



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

KIRIBATI

Agricultural Subsidies for Copra: Improving
Efficiency and Equity and Balancing Trade-offs

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Prepared By

Tewodaj Mogues, Todd Benson, and Huy Nguyen

PARTNERS

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Fiscal Affairs Department

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: This technical assistance mission assessed Kiribati's agricultural output price scheme that subsidizes the production of copra (dried coconut). The mission estimates that subsidies in 2023 amounted to 7.8 percent of GDP. The scheme's technical and allocative inefficiencies, incidence in rural areas, and high fiscal cost, could be mitigated in the short- and medium term, by scaling back the subsidies, replacing them in part with cash transfers and public goods provision in the outer islands, securing fiscal savings in the process, and introducing competitive elements in the copra value chain.

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International Monetary Fund, IMF Publications
P.O. Box 92780, Washington, DC 20090, U.S.A.
T. +(1) 202.623.7430 • F. +(1) 202.623.7201
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Background

In August 2023, the Kiribati Ministry of Finance and Economic Development (MFED) expressed interest in IMF support for technical analysis on options to improve the efficiency of and propose reform options for the government scheme providing output price subsidies for copra (dried coconut—a commodity produced for export by smallholder farmers), given the high fiscal cost of this program. Accordingly, a capacity development (CD) mission was delivered in April/May 2024. The findings and recommendations arising from this CD activity could inform implementation of aspects of the country's 20-year Kiribati Vision development plan (KV20), which aspires to create economic opportunities for the rural population beyond copra production. A recent IMF 2024 Selective Issues Paper developed a theoretical economic model that estimates how lowering or capping the copra support, and channeling some of the fiscal savings to cash transfer payments, could improve debt sustainability, while avoiding a drop in living standards for the most vulnerable.

Summary of Findings

An estimation of the subsidy content of the scheme, accounting for the farmgate price, market access costs along the value chain, the free-on-board (FOB) export price, and quantity conversion factors across different exported coconut products, shows that out of the AUD 4/kg payment, AUD 3.71 constitutes a subsidy, i.e., the government provides a subsidization rate of 93 percent. The total subsidy in 2023 is estimated at 7.8 percent of GDP, which rose from past years due both to the doubling of the administered price and an increase in production.

The scheme is beset with a host of technical efficiency challenges. The Kiribati Coconut Development Ltd. (KCDL), responsible for processing and exporting copra, receives the commodity (not paid for by itself but by the government), and pays private and state-owned shipping companies government-set freight and handling fees to ship the copra to the international ports and processing sites. The private ship operators avoid servicing the harder-to-access islands at the prevailing shipping rates. The SOE responsible for shipping, which has a mandate to serve the more remote islands, is, on the other hand, constrained in conducting effective copra offtake, due to its limited number of vessels and inefficiencies in its operations. As a result, copra sheds on outer islands often fill to capacity, resulting in deteriorating quality and quantity of the commodity, a halt to additional copra purchases on the island, which affects farmers' incomes, and KCDL processing facilities operating well below capacity, which is operationally costly. Quantitative analysis shows a stark growth over time in such technical inefficiencies.

At least as importantly, the subsidy scheme increases allocative inefficiency in the economy, by diverting substantial household labor and other national resources to copra, a commodity that exports at a price lower than the farmgate price. This diverts resources away from producing other food crops, although their prices are substantially higher than what copra would attract without the support scheme.

Neither is the equity goal of copra payments adequately met. Average copra earnings are generally higher for households in deciles with higher non-copra mean income. This is not surprising: As an output price subsidy scheme, it provides greater amounts of resources to households with greater land and labor endowments that enable them to produce more copra.

The equity, efficiency, and fiscal sustainability weaknesses of the existing copra subsidy scheme motivate consideration of alternative policy features. A simulation analysis of various reform options—all entailing the same fiscal savings—shows that reform scenarios that replace part of the subsidy with public goods spending and cash transfers have consistently the highest impact on welfare across the income distribution when compared against other simulated scenarios, including being an improvement over reform scenarios that move part of the subsidies to cash transfers only. But these superior results are expected only to be achieved in the medium term.

Summary of Recommendations

Addressing the large technical inefficiencies in the Kiribati copra sector is crucial—introducing elements of competition can help in this regard. This, however, requires enabling price incentives along the value chain. Except in shipping (and even there only partially), currently, there are no competitive elements within the copra value chain. However, it is impossible to introduce competitive elements at current copra prices, at which there would be no economic incentives for value chain actors to engage. To foster such competition, in a transition period, subsidies to producers would still feature, but would need to be at a lower (floor) price to enable the participation of private commercial firms.

Shipping copra from selected difficult-to-reach islands may require continued public support to transportation during a transition period, as a fully private sector driven copra value chain in Kiribati will tend to neglect copra producers on the difficult-to-access outer islands. But critically, performance measures based on timeliness of transporters' handling—and not, as currently, primarily based solely on volume shipped and distance—would be central to any reformed subsidy scheme.

Moving the copra subsidy system further downstream in the value chain could make a first dent in the current allocative inefficiencies. It will begin to reduce the distortions now seen in outer island economies, which result in overproduction of copra and neglect of more socially remunerative activities processing products from fresh rather than dried coconut. Growth of a diversified agricultural sector is similarly hampered by the high copra price offered farmers. The supply to South Tarawa consumers, in particular, of a range of food crops, particularly nutrient-dense indigenous fruits and vegetables, are currently disincentivized by the copra scheme. Instead, rural and especially urban food consumption is primarily composed of high and growing food imports of low dietary quality. As such, the copra support heavily constrains domestic non-copra agriculture and thus food crops for domestic consumption.

In addition to efficiency and value chain concerns, the program in its current form results in large opportunity costs for Kiribati's development. The high expenditures on copra price subsidies mean that other pressing development activities cannot be undertaken, including the needed public goods provisions enumerated above that could have important multiplier effects for the rural economy and that could, in the medium term, stem outmigration from the outer islands to South Tarawa.

Implementation of subsidy reform requires going beyond technical considerations to thinking through careful communications around reform. Being judicious about the timing and sequencing of reform is just as important for its sustainable implementation.