current or new donor. Also, a number of public officials need to be trained in the mechanics of carrying out privatization. Training of local officials either in-country or at a foreign institution is theoretically possible. However, the limited skilled manpower in the government is already taxed with their current duties to such an extent that their attendance at training even for a short period of time will be at the expense of their on-going responsibilities.

There are other individuals both in the public and private sectors who could work as counterparts to expatriates but their continuing availability could not so far be assured.

7.1.1 Manpower Resources in the Public Sector.

Implementation of a long term privatization program will require accountants, financial analysts, valuation specialists, investment bankers, legal experts and industry specialists. The public sector may be able to supply part-time assistance of accountants and financial analysts but not valuation specialists, investment bankers, or legal experts.

There are four potential manpower sources in the government pertinent to privatization:

1) Ministries (including departments and divisions)
2) Statutory Corporations
3) Registered companies
4) Attorney General's Office

None of the above can provide skilled staff on a full time basis for two to three years. The first three may be able to provide accountants, financial analysts and industry specialists on a short term basis. However, even they will need a minimum training of two to four weeks in order to be entirely useful to the privatization effort.

The Attorney General's office consists of two trained Attorneys, the Attorney General himself, his deputy (who is an expatriate who also doubles as the Governments Registrar) and two executive secretaries. There are no other attorneys in the country. A private attorney who worked primarily for indigent cases, left the country some months ago.

The implementation of the privatization program will require a three-pronged attack to cut the Gordian Knot which the public manpower seems to present. First, there will be a need for short term specialists accompanied by one or two long term experts. Second, several I-Kiribati will need some graduate education, perhaps in a special program off-island. Third, the technical assistance provided by a foreign donor should have a strong in-country short term training component.

The creation of a relatively small, unsophisticated and simple stock exchange should be carried on as a series of training exercises until it is established as a functional entity.

7.1.2 Manpower Resources in the Private Sector.

There are four primary sources which potentially can provide manpower to a privatization program. They are:

- Businesses and Business Organizations
- Cooperatives
- Religious groups
- Island and Town Councils

There are individuals who, as owners and managers of small and medium size businesses, have gained substantial experience in operating their businesses who could be used as short term consultants in privatization. These individuals, like their counterparts in the public sector, will also need short term in-country training.

Among the four groups listed above, there may be a hundred individuals with education and experience useful to a privatization effort. We can expect at least ten to be willing and available. During the two weeks we were in Kiribati, we either met or were informed of a number of individuals with both entrepreneurial spirit and management capability.

7.1.3 Manpower resources for the Privatization Task Force and the Bureau for Privatization and Private Sector Development.

This report is directed toward three distinct audiences which we expect to be directly or indirectly involved with the implementation of a privatization program in general and providing the required manpower sources in particular. They are:

1. The Government of Kiribati

With limited financial and manpower resources, the government can not carry out a privatization program by itself. Much of the information and analysis in this report is already known to the government. It is hoped that this report will add to the knowledge and understanding of the available options, constraints and bottlenecks so that Kiribati officials can undertake judicious decisions to move forward a successful privatization program.

Given the acceptance of this report, we suggest the immediate appointment of a Privatization Task Force consisting of:

Minister of Finance and Vice Present: Chairman
Minister of Trade Industry and Labor: Member
Minister of Natural Resources Development: Member
Attorney General: Member
Secretary of Finance: Advisor
Secretary of Trade, Industry and Labor: Advisor
Secretary of Natural Resources Development: Advisor
Director of National Planning Office: Advisor

In addition to the four members and five advisors, the government should locate a Kiribati citizen in-country or overseas who would be the executive director of the Task Force. He would be the single full time professional on the public payroll. He would receive substantial assistance from the Ministry of Finance Privatization Coordinator who may be Mr. Simon Koomar.

The Task Force would expand tha plans for a privatization program until all appropriate decisions and legislation are passed by the Maneaba, donor funding is assured and the status of the entitities to be privatized is clarified. Upon donor finding the Task Force would be transformed into a permanent bureau under the Presidents office with the members and advisor of the Task Force becoming the Privatization Board responsible to the President for the accomplishments of the Bureau. At this point the bureau would plan on the institutional resources of three ministries as detailed in section 7.2 at the end of this chapter.

2. U.S.A.I.D.

The Agency for International Development of the US Government through its regional office in Fiji, the Private Enterprise Bureau and Asia/Near East Bureau in Washington D.C. is the second audience of this report. The funding of U.S.A.I.D for its worldwide developmental activities has been curtailed and may not rise in the forseeble future. The government of Kiribati would be wise not to expect 100% of the funding to carry out a privatization program for Kiribati from the US Government. However, this does not mean that some short and long term assistance may not be available at some future date.

Should the AID Regional Office Design a long term project based in Fiji to provide technical assistance to the ten countries of the Pacific in Privatization and Private Sector Development. Kiribati as one of these ten countries would benefit from such a project.

Potential contributions to such a project from inside USAID could furnish limited funding from five sources:

AID Mission funds
ANE Bureau funds
PRE Bureau Privatization Project Funds
PRE Bureau Private Enterprise Development Support Project Funds.

A ten year project, incrementally funded to a minimum of $1 to $2 million, per year for the ten Pacific countries which the regional office covers at present would provide a substantial amount but not all the foreign technical assistance Kiribati would need to carry out a successful privatization program and promote its private sector at the same time.

3. Other Bilateral and Multilateral Donors.

The third audience of this report is other donors. Collaboration and close cooperation between the world's bilateral and multilateral donors unfortunately is part rhetoric and only partly real. A donor provides funds consistent with its own policies which may not parallel or overlap other donors' policies. Nevertheless, in the case of the Pacific countries in general and Kiribati in particular the following organizations may be able to participate with USAID on a project to promote privatization and private sector development in the Pacific.

UNDP
FAO
The World Bank
The Asian Development Bank
IFC
Overseas Development Administration (UK)
SPEC
The University of the South Pacific

Australia and New Zealand have not been included in the above list since it is doubtful they would be willing to go above their current assistance level in the future. Each one of the institutions mentioned above take a long time to fund long term projects. However, they may be able to provide occasional short term consultants without being involved in a major financial effort. The emphasis on these institutions is as providers of short term technical assistance, as grants to the maximum extent possible and not as major and single funding sources for a large project.

7.2 Institutional Resources for Privatization

While the major source of political support will emerge from the President, Cabinet and the national parliament, the institutional resources, limited as they may be will probably come from three Ministries: Finance, Industry, Trade and Labor; and Natural Resources Development. The quantity, quality and phasing of these resources are left to the initial efforts of the Privatization Task Force.

CHAPTER VIII: ANALYSIS OF SELECT STATE ENTERPRISES:

8.1 Company Profiles.

This chapter provides brief company profiles of twelve state owned enterprises selected prior to our arrival in Kiribati and four others on which we received some information, the criteria for privatization, the ranking approach which was utilized and its justification as applied to each enterprise. Additional information on each one of the twelve entities is provided in Appendix Two which includes the enterprise check list, financial reports, articles of incorporation and or other pertinent information we were able to gather during this assignment.

8.1.1 Abamakoro Trading Ltd.

The Atoll Wholesale Distributors Ltd., was established in April 1981 for the purpose of conducting the business of import and wholesaling of food and other products. At its inception the company authorized 800,000 shares of common stock and 200,000 shares of preferred stock of A$1.00 each for a total capital of A$1,000.000. The number of outstanding shares is 150,000.

In January 1982 the name of the company was changed to Abamakoro Trading Ltd. The above information is based on the articles of incorporation of the Atoll Wholesale Distributors Ltd., and an announcement issued by the Registrar of Companies, copies of which are given in Appendix Two The present management of Abamakoro considers its founding date as May 1982 as evidenced by the enterprise checklist. 85% of the outstanding shares is owned by the Development Bank of Kiribati and 15% by 400 shareholders. A list of the shareholders including their names number of shares held and par value of shares is given in Appendix Two. The large majority of shareholders own between 10 and 100 shares. There are only seven share holders who own 1000 shares and above with the maximum held by one shareholder who owns 2731 shares. The Development Bank of Kiribati owns 127,721 shares.

Annual revenues increased from A$4.6 million in 1985 to 5.6 million in 1986 with increases in revenue expected in 1987 due to increasing market share estimated at A$ 1 million per year. The increase in market share is at the expense primarily of Abamakoros principal competitor KCWS which has about 60% of the market. Operating profit increased from A$397,000 in 1985 to A$484,000 in 1986 while net income went up to A$119,000 from A$103,000 during these two years. The net worth of the company increased from A$189,000 in 1985 to A$283,000 in 1986. Earnings per share were 69.2 cents Australian per share in 1985 and 78.9 cents in 1986. The number of outstanding shares issued is 150.000.

The management of the Development Bank of Kiribati, the majority shareholder of Abamakoro and in process of transforming itself from The National Loan Board attempted to divest itself of a number of shares primarily through announcements on the radio. This attempt took place in early to mid 1987 and received no response. Some of the entrepreneurs interviewed also by coincidence, happened to be shareholders of Abemakoro within the group of 7 owning more than 1000 shares. These shareholders admitted having made a good investment, expressed their satisfaction at the dividends received which approached three times the purchase price for the early purchasers. . When they were asked as to why they had not purchased additional shares after DBKs anncuncements the replies boiled down to three reasons given below in order of frequency and importance:

1. The General Manager of Abemakoro until recently was an expatriate who was widely respected for his management and intelligent purchasing ability, integrity and hard work. He died some six months ago from cardiac arrest leaving behind an Assistant Manager whom he was training for about 2 years. The current shareholders as well as potential new buyers expressed concern as to the present managers ability to continue company performance. The consequence is a wait and see attitude.

2. The share prices offered for sale in early 1987 were based on book value and found to be too high by current shareholders and potential purchasers.

3. Shortage of cash to affect the purchase was also mentioned as a reason of disinterest.

The current manager was visited by our team and found to be intelligent and energetic and possessing self assurance. He emphasized that he had learned enough under the previous manager to continue the company's growth. The issue of employee ownership was discussed in detail. He indicated he would be interested in owning shares and would invest his limited savings and would even borrow from family and friends if possible to buy shares in Abemakore. His chief accountant who provided us with some of the company data expressed a similar opinion. They also indicated that many of the 24 employees of the company if not all, would be interested in owning shares were it not for the funds needed to buy them.

The profile is that of a successful company with further potential in the future at the expense of its competitors. Given appropriate technical assistance and guidance to the Ministry of Finance and DBK it can be privatized within six months. There is a high level of interest in employee ownership. Although it may not be possible for the employees to substitute DBK as majority shareholders, they can be given an opportunity to own equity equal to the ownership held by the 400 private investors in the short term and more in the longer term. This means current employees can be given an opportunity to own approximately 1000 shares each giving them 15% equity in the company in 6 months and an option to double their equity in 12 months subject to company and individual performance. Both initial purchase and exercise of the option would have to involve a minimal cash transaction with the majority of payment for shares derived from future dividends.

8.1.2 Atoll Motor and Marine Services/Atoll Auto Stores

This enterprise was established in January 1987. It assumed some of the assets of the Gilbert Islands Development Authority at no cost. However, the name at the time was and at present still is Atoll Auto Stores and was a division of the National Loans Board. As the National Loans Board was transformed to the Development Bank of Kiribati a company under the name of Atoll Motor and Marine Services was created in 1986 and left as a shell until the accounts of Atoll Auto Stores were transferred to the new corporation. At the time of our presence in Kiribati, DBK staff were working on this transfer which was expected to come about shortly. The last audit for the fiscal year ending December 31, 1986 was completed and a draft audit report made available to us during our last days in Tarawa, which is given in Appendix Two. This audit report recommended the closure of the company and liquidation of its assets due to all the management and financial problems encountered by the company. The audit report also indicated that AAS operations can not be transferred to AMMS due to the unacceptability of its financial statements and credit conditions.

This enterprise engages in the import and retail sale of passenger vehicles, outboard marine engines, spare automotive parts and general hardware merchandise. It has six stores and one vehicle repair shop. It has changed managers five times since its inception. Our attempts to converse with the current manager were not successful. Our visits to its headquarters indicate a state of disorganization and disarray as well as a feeling of antiquity as if things have not been moved around for the last 40 to 50 years. The building had a large crack in its exterior wall. Both the interior and exterior seemed in bad need of rehabilitation.

This enterprise paid little or no interest on about A$1 million credit received. Long term debts and lack of proper accounting procedures and financial management controls has distorted its financial condition and underestimated its true defects. Neither the operating profit for 1985 of A$117,174 nor the loss of A$200,678 truly reflects the company's condition. Sales have been continually decreasing over the last five years. 1986 sales were about 10% lower than 1985 sales from about A$1 million to slightly above A$900,000. The company suffers from a large inventory of old merchandise that hardly has any chance of ever being sold. In this particular case it is doubtful that the employees would be interested in purchasing parts of all of this company. However, since we were not able to talk to any of its employees this could not be verified.

8.1.3 Otintaai Hotel

The Atoll Hotels Ltd., a United Kingdom Company, was established in the 1960's. It owned and operated two hotels, the Otintai and the Captain Cook. Atoll Hotels Ltd., ceased operations in December 1982 and the company was struck off the United Kingdom Companies Registry in November 1986. The National Loans Board took over the assets and operated the hotels as divisions of NLB. It created a new company called Otientai Hotel Limited, with the intent of converting the division to a registered company. Work on this transfer was proceeding during our presence in Kiribati. The Development Bank of Kiribati will initially own 100% of the stock of this new company and then will proceed to consider three basic options: 1) Outright sale. 2) Management contract. 3) Lease with or without option of purchase.

Annual revenues increased about 2% from A$680,638 in 1985 to A$692,178 in 1986. However, profits decreased by about 30% from A$18,555 to A$13,500 during this period. Nevertheless retained earnings increased from A$29,083 in 1985 to A$42,583 as of December 31, 1986.

An important issue to be settled is the status of an A$447,678 due to the Atoll Hotel Ltd., which is shown under capital employed. The Development Bank of Kiribati will need to resolve this issue before conversion of the division into a registered company and transfer of assets.

The hotel has 28 rooms, an attractive enclosed dining room, a bar in a large hall open to the ocean with about a dozen tables and an open area for dancing. Friday evening dances at the Otintai are a traditional weekly social event with a live band is a good revenue generator for the hotel. Catering facilities are provided for traditional and western style weddings. Primarily the latter is more frequent.

There is really little competition to speak of. The Kiribati hotel established in 1986 in Betio has only six rooms and a bar/dining area on the second floor of a small building. It is owned and operated by a Kiribati family of Chinese descent, the owner intends to expand his operations by constructing a new building across the road with additional rooms unless he is able to buy out the Otintai in which he has expressed an interest if sale terms and conditions allowed such a purchase.

The last audit for the company covered fiscal year ending in December 31, 1986 and was submitted June 30, 1987. The audit found the financial statements acceptable. However, with a net worth of A$54,236, estimated market value of A$400,000 and accumulated debt of A$494,889 including a contingent liability to the National Loans Board, the terms and conditions for sale will need to be evaluated and settled upon carefully.

Interviews with about a dozen Tarawa entrepreneurs indicated that the Otintai was perceived as an attractive investment since it is practically the only hotel that caters to foreigners arriving on business or pleasure. With the completion of the causeway reducing travel time between Tarawa and Betio from 2 hours by ferry to 20 minutes by car and the expansion of hotel Kiribati, Otintai may face more serious competition in the future. The Seaman's Hostel caters to Kiribati seamen on leave or as preliminary living quarters before moving into permanent quarters at retirement. Outer islanders usually stay with friends, relations or in the community Maneabas.

Interviews with the Otintai manager and waiters indicated an interest in owning shares when they were made available.

8.1.4 Shipping Corporation of Kiribati

This company was established as a statutory corporation in 1978 to provide passenger and freight transport between the islands of the republic and foreign ports, it has agents in Fiji and Australia. Its fleet consists of three mixed freight and passenger ships, two large landing crafts, three tugs, and five barges. It also owns dock equipment and cranes used in loading and unloading cargo. There are 184 employees and representative throughout the islands.

Annual revenues of the company increased 10% from A$3.3 million in 1985 to A$3.6 million in 1986. A loss of A$46,187 in 1985 was improved upon with a profit of A$206,721 in 1986. This company holds 95% of the market share of transport services. There are a number of individuals who operate small ships and barges for a limited amount of inter-island transport. Imports are taxed with a special levy which subsidies inter-island transport equalizing the sale price of basic consumer items in the outer islands with Tarawa. This was a subject of complaints by a number of importers.

The major cargo items carried by this line is copra for export and food items and general merchandise for import and inter-island distribution. International trade and prices of copra as well as supply conditions in the outer island effect the revenues of the company. As a statutory company with a virtual monopoly providing a critical service, the chances of privatizing this entity immediately or in the medium term are very small to non-existent. The net worth and estimated market value of about A$5 million is an additional deterrent to its being purchased by local private investors. In our opinion, the government would not wish the line to be owned and operated by foreign investors.

8.1.5 Kiribati Insurance Corporation

This is a statutory corporation established in 1981 to provide insurance services on an exclusive basis in the national territories. It was started with no paid up capital but a repayable start up capital loan of A$20,000 from the government. The company is operated by five employees including an expatriate general manager. Arrangements have been made with the Australian Institute for staff training financed by the United Nations.

The Kiribati insurance corporation reinsures practically all its polices in order to share risk. This reduces its premium income substantially. Annual sales were A$176,487 in 1986 with an operating profit of A$67,000, a net worth of A$163,000 and an accumulated debt of A$117,096.

Prior to the establishment of this company, insurance services were provided by an Australian firm. The government decided to establish such a monopoly considering provision of these services a matter of international interest. During our presence in Tarawa we were informed of objections by the Shipping Corporation in buying insurance from KIC due to the high premium charges. The shipping corporation has been allowed, as an exception, to buy insurance from outside sources.

As a statutory corporation and a monopoly and the governments consideration on national interest, the privatization of this entity has remote possibilities in the immediate to medium term. Employee ownership is not of material importance at present. In the long run with additional financial strength, less risk sharing through reinsurance, keeping a larger portion of the premium income and a bigger staff to take care of needs in a growing economy employee ownership may be a possibility in six to ten years.

8.1.6 Public Utilities Board

The PUB established in 1977 is a statutory body - not a corporation - which provides electricity, water and sewage services. This entity has been suffering both from inefficient management as well as improper financial management as attested by the audit report for 1985 and 1986.

Although annual sales increased from A$2.1 million in 1985 to A$2.4 million in 1986 operating losses continued to exist with A$110.00 in 1985 and A$28,000 in 1986. It's assets decreased A$300,000 while its long term liabilities remained the same at

A$674,000. It's net worth also decreased from A$13.3 million to A$13 million.

The Public Utilities Board is a monopoly with 161 employees including a general manager, engineers accountants and a variety of skilled laborers. In addition to power stations, water storage tanks and galleries its facilities include pump stations, workshops and others. Very limited competition exists from small passive and act ve solar energy systems and small private generators. A piped water system is in process of installation and a sewage system using sea water built with Australian aid is about to be completed.

The auditors have not found the financial statements acceptable and have pointed out a number of weaknesses in need of redressing. The board charges A$.32 per KWH for power supplied to its domestic customers and A$.36/KWH to its commercial/ industrial clients. Water charges are A$1/m³ plus A$9/month for delivery. These charges plus organizational inefficiencies do not allow for expenditures to be recovered from revenues and necessitate continuous annual subsidies.

Based on the limited information at hand this organization needs 4 changes to get it on track for improvement:

1. It needs a more experienced and capable general manager. The government may choose 2 or 3 candidates for training abroad and then choose one as a general manager and the others for the other posts identified below.

2. There is also a need for a technical manager or maybe two to be in charge of the daily operations of power stations, and the water and sewage installations.

3. There is a need for a financial manager to improve the financial management and accounting systems of the Board.

4. The Board requires close supervision of its activities. Thus an Ombudsman to look after the interests of the government as well as the consumers may be useful to improve conditions.

The potential for this entity's privatization in the near or medium term is quite remote. Subsequent to organizational and financial improvements it would need to be transformed into a registered company. The question of public interest in converting a public monopoly into a private monopoly needs careful study. However, once a registered company it, may be possible to break the company into three separate divisions and let out three management contracts to three separate private contractors. Due to the problems mentioned above employee ownership also seems to be far fetched at present.

8.1.7 Betio Shipyards

Initially built in the 1950's and expanded in 1986. The shipyard was established in 1977 as a division of the Ministry of Transport and Communications. It reached "self-accounting" status in December 1985. The last audit available for this entity covers fiscal year 1985 with the field work completed in December 1986 and the report submitted in January 1987.

The Betio Shipyard is involved in the repair and building of ships, engineering, metal fabrication and installation. It can repair wooden boats and can also do fiber glass work. It has 36 employees and is estimated to have an 80% share of the market. Facilities of the shipyard include a slipway with a potential capacity for 250T vessels, boilershops, boat building and carpentry shops, mechanical engineering workshops, a scotch Derrick Crane in good condition several buildings housing offices and warehouses. Most of the buildings were in poor condition but in process of rehabilitation. There are two important activities going on at present. The first is technical and financial improvements financed under an Asian Development Bank. The second is the establishment of a new company which will take over current operations. Since audited financial will be needed for 1986 and 1987 for an appropriate transfer, the new company may not be operational until mid to late 1988.

Annual sales in 1985 were close to A$319 thousand with an operating loss of A$22,891. 1986 financial statements were not available. However, there seems to be a substantial drop in revenue both in 1986 and 1987. The lack of orders plus the loss of one of the major shipyard customers due to discontinuing of ferry services will have exacerbated the condition of this organization. Furthermore no major construction has taken place at the shipyard since 1978.

Brief excerpts from a consultant report to improve the shipyard financed by the Asian Development Bank and the latest audit report is given in appendix........

The shipyard has potential for privatization in the short term. The rehabilitation with ADB financing and improved management with expatriate technical assistance plus conversion to a registered company will increase this entity's attractiveness to private investors. The sales price, terms and conditions may be made sufficiently attractive to draw the attention of local entrepreneurs without necessitating foreign investment. Among local businessmen interviewed there were at least two who showed interest in the shipyard once it has been rehabilitated. Employee ownership is a distinct possibility. Several employees were willing to invest small amounts from savings, current income and loans from relatives should such an opportunity arise.

8.1.8 Government Philatelic Bureau

This Bureau was founded in 1965 as a division of the Ministry of Transport and Communications. Sales increased subsequent to independence and reaches A$1million in 1981/82. The Bureau prospered under a management contract to a U.K. firm which changed its name in 1982 and went into receiver in 1987. The management contract was terminated subsequent to the expatriate manager leaving the island without notice.

Sales have continued to decrease although a small increase was registered in 1986 sales of US$150 thousand in 1986 over US$120 thousand in 1985. Staff has been reduced from close to twenty in its heyday to seven at present. The Bureau was in the process of searching other low cost premises to move into at the time of our presence in Kiribati.

Although this entity is not financially viable according to its financial statements, one of its principal assets is not adequately accounted for. The Bureau has an inventory of stamps in its vaults with a value of close to A$1million. As production cost is a minimal portion of the face value, stamps may be considered as near-money. Thus, the proper marketing of this inventory could improve the financial condition of this entity. The Philatelic Bureau as discussed in more detail in the next chapter is a candidate for immediate privatization. Some employee ownership is also possible.

8.1.9 Government Plant and Vehicle Unit

The Government Plant and Vehicle Unit (GPVU) was established as a department of the Ministry of Works and Energy in 1980 and gained self accounting status in 1981. It is a large organization which rents equipment and vehicles, maintains and repairs all government plant vehicles and undertakes precision machine work for the government and private sector. In addition it services vehicles and equipment for private corporations and individuals. It has 101 employees including a large contingent of auto mechanics, machinists, welders, painters, book keepers and heavy equipment operators.

Its two competitors are Tarawa Motors, 100% privately owned by a foreign investor resident in Kiribati and his native partners and Atoll Motor and Marine Services which is government owned. Annual revenues have increased from US$1.5 million in 1983 to US$1.9 million in 1984 although operating profit decreased from 301 thousand to 256 thousand. Sales figures for 1985 and 1986 were not available although we were told that profits were up for both years.

The criticism that the rental rates charged by GPVU were too high led to a study in 1986 and the lowering of charges on vehicles and equipment in 1987. The audit reports for 1983 and 1984 did not consider that the financial statements gave a true and fair view of the organization. Nevertheless, we believe that this entity has a good potential for privatization in the short term. Obviously audits for 1985, 86 and 87 have to be completed and the department converted into a registered company. A high level of employee ownership is also possible. There is also interest by local entrepreneurs in outright purchase once the departments financial affairs are put into order and outstanding liabilities, some of which are in dispute, are resolved.

8.1.10 Government Supply Division

The Government Supply Division was established as a department of the Ministry of Finance with self accounting status in 1982. The last available audit is of its fiscal year ending December 31, 1985 completed and delivered in October 1986. This department is involved in the import, wholesale and retail of building materials, electrical appliances, furniture, paints, hardware household durables including white and brown goods. It has 71 employees and branches in Kiritimati Island. Its annual sales increased from A$3.5 million in 1985 to 3.8 million in 1986 and have held steady at same during 1987. Operating profit decreased from A$484 thousand in 1985 to A$460 thousand in 1986 and net income also decreased from A$145 thousand to A$71 thousand. Audited net worth (book value) was A$ 2.8 million in 1985 and unaudited figures for 1986 was A$2.9 million.

This entity is considered a good candidate for immediate privatization. The goods provided are available both by the private sector and other government owned entities. Audits for 1986 and 1987 accompanied by conversion to a registered company plus liquidation of some of its assets and write offs on part of its liabilities should facilitate its sale. Employee ownership may be possible subject to further study.

8.1.11 Government Public Works Department

The Government Public Works Department was established from the break up of the Gilbert Islands Development Authority in 1978, just prior to independence. As a department of the Ministry of Works and Energy, it is primarily involved in the design and construction of buildings and civil works for the government. It is also responsible for the maintenance of civic works such as roads and causeways. The maintenance function also extends to government owned buildings such as office buildings and residences. The organization has offices and installations in three locations: Betio, Bairiki and Bikenibou. It has a labor force of approximately 250 people. Its annual revenues were A$187 thousand in 1986 and A$184 thousand in 1985 incurring an operating loss of A$361 thousand in the former and A$383 thousand in the latter years. The major cost item leading to this loss was salary and wages which was A$418 thousand in 1985 and A$391 thousand in 1986.

The Public Works Department due to its present functions and internal accounting conditions is viewed as a potential candidate for privatization in the medium term of two to four years. Appropriate audits will need to be followed by conversion to a registered company and then divestiture. Employee ownership in this case is a matter of further study and evaluation.

8.1.12 Government Printery

The Government Printery was established in 1972 and is currently a department of the Ministry of Home Affairs and Decentralization. It employs 20 people, mostly technical staff skilled in printing and book binding. It is estimated to have 80% of the printing market. The other 20% is shared by two Missionary printers operated by the Catholic and Protestant churches. The total market is estimated at about A$310 thousand per year with A$60 thousand accruing to two Missionary printers and A$250 thousand to the Government Printery. Annual sales of the printery are about A$200 thousand to the Government and A$50 thousand to the private sector. These sales may be approaching A$300 thousand but can not be verified at this time due to the lack of audited statements, the operating profit of A$150-200 thousand is not a reliable estimate either.

The printery is operated at a rent free building but does pay for the power and water supply it utilizes.

The quality and variety of printing undertaken by the printery leaves much to be desired. Both public and private entities have some of their printing done either in Fiji, Australia or United Kingdom. Government offices which rely on the printery for their important documents have complained about delays and the quality of printing they receive. Some officials have expressed the desire to pay reasonable charges for timely deliveries and better quality work if the printery was privatized.

The conditions which were observed during our assignment were confirmed by our purchase of calling cards for A$50 which initially was for a quantity of 500 but we received only 100 and canary yellow instead of white. The printery is one of the best candidates for immediate privatization. It needs a reorganization with better management, and better utilization of the resources it already has. Some employee ownership may be possible. However, an entrepreneurial type of owner/management may be more suitable than a total employee buy out.

The 12 company profiles presented above were of the firms identified in the terms of reference established at the inception of this assignment. During our two week stay in Kiribati we were given information on four other institutions which we did not have the time to look into. Brief information on these institutions is given below while details on each one of the companies is given in Appendix Two.

8.1.13 Kiribati Provident Fund Board

The KPFB was established in 1977 to provide social security coverage to all I-Kiribati both public and private employees in the country. At its inception coverage was provided to government employees and employees of 8 other organizations including a cooperative and a private bank. In 1978 coverage was extended to all employees in the country with certain exemptions. According to information at hand there was a board of directors of 8 members and a staff of 7 in 1985. At the end of that year the fund had A$7.4 million in foreign investments and A$2.3 on short term deposits with the Bank of Kiribati. The fund had 8,326 members working for 159 employers. The total amount of funds employed increased from A$8.4 million in 1984 to A$10.4 million in 1985 while net current assets increased from A$1.9 million to A$3.6 million.

The fund seems well managed. As a prominent institution looking after retirees, widows and disabled employees it privatization may not be possible due to national interest. However, the team is not able to make any assessments or recommendations at this time.

8.1.14 Air Tungaru Corporation

The national airline of The Republic of Kiribati was established in 1977 with the requirements that annual revenues would need to be at levels to meet annual expenditures including appropriate changes for depreciation and interest on capital. The airline has consistently been in deficits met by government subsidies. In 1985 in addition to a government subsidy of A$577 thousand a contribution of A$ 758 thousand was received from NASDA.

Annual revenues decreased from 1.8 million in 1984 to 1.2 million in 1985 with corresponding operating losses of A$1 million and A$778 thousand in respective years. The net losses for 1984 were 1.3 million and for 1985 over A$1 million. The airline has sold aircraft and has changed its schedules in order to cut costs but has found it extremely difficult to improve its bottom line.

Without additional information it is difficult to evaluate this company's potential for privatization. However, given the presence of heavy subsidies and experience in other countries with similar conditions faced by state owned airlines, privatization should be possible as long as it is consistent with national polices and sensitivities. There may also be a good potential for employee ownership subject to further study and evaluation.

8.1.15 Te Mautari Ltd.

Te Mautari is the government owned fishing company which is rich in assets over A$8 million in 1986 and poor in revenue and profits. As of 1984 it had received close to A$1 million in cash grants and a loan of A$250 thousand to lift it to a profitable position which has not occurred in the interim. The accumulated deficit at the time was A$3.1 million.

Annual revenue increased from A$1.2 million in 1985 to A$1.7 million in 1986 with a corresponding decrease from A$586 thousand to A$151 thousand. The total loss was almost A$800 thousand in 1986 over A$1 million in 1985. The accumulated deficit with up to A$3.9 million in 1986.

The government considers the marine portion of its natural resources as one of the most important of its national resources and has considerable sensitivities on the matter. Based on the very limited information at han although privatization may not be possible in the near future, a joint venture with a foreign company may be a probable course of action.

8.1.16 Telcom Kiribati

TK was established as a division of the Ministry of Communications in 1985 with a self-accounting status taking over some of the assets and inventories from the Telecommunications Division of the Ministry of Communication. Total revenue almost doubled from A$447 thousand in 1985 to A$822 thousand in 1986. As a monopoly providing a variety of national and international telecommunications services, Telcom Kiribati is in the process of becoming a statutory corporation. Its privatization will need further study and evaluation and consideration of future government policy.

8.2 Criteria for Prioritization of Privatization Candidates

The Government of Kiribati initially identified an open-ended list of 12 candidates for our examination. The list was open-ended because the government indicated its desire to allow the examination to extend beyond the enterprises listed to include each and every enterprise in Kiribati. However, this was subsequently deemed impractical when the mission's in-country duration was funded by USAID for only two weeks instead of the six weeks requested by the Government.

As a result, the ranking below is illustrative, based on the select group of 12 enterprises identified by the Government. If others are subsequently identified by the Government, it is hoped that the reasoning in this study will establish a model or framework for ranking the subject enterprises.

The ranking of enterprises is subjective and based on a variety of considerations, which we attempt to articulate in respect to each enterprise in the analysis below. Happily, as consultants our services were requested by a Government already familiar with privatization. The Government informed us of their policy priorities in exploring the possibility of a program of privatization-- namely, achieving fiscal self reliance and a higher level of economic development through stimulation of private sector activity.

Working together with Government representatives, we applied the Government's broad policy objectives to the task of ranking the listed enterprises. In establishing priorities, we also recognized that a variety of technical factors -- legal, financial and business-- would dictate the speed with which any given enterprise could be privatized. We applied our experience in these areas to factor in the amount of work and time involved in privatizing each of the enterprisos.

The result is that we applied two broad sets of criteria for ranking enterprises. First, we asked the question, "Why privatize?" and applied the government's basic response-- that it is useful to privatize to help balance the budget and reduce dependence on external borrowings. Privatization also fosters economic development through an increased reliance on the private sector where public sector activity is not essential. Second, we asked the question, "How complicated is this undertaking in respect to any given enterprise?" For example, a large enterprise, with many employees, in poor financial condition, with an unevolved legal status, and potential for generating a political opposition would certainly take longer to privatize than a company registered under the private company ordinance in healthy financial condition with few employees.

It is preferable to establish a momentum in a successful privatization program by focusing, the to extent possible on:

A. Small to medium companies with relatively few employees.
B. Companies that are already profitable or can be made so with minimal effort.
C. Companies which can be privatized quickly and relatively easily with minimum legal, financial and labor complications and political opposition.

The "Why" criteria responds to a macro economic requirement which extends throughout the economy. The "How" criteria is micro economic with a social and psychological dimension. Once a company is targeted for privatization the longer it takes to conclude the transaction the higher the probability of an opposition to gain momentum, especially in the beginning of a privatization program it is important to register a number of successes to maintain public support, favorable opinion by the country's leadership and fuel the attitude that more of the same is beneficial.

By applying these two criteria, we identified groups of enterprises that should and could be privatized immediately, within 6 - 12 months (Priority One Group); those which could be privatized in the short term, about 1 to 2 years (Priority Two Group); those which could be privatized in the medium term, some 2 to 4 years (Priority Three Group); and those which could be privatized in the longer term, 4 to 8 years (Priority Four Group). In the case of Groups 3 and 4, we recognized that in some cases divestiture would not be practicable at all, and that, for example, privatization of management might be optimal. Whereas activities leading eventually to divestiture could begin immediately for enterprises in Groups 1 and 2, in Groups 3 and 4 a variety of factors still require exploration, including political acceptability. The priority groups are as follows:

8.3 Priority Groups

I. Priority One Group

DBK

1. Abamakoro Trading Company, Ltd.

2. Atoll Motor and Marine Services, Ltd.

3. Otintaai Hotel

Ministry of Finance

4. Government Supply Division

Ministry of Transport and Communications

5. Government Philatelic Bureau

Ministry of Home Affairs and Decentralization

6. Government Printing Office

II. Priority Two Group

Ministry of Works and Energy

7. Government Plant and Vehicle Unit

Ministry of Transport and Communications
8. Shipyard

III. Priority Three Group

Ministry of Works and Energy
9. Public Works Department

Ministry of Finance
10. Kiribati Insurance Corporation

IV. Priority Four Group

Ministry of Transport and Communications

11. Shipping Corporation of Kiribati

Ministry of Works and Energy

12. Public Utilities Board

8.4 Enterprise Rankings and Justification

This section applies the two sets of criteria discussed above, consisting of government objectives on the one hand (answering the question, why privatize?) and technical limits on the other (answering the question, how feasible is this from a financial, legal, institutional and political standpoint?). While this is generally a subjective exercise, we cite compelling reasons for giving priority to the Group One companies. In many cases this is a reflection of strongly expressed government objectives.

Should the government proceed on its current plans and consider the adoption of the strategies, policies, and actions recommended in this report ths six Priority One companies can be completely divested at some point in time between June 88 and June 89. One or two of these conceivably could be privatized by June 88.

The two companies in Priority Two Group due to both legal, administrative and financial circumstances will take longer though still considered as candidates for privatization in the short term. The two companies in Priority Three and Priority Four require even more complications which will need resolution.

The last four companies whose profile were given in an earlier section of this chapter and whose financial statement are included in appendix .... of this report were not subjected to this analysis and have not thus been categorized.

1. Abamakoro Trading Company
a. Government Objectives
As a subsidiary of the Development Bank of Kiribati, the

Government, through the latter statutory corporation, has already expressed its desire to divest the trading company to free-up DBK funds and management to move on to projects requiring its intervention. Moreover, the DBK was recently established to replace the National Loan Board precisely so that a proper channel for development funds would exist with a specific charter to make development loans and foster private sector growth. Since there is no reason for DBK or the Government of Kiribati to manage the trading company, it should be eliminated from the DBK portfolio.

As a completely private company (about 15 percent of its shares are already in private hands), it is likely the company could achieve increased efficiencies in sourcing, pricing and distribution. Employee ownership is a distinct possibility in the case of this company. We found no evidence that government ownership was required for any public purpose (e.g. to ensure the flow of goods to the outer islands, which, we understand, will be supplied by the company and its competitors in any event regardless of whether it is publically or privately owned owing to a variety of marketing and financial factors). Since other food importer and distributors exist (e.g., KWCS, Redfern), and since barriers to entry for food importers are relatively low, we do not foresee that expanding the private ownership of Abamakoro will create a private monopoly or lead to price-gouging.

b. <u>Feasibility</u>

The DBK has expressed unequivocal interest in divesting this company. The company itself appears profitable and has been well-managed over the years. It is registered in the form of a company under the Company Ordinance. Some of its shares are already privately held (about 15%). No political opposition has appeared. The possibility of employee ownership was warmly received by present management.

The DBK has already made some attempt to sell shares which proved unsuccessful. We believe that this is more a commentary on the **ad hoc** approach to the offer of shares than on the marketability of the company. In addition, after many years of solid management by a well-respected expatriate manager recently deceased, management responsibilities have devolved upon the former managor's protege and chosen successor, a native of Kiribati. It appears that potential local investors want to monitor this new manager's performance a while before investing.

2. Atoll Motor and Marine Services

<u>a. Government Objectives</u>

This company has been a substantial drain on government resources. In addition, very clearly this service does not require government participation to be rendered; indeed, many private competitors already exist. In this case, it appears likely that private ownership and management would increase efficiency and performance. Several local investors expressed interest in acquiring this company.

b. Feasibility

Once again, as a holding of DBK, this is relatively easily divested, from a technical standpoint. DBK has expressed its unequivocal commitment to divestiture. A shell company has been registered under the Company Ordinance so that the only remaining step is to transfer the assets and liabilities to the juridical entity (AMMS, Ltd.) established for this purpose. A constituted stock company will be relatively easy to sell (no specific Maneaba approval required).

The big hurdle in this case is write-off of the company's debt. DBK management expressed its intention to these consultants to introduce a clean-up bill in the Maneaba that would have the Government forgive the large debts this company has incurred to other parts of the Government (such as the Government Supply Division). Progress here should be monitored in connection with a follow-up mission.

3. Otintaai Hotel

a. Government Objectives

This is obviously an instance where government involvement is not essential and also wnere private ownership and management would likely lead to improved services. The Hotel is important as a projection of the national image of the country and as a principal tourist destination. Present management strives to keep the hotel clean, and does provide a setting for occasional banquets and festivities. All of this, however, could be conducted with considerably more panache.

b. Feasibility

The Hotel is also held by the DBK, which has expressed its intention to divest it. The Hotel has been profitable even under Government management. With more attention to local services, we believe the Hotel could become a good deal more profitable. Several entrepreneurs in South Tarawa expressed interest in acquiring it. Employee ownership is also a realistic possibility here. The Hotel is already a stock company registered under the Company Ordinance.

4. Government Supply Division

a. Government Objectives

This enterprise deserves immediate consideration principally because the GSD is pressing for a new site requiring an investment of several millions of dollars. While the GSD consultancy now attempting to reorganize the entity points to potential benefits from government ownership such as uniform standards, bulk purchase price discounts, and reliable supply of critically needed supplies, we note that those are mainly theoretical benefits. The sad reality has been that the GSD has been subject to widespread pilferage according to the report of those presently charged with reorganizing it, supplies have not been purchased on a best price basis, and stocks have been deliberately over-filled to defend the agency budget (on the theory that even if the Government overpays, the only visible sign of management is whether a desired item is in stock).

Government participation here is not essential. There are other private sector hardware supply outlets in South Tarawa that supply the private sector and the Government in some cases. These entrepreneurs expressed interest in acquiring parts of the GSD, which could be sold in parts to a variety of purchasers. The Government of Kiribati could develop a central procurement unit to use the private sector companies to compete to buy in bulk or to buy according to uniform standards specified by the Government.

b. Feasibility

This presents more difficulties than the others. Fortunately, the GSD is under the Ministry of Finance, which expressed interest in divesting it. Indeed, the President of Kiribati expressed interest in this concept. However, the GSD is still a division. As such, approval of the Maneaba would be required to transform it into a registered company under the Company Ordinance. In addition, the GSD is probably too big and potentially too powerful to divest to one buyer, since that buyer would probably then be in a position to drive competitors out of the market. Accordingly, a divestiture plan in this case would require a market analysis to retain competitiveness. The GSD also benefits from legislation establishing a Special Fund protecting its finances. The "Special Fund" is accorded protection against invasion under the Kiribati constitution. Any divestiture plan must take into account the need to eliminate the special fund provision for the GSD. Liquidation of the GSD, cessation of its activities, and elimination of the special fund or transformation of the GSD into registered companie(s) (and elimination of the special fund) will require an act of the Maneaba. The divestiture plan should focus on the need for uniformity and bulk purchases in procurement, and also for a certain amount of centralized planning to avoid waste and duplication.

5. Government Printing Office

a. Government Objectives

The GPO was criticized for slowness and unresponsiveness to requests. The mission experienced these inefficiencies when it tried to secure a variety of government publications that were unavailable despite months of outstanding requests from government officials (e.g. national development plan). Indeed, notwithstanding a considerable investment by the government in new equipment, and a large staff in the GPO, the Government still relies on printers in Australia for many of its most important jobs.

The printing office can do work for private clients. However, much of non-government printing demand is met by 2 religious printeries and overseas suppliers.

The Government should be able to divest itself of the printery, perhaps in an employee buyout. This would lead to better, prompter service, and possibly lower costs, particularly if the privately owned operation begins to compete for the larger jobs that now go to Australia. A successful privately run printery could exert a large demonstration effect, encouraging the Kiribati people to become involved in entrepreneurial service businesses.

b. Feasibility

Since the Government Printery can expect to generate a substantial amount of government business even in private hands, it would be an attractive acquisition. Some interest was expressed by current management and staff in purchasing it. As a small printery shop, its valuation and preparation for divestiture would not present large technical problems. The principal barrier, however, is its legal status as a "Department" of the Ministry of Home Affairs. The first and critical step would be for the Ministry to propose to restructure the "Department" into a registered company under the Company Ordinance. This requires an act of the Maneaba; in order for this to occur within four months, rather than eight (the generally prescribed two readings), a rider would have to be attached to the first bill indicating urgency. Once the GPO is established a registered company, the other steps toward privatization may be pursued.

6. Government Philatelic Bureau

a. Government Objectives

This is not a service in which government participation is essential. The government's principal objective in divesting the Bureau would be to increase its ability to market its collector's stamps throughout the world. The business requires an aggressive and credible management to build numbers of and confidence among subscribers.

Unfortunately, the Bureau had a poor experience with contracted management, in which the management company from London evidently absconded amid questionable circumstances prior to termination of the contract. Therefore, were the Bureau privatized, safeguards would have to be taken to assure such would not again occur (e.g. perhaps a performance bond would be posted with the Government).

b. Feasibility

This is a very small unit, with perhaps two employees, and a large stock of stamps (near money). This would very likely again attract foreign buyers or managers specialized in the subject matter. As above-noted, in view of prior experience special precautions need be taken. The company has demonstrated in the past its ability to generate significant profitability. It would be useful in both events (whether contract management or divestiture) to restructure the Bureau as a separate registered company under the Company Ordinance; at present it is a "Department" within the Ministry of Transport and Communications.

7. Government Plant and Vehicle Unit
Ministry of Works and Energy
a. Government Objectives

The PVU represents a government monopoly in heavy equipment and also services general purpose vehicles where some competition exists. The PVU also benefits from "Special Fund" legislation that protects its finances from application to the General Fund accessible for all government business. As a result of certain distortions in pricing and depreciation practices, the PVU has been able to generate very large surpluses, larger than reasonably required provisions for replacement costs. Because of the Special Fund, these finances taken from other parts of government remain inaccessible for urgent government needs. The combination of monopoly pricing power and sequestered funds is a very poor policy for the government of Kiribati. While the privatization or divestiture of a public monopoly in heavy equipment into private hands is not advised, the PVU should be restructured to operate more efficiently, in the form of a stock company under the Company Ordinance, and the Special Fund eliminated. This will require an act of the Maneaba.

b. Feasibility

This is certainly feasible, but more complicated than the first group of enterprises. The heavy equipment operation must be separated out and formed into a company; and the special fund eliminated; both with Maneaba authorization. The General Vehicle services may be acceptable candidates for divestiture, providing that sufficient competition exists so that the government department could achieve price and quality needed on repairs. Otherwise these services would continue in the newly formed stock company. The stock company organization would allow for better accounting and more efficient management, possibly by a private management group.8. Kiribati Insurance CorporationThis company has recently been established pursuant to statutory law as a public monopoly on insurance writing. The Act provides, "It shall be the general duty of the Corporation to transact and carry on life insurance business, general insurance business, and business related or incidental thereto...and the Corporation shall so exercise its powers under this Act so as to secure that insurance business, reinsurance business, and risk management business are developed to the best advantage of the economy and community of Kiriabati." The company is involved in writing and reinsuring the following classes of insurance: employer's liability, fire, life, marine, motor, and miscellaneous. According to its managers, the company is able to obtain the best insurance rates and coverage and to assure payment of proper claims. This was not possible when a variety of agencies represented many different government or private companies, since those smaller entities did not have the same leverage as the large one.

There appears to be, however, some disagreement on this score. Reportedly (and this is through second-hand reports), other entities such as the Shipping Corporation have complained about high rates, and about their resulting de facto subsidy of the other companies in Kiribati. The Snipping Corporation reportedly was able to demonstrate that it could itself find a better rate outside the global policy; as a result some accommodation was reached.

This suggests that the government interest in monopoly public control of insurance underwriting may be less strong than originally believed and that the government might be in a position to pull out of the insurance business, at least partially, and allow for a more circumscribed regulatory role. For purposes of making such a decision, the Government should commission a study, eliciting the views of the companies covered by the Kiribati Insurance Company, their rate structures, and those available (in Australia) through potential competitor private insurance company agents.

b. Feasibility

Divestiture or liquidation of the company would require an act of the Maneaba, since the company is organized as a statutory law corporation. As part of the above-referenced study, it would need be determined whether the government company would be dissolved, divested, or remain as one competitor among many when the ban on competition was removed. If the company would be divested, it would appear to be commercially viable, particularly if its clients remained loyal and the insurance contracts written proved competitive.

Ministry of Transport and Communications
9. Shipyard
The Shipyard is currently a department within the referenced ministry. It is a large entity and has been the focus of attention of the Asian Development Bank, which has provided technical assistance and loans. Japanese technical assistance is evidently also in the pipeline. Reportedly, the Shipyard is now being converted into a stock company fully owned by the government.

The commercial viability of the shipyard as a private business remains in doubt. Larger and more efficient commercial operations reportedly exist in Fiji. The Kiribati Government appears interested in consolidating its own repair facilities to assure "self-reliance" in this area. It may anticipate having a larger fleet of vessels later. This government appears to accord a very high interest to its role in the development and control of the fisheries sector; its interest would appear to be analogous to that of other developing countries in their petroleum industries, for example.

b. Feasibility
The first step, of course, is to reconstitute the department to convert it into a stock company. Once this is achieved, the commercial viability of the operation can be monitored.
The Government also appears to believe that continued public ownership of the facility will lead to continued donor assistance in this vital sector.

Ministry of Works and Energy
10. Public Works Department

a. Government Objectives
It is doubtful that Public Works could attain commercial viability in Kiribati, since we do not perceive a great amount of construction in the Gilberts. However, it may be useful and convenient to contract out some of the activities of the PWD to private construction groups.

b. Feasibility

Public Works is still constituted as a department. It would probably be beneficial from a standpoint of cost accounting and efficiency to restructure the department as a stock company under the Company Ordinance. In this structure, it could hope to use part of its budget to develop an indigenous private sector construction industry, that would work on public projects. It may construction industry, that would work on public projects. It may also be in a position to privatize its management.

11. Shipping Corporation of Kiribati

a. Government Objectives

The Government of Kiribati has expressed its interest in maintaining commercially uneconomic operations to service all the Gilberts and even the further islands. Furthermore, the natural market probably accommodates only one carrier. In addition, the maintenance of a Shipping Corporation requires a very large capital investment.

b. Feasibility

It may be possible to privatize management of the Shipping Corporation; or to reconstitute it as a government owned company registered under the Company Ordinance, in order to allow greater managerial flexibility, particularly with respect to employee and labor management. This would require, however, an Act of the Maneaba.

12. Public Utility Board

a. Government Objectives

This is regarded by the Government at this time as an essential government monopoly service. It is a natural monopoly since the market is not large enough for various companies. It requires a high level of investment and technical maintenance. The government has a political interest in keeping rates low.

b. Feasibility

While divestiture is not on the horizon, some innovations may be made to manage the operation more efficiently. For example, the Board may wish to pay its collection agents based on the levels of collection. Collection has certainly been a principle problem. It may be in a position to privatize management of some of its operations.

CHAPTER IX: RECOMMENDATIONS FOR THE IMPLEMENTATION OF A PHASED PRIVATIZATION PROGRAM.

9.1. Phasing of privatization initiatives in Kiribati.

An eleven phase program is recommended for undertaking a successful privatization initiative evolving to a well conceived and implemented program as briefly described below:

Phase One: AID/PRE/CFP, IPC Reconnaissance Study September 1987.

Phase Two: Adoption of a strategy and policies by the cabinet and Maneaba Ni Maungatabu.

Phase Three: Enunciation, publication and Dissemination of strategies, polices and plans for privatization.

Phase Four: Establishment of a Privatization Task Force and Advisory Board.

Phase Five: Technical Assistance Privatization Planning Mission.

Phase Six: Pass legislation allowing and facilitating privatization.

Phase Seven: Complete financial audits of all entities to be privatized.

Phase Eight: Complete conversion of entities to registered company status to facilitate privatization.

Phase Nine: Initiate long/short term donor financed technical assistance.

Phase Ten: Evaluation of the nine parastatal divestitures in priority one, two and three groups.

Phase Eleven: Establishment of the President's Bureau for Privatization and Private Sector Development.

9.2. Analysis of Activities Within Each Phase.

Phase One: Reconnaissance Study

The Fiji Regional Privatization Conference of February 1987 led to a reconnaissance study in September of the same year. Dissemination of this study report and initiations of serious dialogue in Kiribati is expected to culminate in Phase Two.

Phase Two: The Adoption of a Specific Strategy, A Series of

Policies and legislative proposals for the consideration of the Maneaba and Cabinet in March - April 1987.
Phase Three: Publication of activities, speeches by political leaders, radio announcements and dissemination of pamphlets on privatization would start in February, intensify by June and slow down by December 1988.

Phase Four: The President with the approval of the Cabinet, and the advise and consent of the Parliament establishes the Privatization Task Force. The Chairman of the Privatization Task Force is appointed in April 1987 together with the Deputy Chairman who is suggested to be the Secretary to the Cabinet. The Secretary of Finance is appointed as The Task Force Coordinator. Representatives of other Ministries and Organizations as appropriate are also appointed. A search is initiated to appoint a full time Kiribati National as Executive Director to manage the daily operations of the Task Force. He/she is given office space and support. The Board of The Privatization Task Force solicits the formation of a Privetization Advisory Board (PAB) consisting of all the permanent secretaries, The Senior State Advocate, A Senior Accountant, The Chief Planning Officer of the Ministry of Finance and Four Private Businessmen. The PAE initiates a monthly meeting schedule to review work in progress, provide guidelines and remove bottleneck.

Phase Five: A follow up mission to the September 1987 CFP Reconnaissance arrives in May 1988 to work with the Privatization Task Force. The composition of this team to be donor financed is as follows:

1. Economist/Team Leader: To coordinate team activities review privatization activities and produce a document containing The Technical Assistance Manpower and Commodity Requirement for a Long Team Donor Financed Project.

2. Accountant CPA/Financial Analyst MBA: To review all the financial documents of selected state owned enterprises and identify long/short term assistance required for the long term interventions.

3. Privatization Attorney: Review the legal developments and documents for each entity to be privatized immediately and in the short term. Determine the levels of effort frequency and scope of work of short term legal assistance.

4. Investment Banker/ M&A specialist: Identify prospective buyers. Develop draft prospectus for companies to be privatized immediately and short term. Identify feasibility of a small stock exchange and the technical assistance requirements in his field during the long term project. Take technical lead in development of a strategy and approach for each enterprise, that

field during the long term project. Take technical lead in development of a strategy and approach for each enterprise, that is a consideration and selection among such alternatives as employee ownership, private placement, public offering, asset sales, leasing and management contracting. These decisions, made together with all pertinent GOK and enterprise officials, will determine specific scope of work for each enterprise in subsequent phases of privatization.

The level of effort of this mission is estimated at seven person months; 1 1/2 person months each for team members and 2 months for the team leader. The total cost is estimated at about US$.150,000.00. Their report would be completed no later than August 1988.

Phase Six: This phase would start in February 1988 and would terminate in December of that same year culminating with the passing of all the legislation required for the parastatals targeted for privatization immediately and in the short term. It would be helpful if this legislative process is completed before the Mission indicated in phase five arrives in May 1987. Howeve·. given the frequency of parliamentary sessions it might take 2 ·. 3 sessions to complete this legislative process.

Phase Seven: The undertaking of audited financial statements is an on-going process preceding this reconnaisance teams' visit by several years. However, it is suggested that the process is speeded up in January 1988, so that audited financial statements for 1987 are completed for all the companies to be privatized immediately and in the short term by May 1988, if possible. The availability of audited financial statements and the determination by the government of managing liabilities of certain establishments would greatly facilitate the work of the follow-up mission presumably arriving in May 1986.

Phase Eight: The conversion of entities to registered companies is also a process which preceded our reconnaissance study. However, it is recommended that the conversion is completed for the companies to be immediately privatized by May 1988 and those to be privatized in the short term by December 1988. Of course, if both categories are completed by May 1988, this would also facilitate the planning undertaken by the follow-up mission for long term technical assistance.

Phase Nine: The follow-up mission's report completed in August 1988 may take anywhere from three months to three years before it culminates in the commencement of a long term technical assistance. The time period depends on the donor institution who decides to finance this effort. The World Bank and the Asian Development Bank may take three years from the arrival of a preliminary appraisal mission to the arrival of consult--ts to start work. UNDP, EEC may take two years, the Japanese, UK and

US may take a year while Australia could move as fast as six months. These are unbiased but conjectural time frames and exceptions of faster action is always possible.

Phase Nine starts with the long term Technical Assistance Program which is estimated to cover the privatization of immediate, short and medium term candidates. This means that this assistance should last a minimum of four years. It will involve, based on the limited information at hand and subject to the revisions by the follow-up mission, two long term specialists of four years each and about 4 person years of short term technical assistance to privatize nine state owned enterprises, and possibly establish a small stock exchange. This stock exchange could be organized in such a way that eventually it might handle the needs of the ten to fifteen neighboring countries in the Pacific.

Phase Ten: The Government may wish to undertake an evaluation of the privatization experience coinciding with the end of the long term technical assistance in early 1993. The potential advantages are as follows:

1. The experience gained by I-Kiribati Professionals may allow the continuation of privatization activities without expatriate technical assistance.

2. I-Kiribati experience in privatization may be lent to other Pacific countries to help them in their own privatization efforts.

3. The lessons learned would clarify the type and length of technical assistance required for successful privatization projects in other countries.

Phase Eleven: The transformation of the Privatization Task Force into the President's Bureau for Privatization and Private Sector Development should coincide with the arrival of the long term technical assistance team. it is assumed that this team will arrive sometime between January and June 1989. Thus, calendar 1988 would allow the Privatization Task Force to lay the ground work for privatization to take a firm and positive hold in Kiribati society. The transformation into a Presidents Bureau would enable it to increase its status as well as resources enabling it to work effectively with the long term technical assistance team.

9.2 Illustrative List of Selected Tasks Required for Privatization

As indicated in the paragraph in Phase 5 above, the next follow-

up mission will build on the Report realized in this two-week in-
country analysis of prospects for privatization of 12 enterprises
to develop a specific enterprise-by-enterprise scope of work. A
serious approach at the enterprise level will depend on the GOK
following up on this mission by adopting a privatization policy
(Phase Two above); beginning to publicize its plan to privatize
(Phase Three, above); and most importantly, establishing an
institutional framework to carry out a privatization program
(Phase Four, above). Moreover, the various privatization
approaches surveyed below must ultimately be reviewed with a
particular approach adopted by the GOK.

Before recommendations can be made by technical missions on
specific approaches for specific enterprises, a GOK institutional
framework must be established capable of receiving, analyzing and
modifying, and ultimately empowered to act on such
recommendations.

9.2.1 Enterprise Strategy and Underwriter Agency/Stock Exchange

Assuming these functions are carried out, then a follow-up team
can examine each of the 12 enterprises to recommend specifically
how they will be "privatized" and to advise the GOK on its
recommendations. Once the GOK concurs in such recommendations,
and/or modifies same, then a specific scope of work can be
drafted for each enterprise. For example, in the case of
Abamakoro Trading Company, some considerable interest was
expressed in employee ownership. On the other hand, a kind of
"public offering" of securities has already been attempted by the
DBK. In order for a public offering to be carried out, however,
it may be necessary to create a small "stock exchange", or
utilize an innovation such as a government guarantee to redeem
shares at a certain floor price, or any of a number of other such
devices. Alternatively, solely from a standpoint of feasibility,
it may be optimal to simply arrange for a "private placement".
GOK officials, together with follow-up mission experts, must
focus on these options, each of which has different policy
implications, and determine which option per enterprise should be
pursued. Since each of these alternatives entails a different
type of preparation, a very specific scope of work for each
enterprise will depend on such determination being reached by the
GOK.

Similarly, in the case of the Otintaai Hotel, the GOK may wish to
sell it outright as a "private placement" to existing skilled
hotel operators in the country. It may wish to make a "public
offering" of shares in connection with an attempt to create a
small capital market in the country. It may decide to enter into
a leasing arrangement or contract arrangement with the other
hotel operators in the country. Likewise, the management of
Otintaai Hotel expressed some interest in employee ownership.

These decisions are both technical and policy-based and will have to be made in an intensive follow-up mission working closely with a GOK body equipped and authorized to make such decisions, namely, the recommended Privatization Task Force and Advisory Board. Once this determination has been reached, a detailed scope of work may be created.

Similar considerations apply to each of the other enterprises. For example, the Government Supply Division might best be liquidated and its assets sold to other private sector suppliers on the island; or to entrepreneurs who would buy the assets and incorporate a new business. In this event, proper auction or bidding procedures would have to be drawn. Alternatively, it could be reorganized and sold as separate companies under the Company Ordinance. The follow-up mission can make specific recommendations to the PTF.

To the extent that public share offerings are envisioned, then the GOK must be sounded out as to the possibility of forming a small stock exchange, if feasible, which might be handled by the DBK; or as to utilization of some other device (e.g., government guarantee of share redemption at floor price) to facilitate the public offering of securities. In the phase Five follow-up mission, the investment banker should be entrusted with this responsibility.

Although the specific tasks to be performed in respect to each enterprise will depend on the specific privatization approach selected (as just illustrated), general indications can be given with respect to some of the principal tasks involved, as follows:

A. Juridical Organization and Legal Readiness for Divestiture

In most cases, the GOK will have to convert entities into companies organized under the Company Ordinance in order for these to be divested. Indeed, this would probably be a necessary foundation for leasing and contracting arrangements also. Accordingly, for any divestiture candidate not already established as such a company, this type of juridical re-organization must be planned (unless a liquidation and sale of assets will occur, in which case if liquidation of an entire entity and cessation of operations were contemplated, then in most cases legislative authorization from the Maneaba would be required; however, it would not be required of the enabling legislation of the entity involved, or other pertinent legislation, already conferred such power upon the executive agency involved). The section 5.1 on power to privatize explains what is required for each enterprise. To briefly recapitulate here, since the DBK is apparently authorized to divest its holdings, it can now formulate action plans to divest Abamakoro Trading Company, the Otintaai Hotel Ltd., and Atoll Motor and Marine Services, Ltd.. As noted, however, the assets and liabilities of the latter two companies have not formally been transferred to the corporate shell organized under the Company Ordinance. This formality may be accomplished through a filing with the Registrar of Corporations. In addition, the balance sheet of Atoll Motor and Marine Services, Ltd. must be restructured and we were given to understand that this would occur pursuant to legislation introduced into the Maneaba in connection with the financial restructuring of the DBK itself. This process must be monitored and expedited.

For those companies not yet organized under the Companies Ordinance, action must be taken by the Maneaba (Parliament) to authorize same. A legislative strategy must be created for the enterprises involved, that is, whether to consolidate several in one piece of legislation, or allow each to be considered separately. Under Kiribati law a bill is "read" into two sessions of the Maneaba and must be approved by simple majority to become law. Since each session is four months apart, this can be an 8 month process or longer, assuming majority approval. An "urgency" rider can be attached to a bill to have it considered in only one session. The strategy will have to consider whether this approach should be followed. The legal analyst will have to cooperate closely with the financial analyst, to determine if any other GOK action is needed to restructure balance sheets of companies involved.

To the extent that a stock exchange will be created, or other mechanisms connected to public share offerings, then a consideration of whether Maneaba action is required must be undertaken and an action plan drafted accordingly. It may be that the KDB can engage in underwriting or other activities connected to the privatization without further authorization from the Maneaba.

As indicated in Chapter 5.1 above, it may be possible in some cases to liquidate GOK entities <u>without</u> recourse to the Maneaba (in cases where such recourse <u>would otherwise be required</u> to establish a registered company under the (company Ordinance). That legal question must be explored with the ministry and Attorney General on a case-by-case basis with respect to the particular entity in question. If such authority does exist, then it may be expedient to liquidate GOK divisions and sell their assets to entrepreneurs who would use same for an existing enterprise or new enterprise organized under the Company Ordinance. Naturally, this is not solely a legal issue; many factors are involved in a determination on liquidation versus juridical reorganization and sale as a going concern, not least of which is the likely higher revenues to the GOK in selection of the latter alternative in cases where large liabilities are not outstanding.

B. <u>Valuation and Prospectus Preparation</u>

The specific elements minimally required under Kiribati law for preparation of a prospectus in a public share offering are surveyed in Chapter 5 above. This information will be obtained from a financial audit and valuation.

This will encompass audit of the financial statements, and supporting documentation for the last three years. Recent financial statements accompany this report in Appendix Two. In addition, valuation of an enterprise on a "going-concern" basis, taking into consideration the accounting conventions that apply to private sector firms in Kiribati. A valuation based on actual value of assets should also be undertaken. As possible, an analysis of revenues and operating costs should be undertaken as measured against those characteristic for such a business.

The analysis should identify all long and short term debt, including the holders of the debt and the balance owed as well as interest rate and maturities. Analysis should include estimate of the value of hidden liabilities, such as labor indemnities, contingent liabilities and so forth. The analysis should also identify hidden assets, such as trade names. As appropriate, the analysis should also include estimates of any new investments needed to bring an enterprise to a viable level and quality of operations. This is especially important in Kiribati. Moreover, in some instances the audit may show that the company must undergo financial reorganization before being put on the market. This is certainly the case of AMMS, Ltd. This reorganization might entail establishing proper accounting and management systems, budget priorities, debt restructuring, and recapitalization for modernization of equipment.

As noted, the prospectus will contain much of the above It must be carefully drafted to comply with the legal standards set out above in Chapter Five. The timing for release and review of a prospectus are carefully controlled in the case of public offerings; and conditions may be imposed by the Registrar of Corporations in the case of private placements.
At a minimum a prospectus should contain full and complete information and meet legal requirements in the markets where the offer is made. The task of drafting a prospectus should be undertaken by team lawyer and financial analyst. Information should include (but is not limited to) the following:

Technical Information -- Description of the company, its assets, and physical condition; products produced and sold and services offered; markets served, including prior and current performance; labor (number of employees, skill levels, union representation etc.) current problems and potential solutions.

Financial Information -- Audited financial statements, cost accounting data ralated to cost production (fixed and variable);

accounting valuation of assets; profile of all debt owed by the company; estimated labor indemnities (if any); estimated value of hidden assets and liabilities (including contingencies); estimated value of any new investments required.

Conditions of Divestiture -- GOK objectives, including any limitations on type of investor, financing structure or mechanism, disposition of enterprise assets, or future operations. This is an extremely sensitive function that will have to be thoroughly considered by the Privatization Task Force in the case of each subject enterprise.

C. Marketing

In the case of public share offerings, the law of Kiribati imposes specific requirements detailed in Chapter 5 (i.e., Prospectus contents must be approved by Registrar, application for shares or debentures of public company must be accompanied by prospectus registered with the Registrar not earlier than 3 months before date of agreement to allot shares; prospectus must be submitted to Registrar at least 14 days prior to date of intended issue etc.). Registered prospectus should be distributed to identified investors and made available to others and the public in accordance with law. Arrange meetings with seriously interested parties, on-site inspections arranged as appropriate. Public share offerings made through underwriters and stock exchange or other mechanism as formulated.

Private placements are subject to conditions in the discretion of the Registrar of Corporations. The Registrar will need to focus on GOK review of proposals, a critically important process that should be characterized by fairness and transparency to guard against "sweetheart" deals.

1) Uniform criteria must be developed by the Registrar of Corporations together with the PTF and the enterprise involved against which proposals can be judged and ranked.

2) A formal negotiating process must be undertaken by the relevant part of the GOK.

3) Evaluation of final proposals should be conducted on the basis of the criteria established.

D. Contracting or Leasing to Private Management

In some instances the GOK through its PTF may wish to contract out as a first step toward divestiture. This may well apply to such enterprises as the Otintaai Hotel, the Philatelic Bureau, or the Government Printing Office. For some of the larger entities, such as the Shipyard, the Shipping Corporation, the Public Utilities Bureau, and Public Works (and others not explicitly considered here, such as Air Tungaru and Telecommunications), there may be certain functions that can be contracted out to existing private companies in Tarawa, or to new companies formed to undertake these activities at less expense to the Government.

In some cases, it will be necessary to convert the GOK entities involved into companies registered under the Company Ordinance before contracting can be usefully applied. Activities that can be contracted out typically include: computer operations, meter reading, maintenance, printing, others. Any enterprise wishing to do this needs to identify which activities it feels can be handled more cost effectively by private workers, conduct a small cost benefit analysis test its hypothesis, and draw up a plan specifically describing the services it needs, including cost projections, standards for performance and evaluation. Public invitation for bids and negotiation with private parties would ensue.

CHAPTER X: CONCLUSIONS AND RECOMMENDATIONS.

10.1 Summary of Findings and Conclusions

(1) The GOK expressed serious interest in the design and implementation of a privatization program as manifested by the Beretitenti (President of the Republic) in a meeting with mission members. This interest is also evident in the policies published in the National Development Plan 1987-1991 and in the support provided to the September 1987 mission by the Ministry of Finance, Office of the Attorney General and other offices of the GOK.

(2) In order for an acceptable program to be designed, approved and implemented by the GOK, an institutional infrastructure must be installed for this purpose. Adoption by the GOK of the institutional framework recommended below in Summary of Recommendations, or a modified version thereof, will signal a strong determination to move ahead on the project.

(3) The mission identified six entities as part of its Group One Priority privatization candidates that may be privatized within an operational period of one-year. This would occur after a proper institutional framework within the GOK is installed to carry out a privatization program, providing required technical assistance is made available by USAID or other donors. The Group One entities together with the others reviewed are listed in the Executive Summary.

(4) Businessmen who were interviewed displayed ambivalence in being convinced of a change in government attitudes, strategies, polices and specific actions, favoring privatization and private sector development.

(5) The government's sensitivity to being self reliant, preserving its political and economic sovereignty and diversify its economy are the most salient aspect of our observations.

10.2 Summary of Constraints

(1) The GOK has limited professional manpower resources available to design and carry out a privatization program. Further, the GOK has only a limited professional services base in its private sector capable of contributing to such effort. For example, no accounting or legal firms exist in South Tarawa. As a result, donor sponsored technical assistance will be necessary to carry out a privatization effort.

(2) The GOK is understandably concerned that private sector development should not accelerate erosion of traditional values and culture. Due care must be taken to preserve and protect the Kiribati way of life.

(3) Private sector perception of government attitudes and policies is a constraint since businessmen are ambivalent about the governments intent to privatize and truly expand the private sector. There may also be cultural dichotomies which may constrain the further development of privatization and private sector development.

10.3 Summary of Recommendations

(1) The team recommendations that the governments discuss and adopt a privatization strategy involving a demonstration of political and financial commitment to privatization by government through means to guide, direct and influence public opinion. The strategy would lead to a series of polices, programs and actions carrying out privatization projects to successful divestitures.

(2) The GOK should establish a Bureau for Privatization and Private Sector Promotion under the Office of the President of the Republic as described in Chapter 3. The GOK should begin this project by establishing a Presidential Task Force, also described in Chapter 3 and Chapter 9.

(3) The GOK should organize a follow-up technical assistance mission after the Presidential Task Force is established (May 1988). The follow-up mission will work with the GOK to develop a specific privatization approach for each Group One enterprise (i.g., employee ownership, public, offering, private placement, liquidation and asset auction). To the extent public share offerings are envisioned, the GOK must be sounded out as to the possibility of forming a small stock exchange or other appropriate mechanism to facilitate share sales. In addition, the follow up mission will: 1) consider juridical organization of enterprises and begin a process of restructuring same to permit divestiture: 2) conduct enterprise valuations and begin prospectus preparation: 3) make plans for marketing and sale including compliance with all requirements imposed by law as surveyed in Chapter 5.

CHAPTER X: CONCLUSIONS AND RECOMMENDATIONS

10.1 . Summary of Findings and Conclusions

The Government of Kiribati is seriously interested in embarking on a program of privatization and private sector development. The government continues to exhibit signs of paternalism as well as concern as to whether Kiribati society can handle privatization and private sector development without sacrificing too much of its historical and traditional values and culture. Sixteen companies were briefly looked into by the team. Twelve were studied with more detail than the last four. Eight companies can conceavibly be privatized between January 1988 and December 1989. The other four may take much longer depending on government policy and action during 1988 and 1989. Not much can be said of the last four companies which happen to be among the latest deficit sources to the budget. Their disposition is left to future action.

Businessmen who were interviewed displayed ambivelance in being convinced of a change in government attitudes, strategies, polices and specific actions, favouring privatization and private sector development.

There is a small but growing number of privately owned businesses in the contry. Naturally, they are concentrated in areas where profit margins are relatively high, products and services supplied have a secure current and future demand. These firms are mostly involved in import, sholesale and retail of food, vehicles, consumer items, handwork, construction materials, tourism and transportation services.

The government's sensitivity to being self reliant, preserving its political and economic sovereinity and diversify its economy are the most salient aspect of our observations. It is important tha ways and means are found to support the governments position moving forward in privatization and expansion of it private sector.

10.2 Summary of Constraints.

The privatization program will require a substantial amount of legal, financial, and administrative work especially during its first and probably second year, those are not obsticles but serious constraints. Legal structures of most entities will need to be changed, consideration given to long term unpaid and incollected payables and receivables. Valuation, disposition of assets, proper pricing of shares labor outplacements, choosing the method of divestiture and carrying it out are all affected by administrative restraints and manpower shortages.

Private sectors perception of government attitudes and policies are a constraint since businessmen are ambivalent about the governments intent to privatize and truly expand the private sector. There may also be cultural dichotomys which may constrain the further development of privatization and private sector development.

10.3 Summary of Recommendations

The team recommendations that the governments discuss and adopt a privatization strategy involving a demonstration of political and financial committment to privatization by governemnt through means to guide, direct and influence public opinion. The strategy would lead to a series of polices, problems and actions carrying out privatization projects to succesful divestitures.

We recommend that the government establish a Presidential Task Force which in six months to a year would become a permanent bureau under the Presidents office to foster, guide and manage privatization and private sector development projects. We also recommend that a bilateral/multilateral donor funded second follow up mission to the one covered by this report arrive in Kiribati in mid 1988. The major purpose of this mission is to undertake the required analysis and steps to kick off actual privatization of state owned enterprises.

Another recommendation is that consideration be given to the establishment of a small, simple and limited-function stock exchange to create a primary and secondary market for the shares of privatized state owned enterprises.

Finally most of our recommendations were placed in the framework of a phased privatization program with illustrative examples of the specific actions which needed to take place. Eleven phases were identified and detailed in chapter nine considering realistic time frames for specific actions to take place.

It is important to note that a report outline was prepared and used as a briefing document both with the Kiribati Government Official and USAID staff in Fiji. After a review of all documentation and discussions over the outline the team found it useful to deviate slightly from this original approach. The team did exert its best efforts within the time resources provided which consisted of two weeks in-country and five days in the United States for report preparation.