



REPUBLIC OF NAURU

January 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF NAURU

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with the Republic of Nauru, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 22, 2020 consideration of the staff report that concluded the Article IV consultation with the Republic of Nauru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 22, 2020, following discussions that ended on September 26, 2019, with the officials of the Republic of Nauru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 6, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Nauru.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2019 Article IV Consultation with Nauru

On January 22, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Nauru.

Nauru is at a point of transition with a decline in phosphate mining and the activity associated with the Regional Processing Centre (RPC) for asylum seekers. New sources of economic growth and income are needed to support Nauru's development agenda.

Growth picked up to 5.7 percent in FY2018 boosted by RPC related activity, fisheries, and preparations for the Pacific Island Forum. However, growth slowed in FY2019. Despite improved economic performance in recent years, Nauru continues to face challenges in sustaining growth and ensuring fiscal sustainability due to its limited sources of growth and income. The country is also vulnerable to climate change, its antiquated infrastructure hampers trade and growth, and its health indicators are below those of peers due to high incidence of non-communicable diseases. The medium-term outlook depends on the level of RPC activity in the future, fishing revenues, and completion of infrastructure projects. A scaling down of phosphate mining and activities associated with the RPC will reduce budget revenues. With limited access to borrowing, fiscal spending would have to adjust accordingly. Inflation is projected to remain low, in line with the slowdown in the economy, inflation in Australia, and low commodity prices.

Executive Board Assessment²

Executive Directors welcomed the improved economic performance in recent years, but noted that significant challenges remain, including volatile revenue sources, capacity and infrastructure constraints, and climate change. To help address these challenges, Directors urged the authorities

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

to press ahead with reforms to preserve fiscal and debt sustainability, foster economic diversification, and strengthen governance and transparency.

Directors agreed that Nauru's medium-term fiscal outlook is vulnerable to the scaling down of the operations of the Australian Regional Processing Center (RPC) for asylum seekers, entailing a substantial decline in government revenue. They stressed the importance of a timely adjustment of fiscal plans to avoid breaching the fiscal anchor, meet the mandatory Trust Fund contributions, and prevent further accumulation of debt. Directors highlighted that maintaining adequate fiscal buffers would be critical to ensure fiscal liquidity and sustainability, and to allow flexibility in responding to shocks.

Directors urged sustained fiscal reforms, including continued tax and public financial reforms to support fiscal adjustment and help control spending. They underscored the need for continued improvement in public debt management to resolve legacy debt and contain debt accumulation, including within state-owned enterprises (SOEs). Directors urged the authorities to limit the use of supplementary budgets and to set aside windfall revenues for appropriation in the normal budget cycle to boost resources for carefully planned investment spending. They welcomed the new Public Enterprises Act, including establishment of the SOE monitoring unit.

Directors noted that Nauru faces long-term climate change challenges and emphasized the importance of a medium-term fiscal framework that enhances resilience to climate change. They welcomed recent measures in adaptation and mitigation, including the new seaport that will reduce Nauru's carbon footprint. They encouraged the authorities to fully cost adaptation plans and incorporate the projects into a multi-year budget plan.

Directors agreed that prospects for inclusive growth and private sector development can be lifted through improvements in the business environment. They welcomed progress in financial inclusion and called for further strengthening of the anti-money laundering/combating the financing of terrorism (AML/CFT) framework. Directors urged the authorities to seek to improve the quality of health and educational outcomes, and continue to combat non-communicable diseases. Directors strongly encouraged the authorities to improve the quality and timeliness of macroeconomic data for surveillance.

Table 1. Nauru: Selected Social and Economic Indicators, FY2015–21 1/

I. Social and Demographic Indicators 2/							
GDP (FY2018 est.) (in millions of Australian dollars)	160.0			Poverty	24 percent (2013)		
Per capita GDP (FY2018 est.) (in Australian dollars)	12,120			Life expectancy at birth	60.4 years (2011)		
Population (FY2018 est.)	13,201			Total fertility rate	4.3 births per woman (2011)		
				Infant mortality rate	29.9 per 1,000 live births (2013)		
				Adult literacy rate	96.5 (2011)		
II. Economic Indicators							
	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
				Preliminary		Proj.	
Real sector							
Real GDP growth (percent change)	3.4	3.0	-5.5	5.7	1.0	0.6	1.1
Consumer price index (period average, percent change)	9.8	8.2	5.1	0.5	3.9	2.8	2.3
Population (thousand)	12.5	13.0	13.4	13.2	12.7	12.9	13.2
				(In percent of total)			
Structure of the economy							
Agriculture	2.7	2.9	4.4	3.8	4.7	4.7	4.8
Manufacturing	12.9	22.2	17.2	10.1	7.9	7.7	7.6
Services	72.9	65.8	71.8	77.0	73.7	73.2	72.7
				(In percent of GDP)			
Government finance							
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	135.9	103.2
Revenue	74.5	91.6	100.6	108.5	126.6	114.8	87.9
Grants	19.1	23.3	21.3	20.8	15.1	21.1	15.3
Total expenditure	83.1	93.4	100.5	96.8	125.6	120.5	98.8
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	15.5	4.4
Including Trust Fund contribution	10.5	6.6	13.2	23.2	7.3	2.8	-7.9
Stock of government deposits	24.8	10.1	5.6	24.2	35.7	34.0	22.2
Stock of Trust Fund	...	24.6	39.1	52.8	63.6	80.2	96.1
				(In millions of Australian dollars, unless otherwise indicated)			
Balance of payments							
Current account balance	-22.2	2.8	18.4	-7.3	8.3	-7.1	-8.3
(In percent of GDP)	-21.3	2.0	12.7	-4.6	5.0	-4.1	-4.7
Exports (goods)	24.9	47.8	25.3	15.9	6.0	6.0	6.0
Imports (goods)	82.3	76.7	70.0	81.1	83.8	84.6	84.7
RPC-related inflows	35.8	32.6	42.3	36.5	32.6	22.4	23.4
Capital account balance	4.6	17.0	12.4	8.4	5.0	7.2	6.8
Financial accounts balance and other flows	-17.7	19.8	30.8	1.1	13.3	0.1	-1.4
Government debt indicators							
External debt 3/	47.8	46.8	48.8	49.0	47.4	48.6	49.7
(In percent of GDP)	45.8	34.0	33.6	30.6	28.7	28.5	28.3
Domestic debt 4/	62.6	62.6	62.6	69.9	55.3	53.3	52.3
(In percent of GDP)	60.0	45.5	43.1	43.7	33.5	31.3	29.8
External debt service	2.3	2.2	0.0	2.3	9.8	0.0	0.0
(In percent of exports of goods and services)	4.2	3.1	0.0	5.6	29.9	0.1	0.1
Exchange rates							
Australian dollar per U.S. dollar (period average)	1.2	1.37	1.33	1.29	1.40	...	...
Real Effective Exchange Rate (period average)	98.2	101.7	113.5	111.1	...	...	...
Nominal GDP (in millions of Australian dollars)	104.3	137.5	145.3	160.0	165.3	170.2	175.4
Nominal GNI (in millions of Australian dollars)	142.4	187.0	203.4	214.6	243.5	236.8	241.6
Nominal GNI per capita (in US dollars)	9,551	10,439	11,409	12,605	13,764	...	...

Sources: Nauru authorities and IMF staff estimates and projections.

1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.

2/ The social indicators are taken from United Nations Development Program and Secretariat of the Pacific Community.

3/ Including the defaulted Yen bonds.

4/ Including the estimated government liability related to Bank of Nauru's liquidation.



REPUBLIC OF NAURU

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

January 6, 2020

KEY ISSUES

Context. Nauru is at a point of transition, given the continued decline in both phosphate mining and activity associated with the Regional Processing Centre (RPC) for refugees and asylum seekers. Nauru remains vulnerable to climate change and has a narrow economic base and limited capacity. Development challenges are increased by unavailability of land and high incidence of non-communicable diseases (NCDs). This is the second Article IV Consultation since Nauru became the 189th Fund member in April 2016.

Outlook and risks. Growth was stronger than expected in FY2018, but slowed in FY2019. The outlook is subdued, with growth expected to reach 2 percent in the medium term. Revenues are projected to decline, necessitating a fiscal adjustment. Risks are skewed to the downside and include the scaling down of RPC activity and revenues, volatile fishing revenues, climate change, and delays in fiscal and structural reforms.

Key policy recommendations

- **Fiscal policy.** Fiscal adjustment is required to avoid a breach of the fiscal anchor, contain debt, and maintain the Trust Fund contributions. Adjustment measures should involve reduced spending in non-priority areas, tax reform, and implementation of PFM reforms. A cash buffer target of at least 2 months of non-RPC current spending would help to manage liquidity and provide fiscal space.
- **Governance.** Stronger monitoring and accountability on the use of public sector resources would ensure that resources are used to help reach development goals. Building on progress to date, improvements to the AML/CFT framework should be continued.
- **Structural reforms.** New sources of economic growth and income are needed to support Nauru's development agenda. Policies should be implemented in the near term to support private sector activity, including through financial sector development, SOE reform, and land rehabilitation. The effectiveness of education and health spending needs to be improved to meet development goals.

Approved By
Andreas Bauer
and Kevin
Fletcher

Discussions were held in Nauru during September 16–26, 2019. The staff team comprised Ms. Kaendera (head), Ms. Hunter (Resident Representative), Ms. Madhu Nair, Ms. Singh (all APD). Ms. Park (OED) participated in the discussions. Ms. Kanyabutembo assisted in preparing this report. The mission met with the President and members of the Cabinet, the Finance Minister, senior government officials and representatives from public enterprises, the private sector, and development partners.

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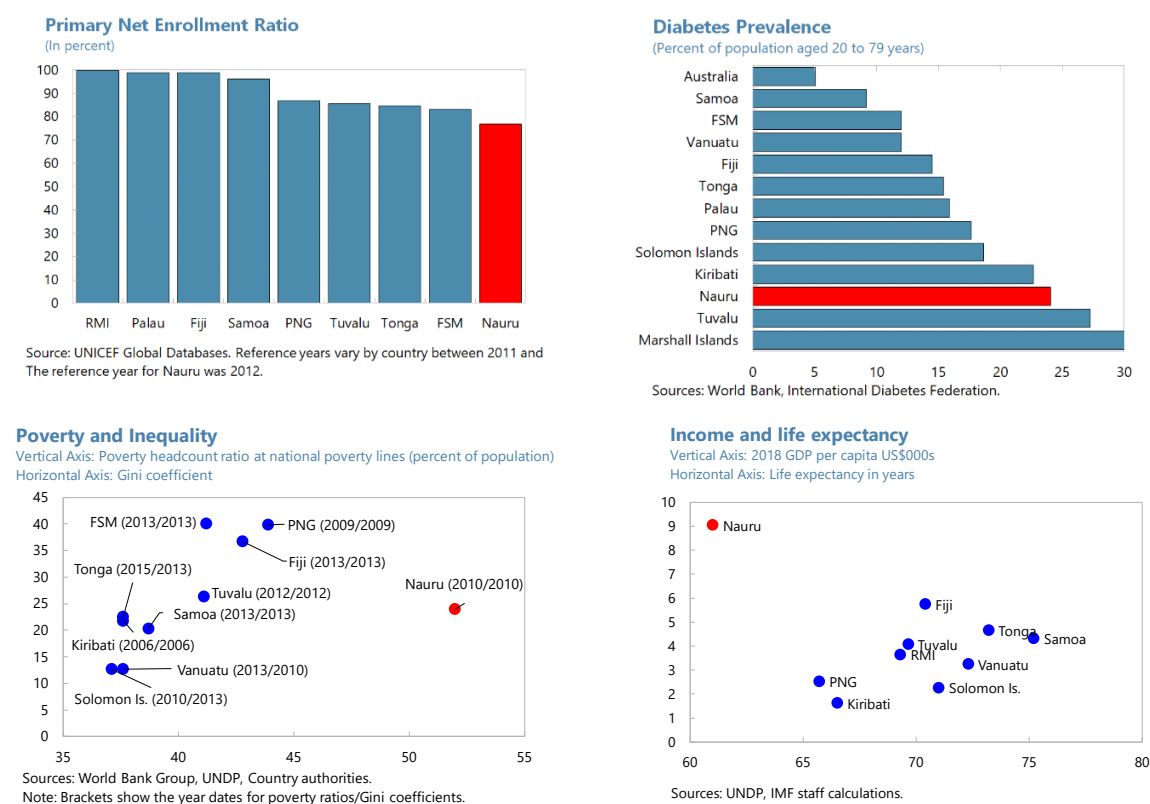
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CONTEXT

1. Nauru has a narrow economic base and limited capacity in both the public and private sectors. Nauru is a micro-state with a land area of about 8 square miles and a population of around 12,500 in 2015. Extensive phosphate mining has left most of Nauru's land unusable. When phosphate revenues peaked in the early 1990s, Nauru briefly became one of the world's richest nations—the Nauru Phosphate Royalty Trust (NPRT) fund held more than A\$1 million per capita. Declining phosphate revenue and weak management of public finances led to economic decline, depletion of the NPRT, and collapse of state-owned enterprises (SOEs), including the Bank of Nauru. In FY2012 the economy was boosted by the establishment of the Australian Regional Processing Center (RPC) for asylum seekers, alongside higher revenue from fishing license fees and a pick-up in residual phosphate mining activity.¹ Nauru established a new trust fund in FY2016 aimed at providing long-term fiscal financing (Box 1).

2. The key economic challenge is to develop new sources of economic activity and income. Preparing for and managing the scaling down in RPC activity is a key policy priority. Increased fishing license revenues have provided welcome diversification, but private sector development is hampered by infrastructure and capacity limitations. Nauru is vulnerable to climate change and exhibits worse social indicators than peers (Text Figure 1).

Text Figure 1. Nauru Social Indicators



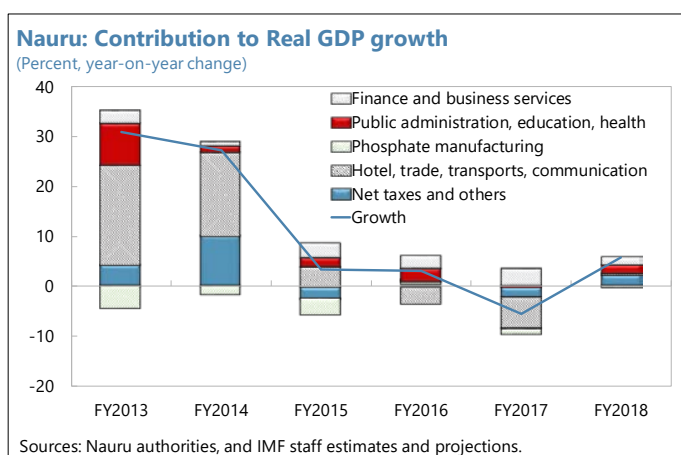
¹ Nauru's fiscal year runs from 1 July to 30 June.

3. Governance challenges result in inefficient management of resources and create vulnerabilities to corruption, which weaken growth. Main risks stem from fiscal governance (PFM controls), lack of accountability and monitoring of SOEs, weaknesses in the rule of law (investor protection and contracts), and the AML/CFT framework. Mitigating governance risks will require a long-term effort, with greater transparency in key areas and a robust accountability framework for SOEs.

4. Nauru's economic policies in FY2018 and FY2019 were partly in line with previous IMF advice (Annex I). Fiscal surpluses have been maintained, and a cash buffer was created in 2018 following the 2017 Article IV recommendations. Progress has been achieved in strengthening revenue administration, and plans are underway to introduce a consumption tax. Fiscal transparency has improved with budget documents now published online. Further efforts are needed to better prioritize expenditures in line with the National Development Strategy and to strengthen public debt management.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

5. Following a rebound in FY2018, growth has slowed due to reduced activity in phosphate mining and at the RPC. Economic activity rebounded in FY2018 and moderated in FY2019. A higher-than-expected refugee presence in FY2018, alongside strong fishing activity and preparations for hosting of the Pacific Island Forum, contributed to a pick-up in growth to 5.7 percent. However, lower numbers of refugees and asylum seekers have reduced activity in FY2019, and growth is estimated to have slowed to 1.0 percent. Inflation moderated to 0.5 percent in FY2018 mirroring low inflation in Australia but picked up to 3.9 percent in March 2019.



6. The FY2019 fiscal surplus is estimated at 16.1 percent of GDP. The surplus reflects a 12 percent of GDP spike in fishing revenue partly offset by expenditure growth from subsidies and a wage increase related to the new superannuation fund (Box 2). Surpluses have been used to contribute to the Trust Fund, build government deposits, and reduce arrears. In FY2019 government deposits increased to 35.7 percent of GDP, and the Trust Fund to 63.6 percent of GDP (A\$105.2 million). Total public debt—including SOE debt—increased to A\$138.8 million (86.8 percent of GDP) in 2018 reflecting a new loan from Taiwan Province of China to purchase equipment for secondary phosphate mining.

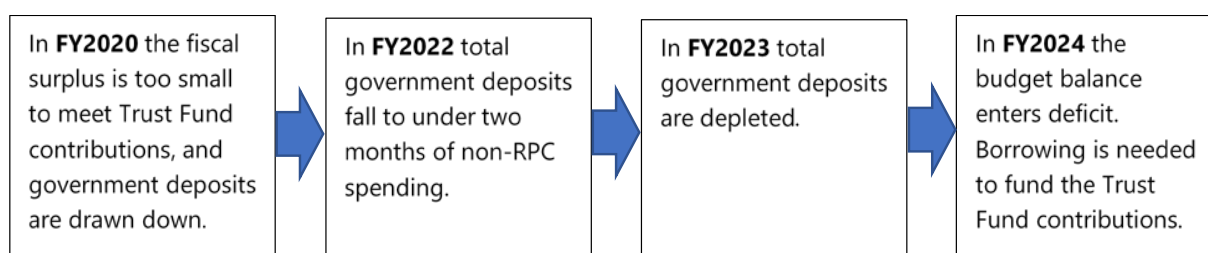
7. Nauru's external position in FY2018 is substantially weaker than implied by medium-term fundamentals and desirable policies (Annex 2). The current account balance (CAB) deteriorated in FY2018 due to reduced RPC and phosphate activity. It recorded a deficit of around 4.6 percent of GDP in FY2018 after a surplus of 12.7 percent of GDP in FY2017. The CAB is estimated

to have returned to a surplus in FY2019 due to a spike in fishing revenue inflow. The sustainability of the external sector will depend critically on exogenous factors such as RPC activity, fishing license fees and donor support, while REER changes have only a limited impact.

8. The macroeconomic outlook depends on RPC activity, fishing revenues, and completion of infrastructure projects. It is estimated that 300 refugees and asylum seekers will remain in Nauru in FY2020. On this basis growth is expected to moderate further to 0.6 percent in FY2020. Medium-term growth is projected to strengthen to around 2 percent, supported by improved infrastructure and structural reforms. Average inflation is projected to remain low, in line with Australian inflation and stable commodity prices. The current account balance is expected to deteriorate over the medium term with an average deficit of around 5 percent of GDP due to reduced phosphate mining, reduced RPC activity, and normalizing fishing license fees.

9. Nauru and Australia have signed an agreement for a “hybrid” model of joint management of RPC commercial operations and services for the current financial year. Under the new hybrid model much of the core RPC activity is expected to remain under Australian control. However, Nauru will have responsibility for certain activities with corresponding profit-making opportunities. The authorities are also engaged in negotiations with Australia for increased revenues related to maintaining the RPC, even if activity is to decline. As part of the management arrangements for FY19/20 the authorities received an additional A\$21.1 million in the form of a “hosting fee”, which has boosted spending for the year. However, arrangements for hosting fee payments in future years are currently unknown.

10. The fiscal surplus will be maintained in the near term but turn to deficit over the medium term. Over the medium-term staff projects revenue to decline as around 30 percent of revenue is linked to RPC operations and is unsustainable in the long run. At the same time, staff projects expenditure to revert to around the FY2018 level in terms of percent of GDP, meaning that the fiscal surplus declines through the projection period, until turning to deficit in 2024. As it declines, the fiscal surplus will no longer be available to fund Nauru’s committed contributions to the Trust Fund. Staff projections assume that the planned Trust Fund contributions will continue, at first through reductions in the cash balance, and later through payment arrears and increased domestic debt.



11. Risks are skewed to the downside (Annex III, RAM). Downside risks include a faster-than-expected scaling down of RPC activity, and delays in fiscal and structural reforms. Adverse spillovers from global developments are likely to be limited, but weaker-than-expected global growth and volatility in commodity prices could affect fishing revenue. On the upside, positive spillovers from the RPC operations (such as small business development) and higher-than-expected fishing revenue would boost activity and improve fiscal space.

Authorities' Views

12. The authorities agreed that the near-term outlook for growth and government revenue is highly uncertain but took a more optimistic view of the balance of risks. The authorities agreed that the wind-down of RPC and phosphate activity posed downside risks to revenues and growth but were positive about negotiations with the Australian government on the RPC. They noted that the new “hybrid model” would see a larger Nauruan role in providing services. While agreeing that fishing revenues are potentially volatile, the authorities noted that Nauru has experienced relatively stable demand for its fishing days, as its fish stock has been less sensitive to the impact of shifts in ocean temperatures compared to other Pacific countries. The government is reviewing the plans for secondary phosphate mining given the sharp decrease in phosphate prices.

ENSURING FISCAL SUSTAINABILITY

Fiscal sustainability is threatened by declining RPC revenues, mandatory Trust Fund contributions, and rising non-priority spending. Spending prioritization is needed to adequately provide for infrastructure, health, education and climate change adaptation. Governance improvements are needed to raise the quality of public services and reduce vulnerabilities to corruption. Debt is unsustainable under current policies, and renewed effort is needed to reconcile and resolve long-standing debt arrears.

13. Fiscal policy is anchored by the government’s commitment to achieve a positive budget balance (text box 1). At a minimum, the budget is expected to run a surplus that is sufficient to meet the mandatory annual Trust Fund contribution of 8–12 percent of domestic revenue. As the Trust Fund is not accessible until 2033, and borrowing capacity is constrained, government deposits effectively represent the country’s fiscal space (and also its stock of foreign exchange reserves). Government deposits include a “cash buffer”, which was recommended by staff for liquidity management purposes.² Additional buffers to prepare for further RPC scale down may be needed, but it is difficult to determine the size due to uncertainty about the pace and magnitude of the scale down.

14. A fiscal adjustment plan is needed to avoid a breach of the fiscal anchor and ensure debt sustainability (text box 1 and text figure 2). Under the baseline with unchanged policies, the fiscal balance would be insufficient to make the required Trust Fund contributions from FY2021 onward and the public debt-to-GDP ratio would begin rising in FY2024. Staff recommends a multi-year adjustment plan on both revenue and expenditure sides:

- *Reduce expenditure by 5 percent of GDP on average over the medium term, compared to baseline.* The FY2021 budget offers an opportunity to begin reorienting spending priorities and reduce current spending through a combination of: constant public employment, maintaining public sector wages and transfers constant in real terms, eliminating unproductive spending (subsidies), and better targeting of social programs.

² The cash buffer was created in 2018 following the 2017 Article IV recommendations. It is maintained at Bendigo Bank agency, in a fixed term deposit account.

Nauru's Fiscal Framework

Nauru's fiscal framework comprises three "fiscal responsibility ratios" that guide budget planning, a commitment to Trust Fund contributions, and a target cash buffer.

- *The fiscal responsibility ratios are:* The fiscal balance to GDP ratio must not be negative; personnel costs must be less than 30 percent of current expenditure; and tax revenue be maintained within 25 percent of GDP.
- *Nauru's fiscal surplus to fund the Trust Fund contributions.* The Trust Fund MOUs require Nauru to contribute 10-12 percent of domestic revenue to the Trust Fund when domestic revenue is greater than AU\$100 million. Nauru's domestic revenue has exceeded AU\$100 million since FY2016 and is expected to remain in this range over the medium term. The Trust Fund Committee has discretion to adjust contributions but the exact conditions that would trigger the flexibility are unclear.
- *A "cash buffer" of at least 2 months of non-RPC recurrent spending should be held in government deposits.* Total government deposits currently exceed 2 months of non-RPC spending, but the deposit account that was established as the "cash buffer account" (a fixed term account) is about 0.9 months of non-RPC spending.

The main fiscal anchor is the need for fiscal surpluses to be sufficiently large to fund Trust Fund contributions. The cash buffer requirement also adds to the magnitude of the surplus.

- *Increase tax revenue by 1 percent of GDP on average over the medium term, compared to baseline.* Staff welcomes the authorities continued interest in tax reform, including the introduction of a consumption tax and strengthening revenue administration and compliance.

If the fiscal adjustment cannot be fully implemented then Trust Fund contributions may need to be reduced, at the cost of lower Trust Fund revenues in future.

15. With the cash buffer target of two months of non-RPC current spending yet to be reached, staff recommends the following steps to safeguard the cash buffer:

- *Provide guidance on use and replenishment of the cash buffer within the fiscal framework.* The cash buffer should ease day-to-day cash management and provide the flexibility to respond to shocks.
- *Establish a cash management unit (CMU) and a cash management committee (CMC).* The CMU would prepare cash flow forecasts for the CMC to smooth the payments profile in line with cash availability and ensure the cash balance target is maintained. The CMU would regularly update the CMC on plans and adjust as required.

16. The authorities have reformed the tax system over recent years. An employment and services tax was introduced in 2014 (FY2015), followed by a business profits tax in 2016 (FY2017) and improvements in customs and tax administration. The tax reforms have increased tax revenues, but not to a level sufficient to offset the projected decline in RPC revenue. The bulk of domestic taxes are levied on and paid by expatriate workers.

Text Table 1. Nauru: Central Government Operations, Baseline and Reform Scenario, FY2015–24

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
				Prelim.				Proj.		
				(In percent of GDP)						
				Baseline						
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	135.9	103.2	101.0	99.6	97.1
Expenditure	83.1	93.4	100.5	96.8	125.6	120.5	98.8	98.2	98.4	97.8
RPC expenses	5.8	12.1	21.0	22.0	21.0	16.4	15.8	15.2	15.0	14.3
Non-RPC expenses	65.3	70.7	67.7	62.7	87.4	90.2	73.9	74.1	73.6	73.9
Net acquisition of non-financial assets	12.1	10.6	11.8	12.1	6.4	13.9	7.4	7.3	8.2	8.0
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	15.5	4.4	2.8	1.2	-0.7
Including trust fund contribution	10.5	-2.8	7.9	23.2	7.3	-0.6	-11.1	-9.8	-11.0	-12.5
Net acquisition of financial assets	4.9	15.6	9.5	32.5	24.5	14.3	3.8	2.2	0.7	11.5
Of which : Changes in government deposit	4.9	-8.7	-3.9	19.1	12.2	-1.7	-11.7	-10.3	-11.5	-0.3
Net incurrence of financial liabilities	-7.1	-3.6	0.0	-1.6	3.7	-1.2	-0.6	-0.6	-0.5	12.2
Statistical discrepancy	-1.5	2.2	11.8	-1.6	-4.7	0.0	0.0	0.0	0.0	0.0
				Reform scenario						
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	135.9	103.2	102.1	101.0	98.5
Expenditure	83.1	93.4	100.5	96.8	125.6	120.5	96.1	92.8	92.1	91.7
RPC expenses	5.8	12.1	21.0	22.0	21.0	16.4	15.8	15.2	15.0	14.3
Non-RPC expenses	65.3	70.7	67.7	62.7	87.4	90.2	71.2	68.6	67.3	67.8
Net acquisition of non-financial assets	12.1	10.6	11.8	12.1	6.4	13.9	7.4	7.3	8.2	8.0
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	15.5	7.1	9.3	8.9	6.9
Including trust fund contribution	10.5	-2.8	7.9	23.2	7.3	-0.6	-8.4	-3.2	-3.3	-5.1
Net acquisition of financial assets	4.9	15.6	9.5	32.5	24.5	14.3	6.5	8.8	8.4	6.4
Of which : Changes in government deposit	4.9	-8.7	-3.9	19.1	12.2	-1.7	-9.0	-3.7	-3.9	-5.6
Net incurrence of financial liabilities	-7.1	-3.6	0.0	-1.6	3.7	-1.2	-0.6	-0.6	-0.5	-0.5
Statistical discrepancy	-1.5	2.2	11.8	-1.6	-4.7	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP	104.3	137.5	145.3	160.0	165.3	170.2	175.4	180.8	187.9	195.5
Stock of government debt (in percent of GDP)										
Baseline	105.8	79.6	76.7	74.3	62.1	59.9	58.2	56.5	54.4	65.1
Reform scenario	105.8	79.6	76.7	74.3	62.1	59.9	58.2	56.5	54.4	52.4
				(In months of non-RPC current spending)						
Baseline - stock of government deposits 1/	4.6	1.7	1.0	4.6	4.9	4.5	3.6	1.9	0.0	-2.1
Yield from measures in reform scenario	...	...	...	...	...	...	0.6	1.8	3.1	4.1
Reform scenario - stock of government deposits 1/	4.6	1.7	1.0	4.6	4.9	4.5	4.2	3.7	3.1	2.0

Sources: Nauru authorities and IMF staff estimates and projections.

1/ Under the baseline scenario, current policies would deplete government deposits by FY2023 and require borrowing of around 2.1 months of non-RPC spending in FY2024. With the expected yield from measures, the borrowing is avoided and the government deposit target of 2 months of non-RPC current spending achieved.

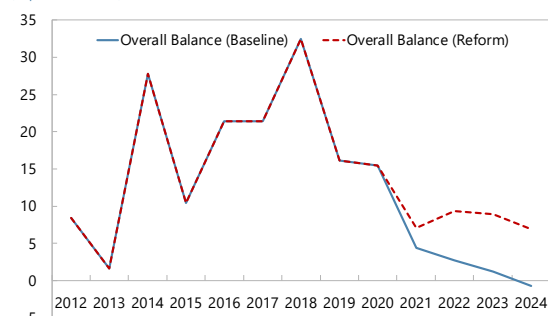
17. Further tax reform is an opportunity to generate revenue more efficiently. Increased domestic tax revenue will be needed to offset lost customs revenue from Nauru's ratification of the Pacific Agreement on Closer Economic Relations Plus (PACER Plus) and loss of revenue from a scaling down in RPC activity.³ The focus on introducing a consumption tax in the near term is appropriate, but for the reform to yield expected results it requires careful design (including choice of tax base and rate structure), sequencing and timing of implementation, as well as modernization of the tax administration. Staff recommends setting tax reform in a comprehensive medium-term revenue strategy to coordinate broad based reforms. The IMF is available to provide advice through PFTAC. As most Nauru citizens do not have experience of paying tax, policy changes will require careful communication to engender taxpayer compliance.

18. Improved public financial management (PFM) is needed to improve fiscal discipline and the quality of spending, based on the PFM roadmap. The authorities are working to address the issues identified during the 2016 PEFA assessment, following their PFM roadmap. Good progress has been made towards improvement in transparency, with the online availability of budget statements (see also paragraph 32). Staff encourages continued focus on PFM reform, given weaknesses remaining to be addressed. Staff recommends:

³ The Pacific Agreement on Closer Economic Relations (PACER) is an umbrella agreement between members of the Pacific Islands Forum plus Australia and New Zealand. The agreement provides a framework for the future development of trade cooperation.

Text Figure 2. Fiscal Policy: Authorities' Baseline and Staff's Suggested Policy Scenario**Overall Balance**

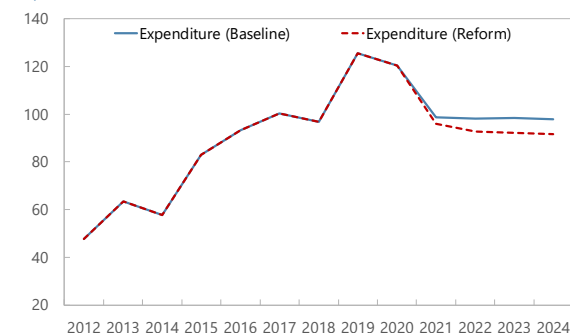
(In percent of GDP)



Sources: IMF staff estimates.

Government Expenditure

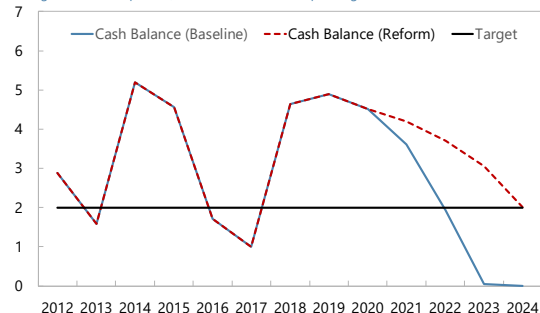
(In percent of GDP)



Sources: IMF staff estimates.

Cash Balance

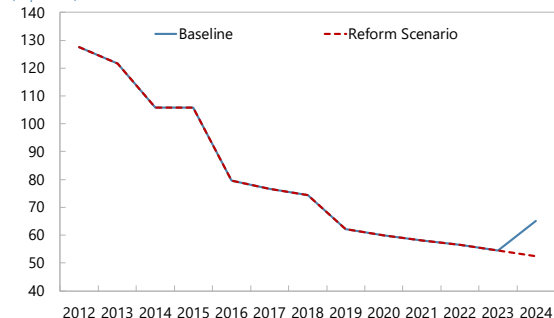
Total government deposits (In months of non-RPC spending)



Sources: IMF staff estimates.

Ratio of Debt to GDP

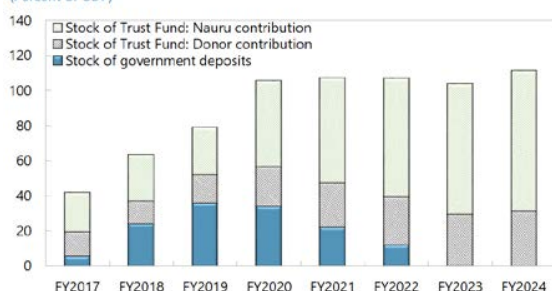
(In percent)



Sources: IMF staff estimates.

Government Deposits (Baseline)

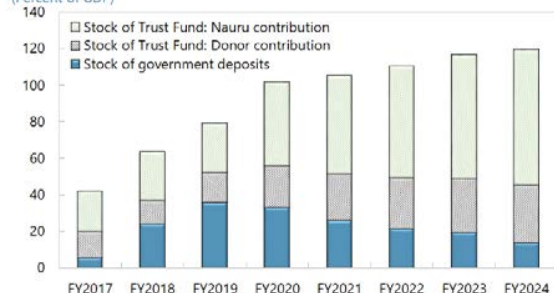
(Percent of GDP)



Sources: Nauru authorities, and IMF staff estimates and projections.

Nauru: Government Deposits (Reform Scenario)

(Percent of GDP)



Sources: Nauru authorities, and IMF staff estimates and projections.

- *Limiting the use of supplementary budgets.* Supplementary budgets have been used excessively, with six issued in FY2018/19 and three so far in FY2019/20 to increase spending of windfall revenues in non-priority areas. Staff encourages the authorities to set aside windfall revenues for appropriation in the normal budget cycle rather than through a supplementary budget process. Windfall revenues should be used to boost resources for carefully planned investment spending.
- *Continuing efforts to reconcile government accounts.* Continued work is needed to reduce the large discrepancies between recorded revenues and expenditures, and government financing data.

- *Phasing out the use of cash for tax and other payments.* While large taxpayers make online tax payments, many smaller tax payers still pay in cash, and government departments are often handling cash. The handling of cash should be phased out to strengthen financial controls, improve accountability, and reduce corruption vulnerabilities.

19. Implementation of the new Public Enterprises Act is a high priority. Poorly performing SOEs absorb large amounts of scarce capital on which they provide low returns and divert government resources from other critical investments.⁴ Performance improvement in the National Utilities Corporation (NUC) demonstrates the benefits of successful SOE reform. Staff welcomes the new Public Enterprises Act (2019), which provides for the establishment of an SOE monitoring committee and requires quarterly financial reporting. The next step will be to implement the Act and ensure that SOEs meet the Act's requirements, particularly regarding submission and publication of audited financial statements, given long-standing gaps in financial reporting.

20. Staff emphasizes sound public debt management, including reconciling and resolving old debts, to ensure debt sustainability and improve Nauru's access to credit markets (Annex IV, DSA). A reasonable resolution of the yen-denominated bonds would remove a large share of total government debt. Reconciliation work to identify amounts owed by SOEs, including outstanding royalty payments to landowners by the Nauru Phosphate Trust Fund and RONPHOS, should be expedited to resolve these debts. Staff assesses public debt as unsustainable under current policies.

Authorities' Views

21. The authorities are committed to maintaining fiscal and debt sustainability. They agreed on the need to adjust spending if RPC revenues were to fall in line with the staff's baseline projection. They noted that tax reform should not push up consumer prices and would seek to preserve government revenue at current levels. Any new taxes should be easy to implement and monitor and would preferably be imposed at the border. The authorities have commenced modernization of taxpayer records and data and welcomed PFTAC assistance in this area. They agreed with staff's recommended target cash buffer and intended to press ahead with public enterprise reform and establish the SOE monitoring unit, in accordance with the new Public Enterprise Act.

FINANCIAL SECTOR

22. Efforts in financial sector reforms are commendable but challenges remain (Box 3). The Bendigo Bank Agency (the "agency"), the sole financial institution and provider of financial services in Nauru, has helped in reestablishing trust in the financial sector, contributing to improvements in financial inclusion and payment services. The agency recently opened its first US correspondent bank

⁴ State Owned Enterprises include: Nauru Utilities Corporation (NUC), Nauru Air Corporation (NAC), Republic of Nauru Phosphate Corporation (RONPHOS), Nauru Rehabilitation Corporation (NRC), Eigigu Holdings Corporation (EHC), Eigigu Solutions Corporation (ESC), Nauru Port Authority (NPA), Cenpac Net Incorporated (internet services), Nauru Phosphate Royalties Trust (NPRT), and others. On average, subsidy over the past 3 years has been \$9m or 5 percent of GDP. However, FY2019 was extraordinary, the government transferred \$9m to SOEs and also borrowed \$7m on behalf of Ronphos.

account and is seeking to open correspondent bank accounts in other major currencies. Efforts to improve financial literacy should continue.

23. Availability of formal credit products is needed to support private sector growth. Staff encourages the authorities to work towards developing new credit legislation, to pave the way for micro-finance loans and potentially other forms of credit such as working capital.

ECONOMIC DIVERSIFICATION, INCLUSIVE GROWTH

24. Significant opportunity exists to diversify the economy and create jobs through private sector development. Steps are needed to streamline business registration requirements, reduce high business visa fees, develop a credit act, and pave the way for the reintroduction of an insurance product. Legislation that reduces incentives for non-citizens to invest should be reviewed and amended if necessary. SOE reform should involve the opening of non-performing SOEs to private sector management or ownership. Over time, overcoming barriers to land use will require solutions that benefit all parties. Staff encourages the authorities to work with the private sector through regularized dialogue to identify measures that can be implemented in the near term to improve the business environment.

25. The business environment will benefit from efforts to improve infrastructure, including the port and undersea cable. Reforms at the Nauru Utility Corporation have improved water and electricity provision, and steady progress is being made on the new port development. A new undersea cable is expected to be in place by 2020/2021, with assistance and funding from development partners. Internet connectivity is especially important given Nauru's remote location and reliance on internet access for financial services provided by the Bendigo Agency. The cable will significantly improve business conditions and opportunities and is expected to also improve the efficiency of public sector service delivery.

26. Land rehabilitation has been limited to date but is needed for long term development. Loss of arable land has increased reliance on imported food, reinforcing a dietary switch to imported food products that has been linked to an increased rate of NCDs. The Nauru Rehabilitation Corporation has rehabilitated 5 hectares of land and has started work on a further 6 hectares to clear land for solar panels. Plans are underway to rehabilitate more land for agriculture.

27. Nauru faces severe health challenges but is taking steps towards improving health outcomes. Nauru has one of the lowest life expectancies in the world due to the high incidence of NCDs. Given limited medical services on the island, many patients suffering from NCDs need overseas medical referrals, weighing heavily on the health budget. Nauru is focusing on primary healthcare improvement, with assistance from development partners, including the digitalization of patient records. Preventative measures have included campaigns to encourage physical activity and improve nutrition through cultivation of household gardens. Staff encourages the authorities to ensure that maintenance issues with hospital buildings are addressed as needed to ensure an appropriate standard for patient care. Health spending should continue to focus on preventive measures, with careful monitoring and evaluation of health-related spending.

28. Renewed effort is needed to improve the quality of education and clearly identify and address underlying causes of low attendance. Nauru provides compulsory free education,

including for early childhood education. Despite this, enrolment rates and attendance have been low. Literacy rates urgently need to be updated, but 2010 data signaled a very low literacy rate of 25 percent for Year 7 pupils (11 years of age).⁵ In an attempt to improve participation, Nauru implemented a school lunch program and daily payments for school attendance, but problems have persisted. Key areas of concern have included high student-teacher ratios, language barriers faced by students with limited English language skills, and deficiencies in teacher qualifications.⁶

29. Plans to continue secondary phosphate mining must be carefully evaluated. An in-principle decision to mine secondary phosphate was made in 2019, and mining equipment has been purchased by RONPHOS. Despite this, staff believes that further mining is economically inefficient given the significant costs attached to secondary phosphate mining in an environment of decreasing phosphate prices, as world supply has increased.

Authorities' Views

30. The authorities expressed broad agreement on the need to improve the business environment to mobilize private investment and diversify the economy. They were keen to remove impediments to doing business and planned to engage the private sector to address concerns. The authorities saw scope for diversification by investing in agriculture to contribute to growth and improve nutrition, but this will require accelerating land rehabilitation. They noted that the new sea port and undersea cable have the potential to support growth and provide new growth opportunities.

GOVERNANCE

31. Governance challenges are significant and are exacerbated by limited public sector capacity. The main governance risks stem from weaknesses in fiscal governance (PFM controls, as discussed in paragraph 18), lack of accountability and monitoring of SOEs, gaps in business legislation (as discussed in paragraph 24), and the AML/CFT framework. These weaknesses result in inefficient management of resources, create vulnerabilities to corruption, and reduce growth. Mitigating governance risks requires improving transparency in key areas and putting in place a robust accountability framework for SOEs. Staff welcomes the “largely compliant” rating from the recent OECD peer review on transparency and exchange of information for tax purposes.

32. Staff welcomes the online publication of fiscal documents. Next steps in the effort to increase fiscal transparency could include publication of the public sector’s assets and liabilities and more timely release of audited financial statements. Continued effort is needed to improve the quality of fiscal data and extend the data coverage from core government to SOEs. The mission encourages a strong focus on enhancing procurement practices and greater transparency on funds disbursed at the district level to ensure access for all citizens to these funds.

33. Nauru is making good progress on its AML/CFT framework. In preparation for the 2022 mutual evaluation, the Financial Investigations Unit (FIU) is undertaking a review of Nauru’s AML/CFT legislation and is working on an information-sharing MOU with Austrac. Amendments to the

⁵ UNICEF 2017 “Situation Analysis of Children in Nauru”.

⁶ Ibid.

Corporations Act, the Business Licenses Act, the Beneficial Ownership Act, the new Trusts Act (October 2018), the Partnership Act, and the Business Names Registration Act (December 2018) will improve transparency and accountability and strengthen investor protection and contract rights.

Authorities' Views

34. The authorities are committed to implementing PFM reforms and are working hard to prepare for the next mutual evaluation. They reiterated their strong commitment to PFM improvements, including necessary improvements to SOE transparency and accountability. The authorities are steadily moving forward with efforts to strengthen the AML/CFT framework, which has involved removing the offshore financial center.

CLIMATE CHANGE RESILIENCE

35. Nauru is actively engaged with development partners on mitigation and adaptation measures. The new port is expected to reduce Nauru's carbon footprint by as much as 30 percent, by reducing the waiting time (and hence fuel consumption) for ships to use the current mooring system. Work is underway with assistance from development partners on solar power generation capacity that will generate as much as 50 percent of Nauru's electricity needs. The government is also moving to cleaner fuels for its vehicles.

36. Staff encourages steps towards integrating climate change plans into economic and development policies. Staff encourages the authorities to cost adaptation plans and integrate them into the budget and medium-term framework, ensure new infrastructure is climate proof, seek donor funds for green projects, and broaden development partner relationships to access funds for agriculture and food security. Transparent budget management would facilitate the mobilization of climate change financing and technical assistance from donors.

STATISTICS AND CAPACITY DEVELOPMENT

37. Gaps in statistics pose a significant challenge for policy development and surveillance. Nauru's Statistics Office remains very small and is currently limited to producing the CPI, with reliance on TA experts to compile national accounts. Data is lacking or outdated in several areas, with shortcomings that significantly hamper surveillance. Staff welcomes plans to implement a household survey, and a business survey, which will provide valuable information for policymaking. In addition, the planned update of the last census, from 2011, will provide important population data. These efforts will need adequate resourcing to be successfully implemented. Staff encourages the authorities to take full advantage of development partner assistance to continue improving the quality and availability of statistics.

38. Capacity development efforts in statistics, revenue, and PFM are well aligned with the National Sustainable Development Strategy (NSDS) and surveillance priorities. Continued progress in these areas would help to achieve the NSDS goals, including fiscally responsible government, enhanced public service provision, and broadening the revenue base of the economy. While the current capacity supplementation is helpful, scope exists for a gradual reduction of supplementation over time. Staff encourages the authorities to continue to develop domestic

capacity with assistance from development partners, underpinned by strong ownership and commitment.

STAFF APPRAISAL

39. Nauru's key economic challenge is to develop new sources of economic activity and income. The economy is in transition, given reduced RPC and phosphate activity. Growth exceeded expectations in 2018, but has been modest in 2019. Preparing for and managing the scaling down in RPC activity is a policy priority. Increased fishing license revenues have provided welcome diversification, but private sector development is hampered by infrastructure and capacity limitations. Staff encourages efforts to re-engage and revitalize private sector development in order to provide for future growth.

40. The authorities need to confront the rising fiscal risks. Revenue is likely to decline significantly over the medium term as around 30 percent of the receipts of the budget are linked to RPC operations. A fiscal adjustment plan is needed to avoid breaching the fiscal anchor, meet the mandatory Trust Fund contributions, and avoid further debt accumulation. Staff recommends maintaining a cash buffer target of two months of non-RPC current spending, to ease day-to-day cash management and provide the flexibility to respond to shocks. The authorities should also redouble efforts to seek a reasonable resolution of the defaulted yen-denominated bonds, which would help put the public debt back on a sustainable path.

41. Fiscal reforms should focus on strengthening revenues and PFM to increase fiscal discipline and lift the quality of spending. A medium-term revenue strategy could provide a governance structure to coordinate tax reforms, engage stakeholders, and foster cooperation among development partners. On public financial management, stronger monitoring and accountability of SOEs is needed to improve performance and reduce reliance on budget transfers. Equally important is strengthening public debt management. Staff encourages the authorities to limit the use of supplementary budgets and set aside windfall revenues for appropriation in the normal budget cycle rather than through a supplementary budget process, to boost resources for carefully planned investment spending.

42. Staff assess Nauru's external position in FY2018 as substantially weaker than implied by medium-term fundamentals and desirable policies. In the absence of monetary and exchange rate policies, Nauru relies on fiscal policy and structural reforms to ensure external sustainability. Maintaining prudent fiscal policy over the medium term would help build-up fiscal buffers and preserve the external balance whereas improving infrastructure would provide some impetus to diversify the export base.

43. Structural reforms will promote inclusive growth, provide opportunity for economic diversification, and mitigate governance and corruption risks. SOE reform should continue to strengthen governance, transparency, and accountability and reduce reliance on budget financing. The return of banking services in Nauru through Bendigo Bank agency has improved financial inclusion. Efforts to strengthen the AML/CFT framework and enhance financial literacy should continue to promote confidence and financial stability. Renewed effort is needed to improve quality of education and health outcomes, including by combating NCDs. Steps should be taken to improve

the ease of doing business. The new seaport and undersea cable have the potential to support growth and provide new growth opportunities.

44. Transparent budget management would catalyze climate change financing and technical assistance from donors. Nauru's mitigation and adaption efforts are commendable, including the new seaport which will reduce Nauru's carbon footprint. However, to strengthen resilience to climate change, the authorities need to fully cost adaptation plans and integrate them into the budget and medium-term framework, ensure new infrastructure is climate proof, and seek donor funds for green projects.

45. Nauru's statistical capacity remains weak, and data suffers from shortcomings that prevent timely analysis and hamper surveillance. Technical assistance will continue to play an important role in strengthening economic statistics.

46. It is recommended that the next Article IV consultation take place on the 24-month cycle.

Box 1. Trust Fund

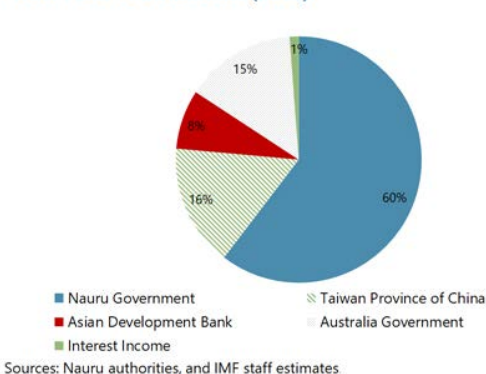
Nauru's intergenerational Trust Fund has been operational for three years. The Trust Fund was established with development partner support to save windfall revenue over the medium term that, through earnings on accumulated funds, will generate revenue over the long term. The Trust Fund is perpetual, and the charter does not provide for withdrawals during the build-up period of 2016–33, unless the Trust Fund Committee determines otherwise.

Australia, Taiwan Province of China, the Asian Development Bank, and the Government of Nauru (GoN) have committed to contribute to the Fund. New Zealand recently became the Trust Fund's newest contributor and will continue its association with the Fund through additional contributions and as a future representative on the Fund's Committee.

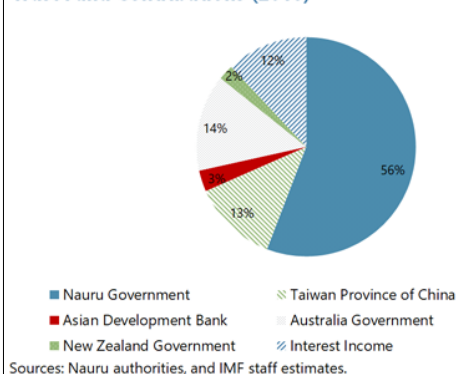
The Trust Fund reached A\$84.4 million (60 percent of GDP) in FY2018, from a starting value of around A\$34 million (25 percent of GDP) in FY2016. Nauru contributed A\$14.8 million to the Trust Fund in FY2016 and made a total contribution of A\$47.1 million as of 30 June 2018. Since the Trust Fund was established, Australia has contributed A\$12.1 million, Taiwan Province of China A\$10.6 million, and New Zealand A\$1.9 million.

Nauru's Trust Fund has reached major milestones. Nauru has joined the International Forum of Sovereign Wealth Funds and has completed a self-assessment of the Trust Fund in line with the Santiago Principles. In addition, the Trust Fund has transitioned to Stage 2 of the investment strategy, broadening its portfolio to include more illiquid assets. In FY2019, the Trust Fund made initial investments into illiquid asset classes, including property and private equity.

Trust Fund Contributions (2016)



Trust Fund Contributions (2018)



Box 2. Nauru's Superannuation Fund

In July 2018 the Government introduced Nauru Super, a defined-contribution superannuation scheme. The Nauru Super Scheme is governed by a Board of Trustees and managed by a New Zealand-based fund manager, Superlife. Payments from Nauru Super will be additional to existing pension payments for individuals over 60 years old. The scheme was originally made available only to Nauruan government employees, including those of SOEs. However, from January 1, 2019, the scheme was expanded to citizens residing in Nauru and government officials posted overseas, and all employers of one or more Nauruan staff. This scheme is not applicable to contract or expatriate employees.

Enrollment in Nauru Super is compulsory, and both employers and employees are required to contribute 5 percent of salaries to the fund. To encourage acceptance of the scheme, the government initially raised salaries by 5 percent, so there would be no change to take-home pay. Employees can make additional contributions to the fund on a voluntary basis at any time, but these will not be matched by the employer. Access to the funds will only be granted at the retirement age of 55 years or more. Currently, the scheme does not include options for life insurance cover or other insurance programs, but these can be evaluated and added at a later stage.

Box 3. Nauru's Financial Sector

The Bendigo Bank Agency (the "agency") is the sole financial institution and provider of financial services. The agency is a special project under the Ministry of Finance and Bendigo and Adelaide Bank Limited of Australia (Bendigo Bank). When it opened in 2015, it was the first bank operation in Nauru in over a decade. As part of Bendigo Bank, the agency falls under Australian bank supervision, and customers hold Australian bank accounts. It is the only Australian agent bank operating outside Australia. The agency recently opened its first U.S. correspondent bank account and is continuing efforts to open correspondent bank accounts in other major currencies. Nauru citizens have access to deposit accounts, ATMs, and internet banking through the agency, but there are currently no available credit or insurance products.

The agency has contributed to improvements in financial inclusion and payment services. The agency has 11,200 accounts, representing close to full account penetration among adults. The agency has installed 11 ATMs, processing up to 36,000 transactions per month. About 9,000 ATM cards have been issued – roughly the same as the number of smart phones in Nauru. Although the economy remains heavily cash-based, greater use is being made of online transaction facilities. For example, most large taxpayers make online tax payments. The agency is starting to install Point of Sale (POS) terminals, which are in strong demand. To help improve financial literacy, the agency is offering deposit accounts to students and is working with development partners on the potential introduction of financial education in schools.

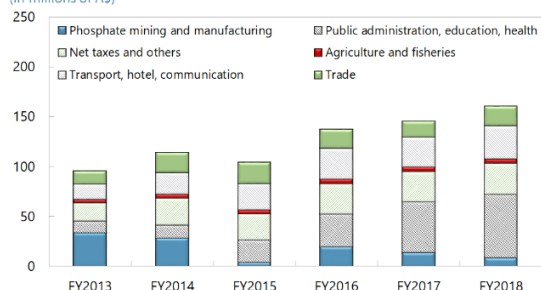
The agency operates in accordance with Australian financial regulation, but it continues to face challenges in transferring funds internationally. The agency adheres to the Australian-standard AML/CFT requirements, and the parent bank in Australia carries out regular internal audits. For example, it implements transaction monitoring by Bendigo's financial crimes department, which is in regular contact with Nauru's Financial Intelligence Unit. Nonetheless, the agency continues to face restrictions imposed by correspondent banks that prevent transferring funds internationally.

Figure 1. Real and External Sector Developments

Economic activity has been driven by trade and service sectors related to the operation of the Regional Processing Center (RPC).

Nominal GDP

(In millions of A\$)

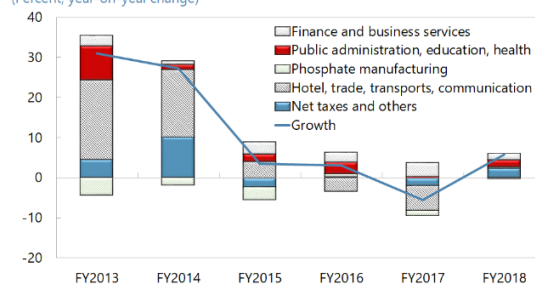


Sources: Nauru authorities, and IMF staff estimates and projections.

The services sectors have replaced the phosphate industry as the main source of growth.

Contribution to Real GDP growth

(Percent, year-on-year change)

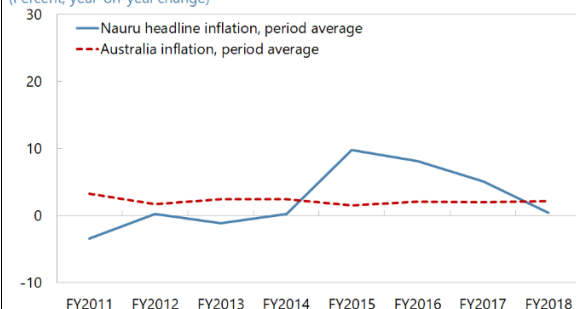


Sources: Nauru authorities, and IMF staff estimates and projections.

Average inflation moderated during FY2017–18, in line with the contracting economy.

Inflation

(Percent, year-on-year change)

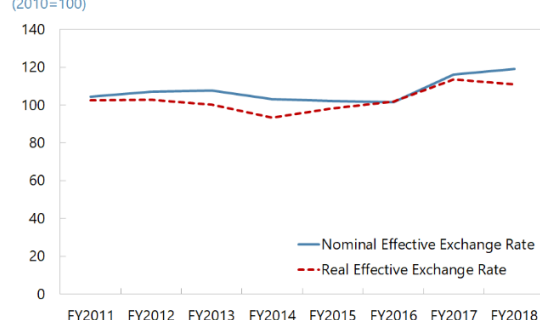


Sources: Nauru authorities, and IMF staff estimates and projections.

As a result, the real effective exchange rate has depreciated somewhat.

Effective Exchange Rates

(2010=100)



Sources: Nauru authorities, and IMF staff estimates and projections.

Phosphate exports have declined significantly, while imports remain strong ...

Exports and Imports

(Percent of GDP)

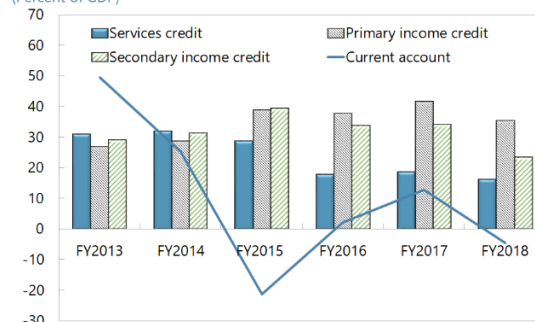


Sources: Nauru authorities, and IMF staff estimates and projections.

... worsening the current account balance although RPC-related inflows and fishing license fees increased.

Current Account

(Percent of GDP)



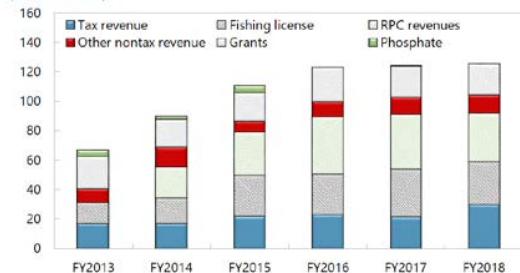
Sources: Nauru authorities, and IMF staff estimates and projections.

Figure 2. Fiscal Sector Developments

Revenues have increased substantially for the past five years ...

Fiscal Revenue

(Percent of GDP)

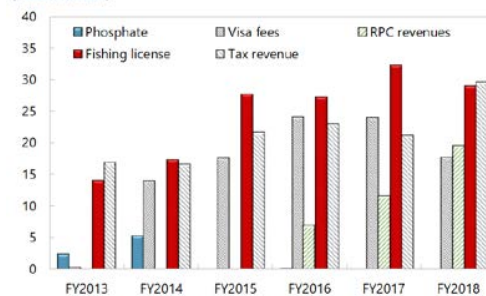


Sources: Nauru authorities, and IMF staff estimates and projections.

... owing to large RPC-related revenues, tax revenue, and fishing license fees, while phosphate-related revenues have reduced.

Major Fiscal Revenue

(Percent of GDP)

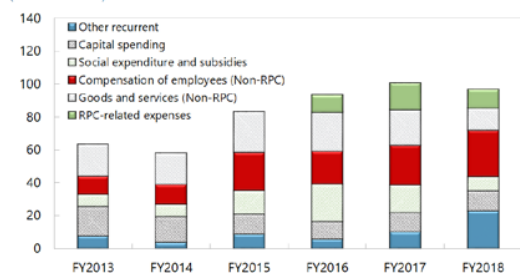


Source: Nauru authorities, and IMF staff estimates and projections.

Government spending has also increased rapidly since FY2015 ...

Fiscal Expenditure

(Percent of GDP)

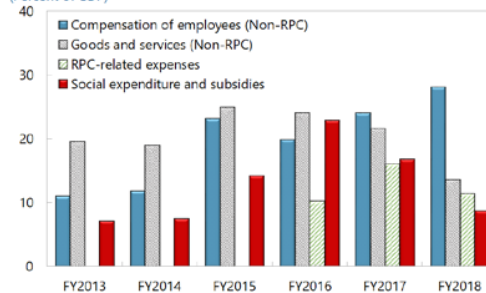


Sources: Nauru authorities, and IMF staff estimates and projections.

... driven by the wage bill, goods and services, and social expenditure.

Major Fiscal Expenditure

(Percent of GDP)

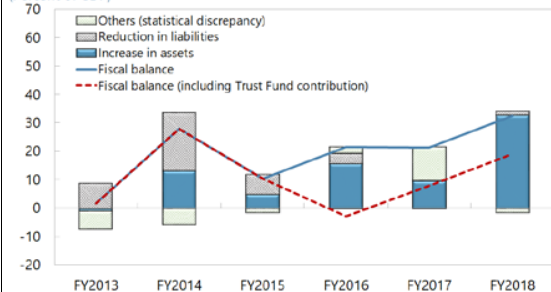


Sources: Nauru authorities, and IMF staff estimates and projections.

Despite large spending increase, the fiscal balance has recorded large surpluses...

Fiscal Balance

(Percent of GDP)

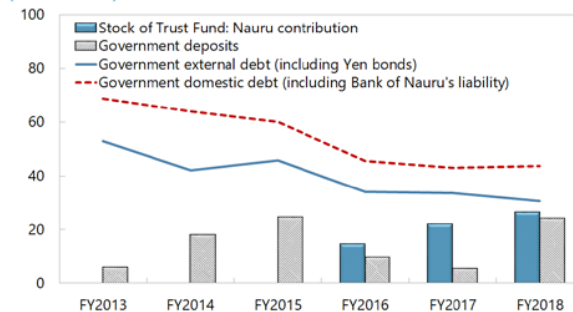


Sources: Nauru authorities, and IMF staff estimates and projections.

... surpluses have been used to build up government deposits and contribute to Nauru trust fund.

Government Deposits and Debt

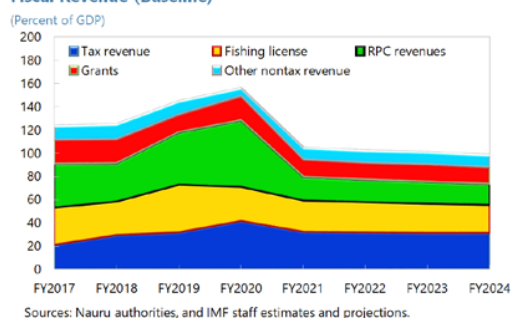
(Percent of GDP)



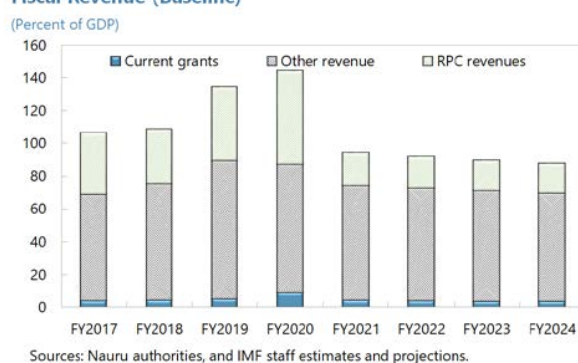
Sources: Nauru authorities, and IMF staff estimates and projections.

Figure 3. Medium-Term Fiscal Outlook

Fiscal revenues are projected decline in the near term and stabilize over the medium term ...

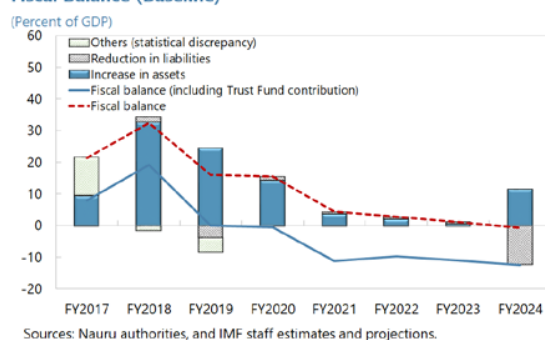
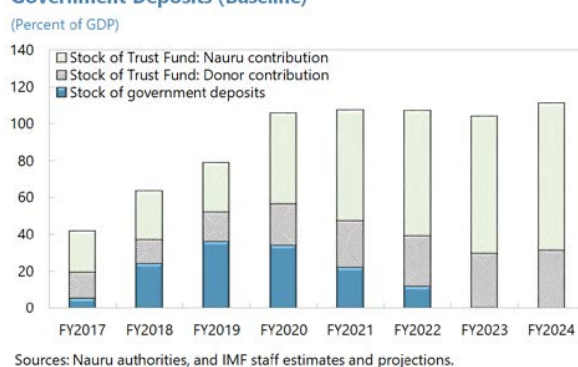
Fiscal Revenue (Baseline)

... Fishing license fees, tax collection, and grants are expected to remain steady over the medium term while RPC revenue declines

Fiscal Revenue (Baseline)

Without spending restraint or additional revenues, the fiscal surplus would be enough to build the trust fund in the near term only...

... and cash buffers would fall below target as early as FY2022.

Fiscal Balance (Baseline)**Government Deposits (Baseline)**

By controlling spending growth from FY2021 onward ...

...the cash buffers could be raised to provide fiscal space and ensure short-term liquidity.

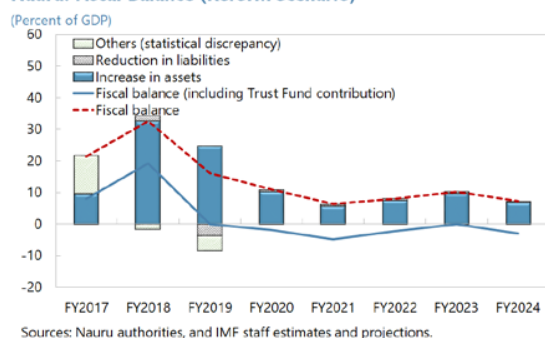
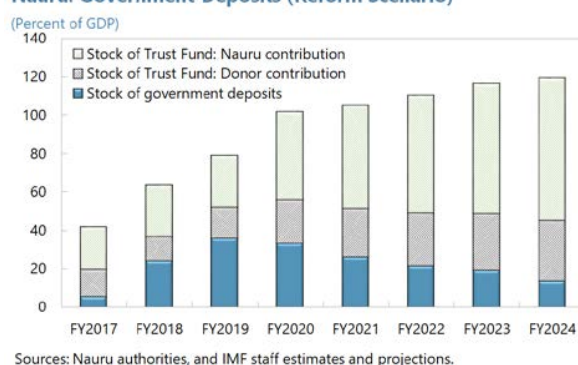
Nauru: Fiscal Balance (Reform Scenario)**Nauru: Government Deposits (Reform Scenario)**

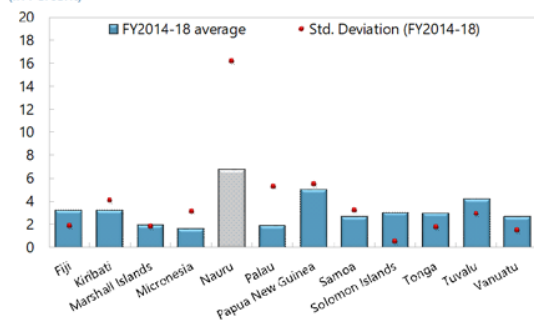
Figure 4. Recent Economic Developments in the Regional Context

Nauru's growth over the past decade was stronger than peers, but it was also the most volatile due to its reliance on just a few sectors.

Nauru's inflation was above the Pacific average mainly due to one-off factors.

Real GDP Growth Rate

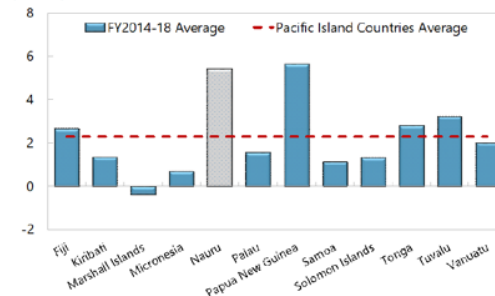
(In Percent)



Sources: IMF World Economic Outlook, and staff estimates.

Inflation

(Percent)



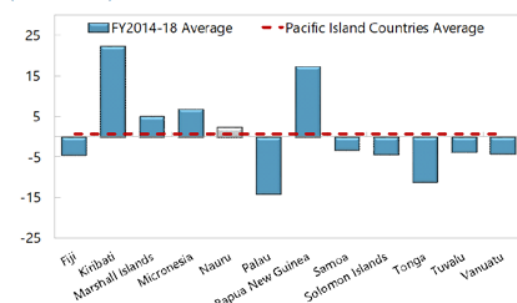
Sources: IMF World Economic Outlook, and staff estimates.

Nauru's current account has been volatile but remains around the Pacific average ...

... but large fiscal surplus have been generated compared to other Pacific Island countries.

Current Account Balance

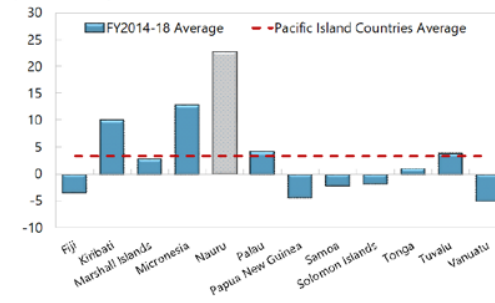
(Percent of GDP)



Sources: IMF World Economic Outlook, and staff estimates.

Fiscal Balance

(Percent of GDP)



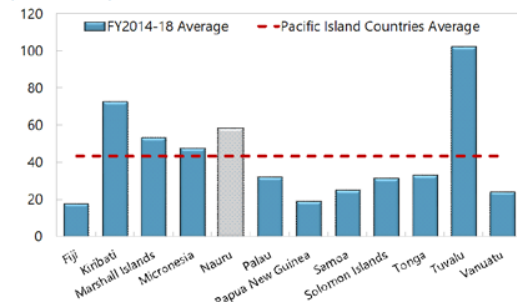
Sources: IMF World Economic Outlook, and staff estimates.

The government current expenditure is slightly above the Pacific average...

...and public debt is relatively high compared to peers, although three quarters of it comprises of longstanding arrears.

Current Expenditure

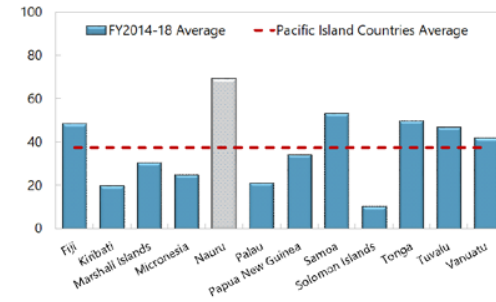
(Percent of GDP)



Sources: IMF World Economic Outlook, and staff estimates.

Public Debt

(Percent of GDP)



Sources: IMF World Economic Outlook, and staff estimates.

Table 1. Nauru: Selected Social and Economic Indicators, FY2015–21 1/

I. Social and Demographic Indicators 2/							
GDP (FY2018 est.) (in millions of Australian dollars)	160.0			Poverty rate	24 percent (2013)		
Per capita GDP (FY2018 est.) (in Australian dollars)	12,120			Life expectancy at birth	60.4 years (2011)		
Population (FY2018 est.)	13,201			Total fertility rate	4.3 births per woman (2011)		
				Infant mortality rate	29.9 per 1,000 live births (2013)		
				Adult literacy rate	96.5 (2011)		
II. Economic Indicators							
	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
				Preliminary		Proj.	
Real sector							
Real GDP growth (percent change)	3.4	3.0	-5.5	5.7	1.0	0.6	1.1
Consumer price index (period average, percent change)	9.8	8.2	5.1	0.5	3.9	2.8	2.3
Population (thousand)	12.5	13.0	13.4	13.2	12.7	12.9	13.2
				(In percent of total)			
Structure of the economy							
Agriculture	2.7	2.9	4.4	3.8	4.7	4.7	4.8
Manufacturing	12.9	22.2	17.2	10.1	7.9	7.7	7.6
Services	72.9	65.8	71.8	77.0	73.7	73.2	72.7
				(In percent of GDP)			
Government finance							
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	135.9	103.2
Revenue	74.5	91.6	100.6	108.5	126.6	114.8	87.9
Grants	19.1	23.3	21.3	20.8	15.1	21.1	15.3
Total expenditure	83.1	93.4	100.5	96.8	125.6	120.5	98.8
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	15.5	4.4
Including Trust Fund contribution	10.5	6.6	13.2	23.2	7.3	2.8	-7.9
Stock of government deposits	24.8	10.1	5.6	24.2	35.7	34.0	22.2
Stock of Trust Fund	...	24.6	39.1	52.8	63.6	80.2	96.1
				(In millions of Australian dollars, unless otherwise indicated)			
Balance of payments							
Current account balance	-22.2	2.8	18.4	-7.3	8.3	-7.1	-8.3
(In percent of GDP)	-21.3	2.0	12.7	-4.6	5.0	-4.1	-4.7
Exports (goods)	24.9	47.8	25.3	15.9	6.0	6.0	6.0
Imports (goods)	82.3	76.7	70.0	81.1	83.8	84.6	84.7
RPC-related inflows	35.8	32.6	42.3	36.5	32.6	22.4	23.4
Capital account balance	4.6	17.0	12.4	8.4	5.0	7.2	6.8
Financial accounts balance and other flows	-17.7	19.8	30.8	1.1	13.3	0.1	-1.4
Government debt indicators							
External debt 3/	47.8	46.8	48.8	49.0	47.4	48.6	49.7
(In percent of GDP)	45.8	34.0	33.6	30.6	28.7	28.5	28.3
Domestic debt 4/	62.6	62.6	62.6	69.9	55.3	53.3	52.3
(In percent of GDP)	60.0	45.5	43.1	43.7	33.5	31.3	29.8
External debt service	2.3	2.2	0.0	2.3	9.8	0.0	0.0
(In percent of exports of goods and services)	4.2	3.1	0.0	5.6	29.9	0.1	0.1
Exchange rates							
Australian dollar per U.S. dollar (period average)	1.20	1.37	1.33	1.29	1.40	...	...
Real Effective Exchange Rate (period average)	98.2	101.7	113.5	111.1	...	...	...
Nominal GDP (in millions of Australian dollars)	104.3	137.5	145.3	160.0	165.3	170.2	175.4
Nominal GNI (in millions of Australian dollars)	142.4	187.0	203.4	214.6	243.5	236.8	241.6
Nominal GNI per capita (in US dollars)	9,551	10,439	11,409	12,605	13,764	...	...

Sources: Nauru authorities and IMF staff estimates and projections.

1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.

2/ The social indicators are taken from United Nations Development Program and Secretariat of the Pacific Community.

3/ Including the defaulted Yen bonds.

4/ Including the estimated government liability related to Bank of Nauru's liquidation.

Table 2. Nauru: Illustrative Medium-Term Baseline Scenario, FY2015–24 1/

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
				Preliminary				Proj.		
Real sector										
Real GDP growth (percent change)	3.4	3.0	-5.5	5.7	1.0	0.6	1.1	1.5	1.8	2.0
Consumer price index (period average, percent change)	9.8	8.2	5.1	0.5	3.9	2.8	2.3	2.0	2.0	2.0
				(In percent of GDP)						
Government finance										
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	135.9	103.2	101.0	99.6	97.1
Total expenditure	83.1	93.4	100.5	96.8	125.6	120.5	98.8	98.2	98.4	97.8
Current expenditure	71.0	82.8	88.7	84.7	108.4	106.6	89.7	89.2	88.6	88.3
Net acquisition of non-financial assets	12.1	10.6	11.8	12.1	6.4	13.9	9.1	9.0	9.8	9.6
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	15.5	4.4	2.8	1.2	-0.7
Including trust fund contribution	10.5	6.6	13.2	23.2	7.3	2.8	-7.9	-6.6	-7.9	-9.6
Stock of government deposits	24.8	10.1	5.6	24.2	35.7	34.0	22.2	11.9	0.3	0.0
Stock of Trust Fund	...	24.6	39.1	52.8	63.6	80.2	96.1	108.9	120.5	131.4
				(In millions of Australian dollars, unless otherwise indicated)						
Balance of payments										
Current account balance	-22.2	2.8	18.4	-7.3	8.3	-7.1	-8.3	-9.0	-9.1	-9.1
(In percent of GDP)	-21.3	2.0	12.7	-4.6	5.0	-4.1	-4.7	-5.0	-4.9	-4.6
Exports (goods)	24.9	47.8	25.3	15.9	6.0	6.0	6.0	6.0	6.0	6.0
Imports (goods)	82.3	76.7	70.0	81.1	83.8	84.6	84.7	85.5	86.0	87.4
Capital account balance	4.6	17.0	12.4	8.4	5.0	7.2	6.8	6.8	7.1	7.1
Financial accounts balance and other flows	-17.7	19.8	30.8	1.1	13.3	0.1	-1.4	-2.2	-2.0	-2.0
Government debt indicators										
External debt 2/	47.8	46.8	48.8	49.0	47.4	48.6	49.7	50.8	52.0	53.1
(In percent of GDP)	45.8	34.0	33.6	30.6	28.7	28.5	28.3	28.1	27.7	27.2
Domestic debt 3/	62.6	62.6	62.6	69.9	55.3	53.3	52.3	51.3	50.3	74.2
(In percent of GDP)	60.0	45.5	43.1	43.7	33.5	31.3	29.8	28.4	26.8	38.0
External debt service	2.3	2.2	0.0	2.3	9.8	0.0	0.0	0.0	0.0	0.0
(In percent of exports of goods and services)	4.2	3.1	0.0	5.6	29.9	0.1	0.1	0.1	0.1	0.0
Exchange rates										
Australian dollar per U.S. dollar (period average)	1.20	1.37	1.33	1.29	...	...	...	...	...	...
Real Effective Exchange Rate (period average, 2010=100)	98.2	101.7	113.5	111.1	...	...	...	...	...	...
Nominal GDP (in millions of Australian dollars)	104.3	137.5	145.3	160.0	165.3	170.2	175.4	180.8	187.9	195.5
Sources: Nauru authorities and IMF staff estimates and projections.										
1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.										
2/ Including the defaulted Yen bonds.										
3/ Including government liability related to Bank of Nauru's liquidation.										

Table 3. Nauru: Balance of Payments, FY2015–24 1/

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
				Preliminary				Proj.		
(In millions of Australian dollars)										
Current account balance	-22.2	2.8	18.4	-7.3	8.3	-7.1	-8.3	-9.0	-9.1	-9.1
Goods (f.o.b.)	-57.5	-29.0	-44.8	-65.2	-77.7	-78.5	-78.7	-79.5	-80.0	-81.4
Credit	24.9	47.8	25.3	15.9	6.0	6.0	6.0	6.0	6.0	6.0
Debit	82.3	76.7	70.0	81.1	83.8	84.6	84.7	85.5	86.0	87.4
Services balance	-19.1	-29.6	-22.7	-20.0	-20.7	-20.7	-19.1	-17.4	-16.3	-16.2
Credit	29.9	24.4	26.8	25.8	26.6	27.4	28.9	30.6	32.5	33.8
Debit	49.0	54.0	49.4	45.8	47.3	48.1	48.0	48.0	48.8	50.1
Primary income balance	38.1	49.5	58.1	54.6	78.2	66.6	66.2	66.9	67.3	66.4
Credit	40.4	51.8	60.3	56.5	79.7	68.1	67.8	68.4	68.8	67.9
Debit	2.3	2.2	2.2	1.9	1.5	1.5	1.5	1.5	1.5	1.5
Secondary income balance	16.2	11.8	27.8	23.3	28.5	25.5	23.3	21.1	19.9	22.2
Credit	40.9	46.1	49.4	37.4	43.0	40.5	38.7	36.3	35.0	37.8
Debit	24.7	34.3	21.7	14.0	14.5	14.9	15.4	15.2	15.0	15.7
Capital account balance	4.6	17.0	12.4	8.4	5.0	7.2	6.8	6.8	7.1	7.1
Credit	4.6	17.0	12.4	8.4	5.0	7.2	6.8	6.8	7.1	7.1
Debit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / borrowing	-17.7	19.8	30.8	1.1	13.3	0.1	-1.4	-2.2	-2.0	-2.0
Financial account balance	-32.5	34.6	25.4	14.6	13.3	0.1	-1.4	-2.2	-2.0	-2.0
Assets	-36.3	38.8	28.2	18.8	24.5	35.9	37.6	34.7	36.5	38.6
Liabilities	-3.8	4.2	2.7	4.2	11.3	35.8	39.0	36.9	38.5	40.6
Errors and omissions	-14.9	14.7	-5.3	13.5	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>										
Nominal GDP	104.3	137.5	145.3	160.0	165.3	170.2	175.4	180.8	187.9	195.5
Current account balance (in percent of GDP)	-21.3	2.0	12.7	-4.6	5.0	-4.1	-4.7	-5.0	-4.9	-4.6
Stock of external assets	41.4	65.6	79.3	138.4	179.4	209.5	222.8	233.7	242.2	272.2
Government deposits	25.9	13.9	8.2	38.8	59.0	57.8	39.0	21.5	0.5	0.0
Trust Fund	...	33.8	56.8	84.4	105.2	136.5	168.6	197.0	226.4	257.0
Others, including donor funds	15.5	18.0	14.3	15.2	15.2	15.2	15.2	15.2	15.2	15.2
Change in external assets	6.0	22.4	13.7	59.0	41.0	30.1	13.3	10.9	8.5	30.1
External debt (in millions of Australian dollars) 2/	47.8	46.8	48.8	49.0	47.4	48.6	49.7	50.8	52.0	53.1
Medium- and long-term debt	40.9	39.9	42.0	42.2	46.4	47.6	48.7	49.8	51.0	52.1
Yen bond	31.2	33.6	35.7	38.2	39.4	40.5	41.6	42.8	43.9	45.0
Informal debt (overdue fees and obligations)	6.9	6.9	6.8	6.8	1.0	1.0	1.0	1.0	1.0	1.0
Short term debt (trade credit)	4.3	6.1	7.9	7.1	7.1	7.1	7.1	7.1	7.1	7.1
External debt service	2.3	2.2	0.0	2.3	9.8	0.0	0.0	0.0	0.0	0.0
Principal	1.5	1.9	0.0	2.1	9.8	0.0	0.0	0.0	0.0	0.0
Interest	0.8	0.4	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
International Investment Position	76.6	102.9	128.4	147.1	182.7	212.6	243.6	273.5	304.8	337.5
Assets	128.8	157.5	185.2	203.2	237.3	268.3	300.5	331.5	364.0	397.8
Liabilities	52.2	54.7	56.8	56.2	54.6	55.7	56.9	58.0	59.1	60.3

Sources: Nauru authorities and IMF staff estimates and projections.

1/ The fiscal year ends in June.

2/ Including the defaulted Yen bonds.

Table 4. Nauru: Central Government Operations, FY2015–24 1/

	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
				Preliminary	Budget	Proj.		Proj.		
(In millions of Australian dollars)										
Total revenue and grants	97.6	157.9	177.1	206.8	234.2	229.2	231.4	180.9	182.6	187.2
Revenue	77.7	126.0	146.2	173.6	209.3	198.9	195.4	154.1	155.8	158.3
Of which: RPC revenue 2/	30.7	53.8	54.3	52.6	74.4	...	96.3	34.7	34.5	34.4
Tax revenue	22.6	31.6	30.8	47.4	53.5	72.2	71.2	57.1	58.3	60.0
Nontax revenue	55.1	94.4	115.3	126.2	155.7	126.8	124.2	97.0	97.5	98.3
Of which: Fishing license fees	28.9	37.4	46.9	46.4	67.2	50.5	50.4	47.7	47.3	47.3
Visa fees	18.4	33.1	34.8	28.4	18.2	11.2	6.8	6.8	6.8	6.8
Other RPC revenue	...	9.7	16.9	31.3	51.6	55.7	55.7	24.5	24.5	24.5
Others	7.8	14.2	16.7	20.2	18.7	9.4	11.4	17.9	18.8	19.7
Grants	19.9	32.0	30.9	33.3	24.9	30.3	36.0	26.8	26.8	28.9
Budget support (current)	7.3	4.4	6.1	7.3	8.7	15.9	15.9	8.1	7.9	7.7
Development fund (capital)	12.6	14.6	17.2	19.3	10.6	14.4	14.4	13.0	13.2	15.5
Trust fund: Donor contribution	...	13.0	7.6	6.6	5.7	...	5.7	5.7	5.7	5.7
Expenditure	86.7	128.5	146.0	154.8	207.6	201.5	205.0	173.2	177.6	184.9
Expenses	74.1	113.8	128.9	135.5	179.3	177.9	181.4	157.2	161.4	166.5
Of which: Non-RPC expenses	68.1	97.2	98.4	100.4	144.5	...	153.6	129.6	133.9	138.2
Compensation of employees	24.2	33.9	50.4	57.3	71.6	67.8	68.4	70.6	73.0	76.0
Goods and services	26.0	40.8	39.6	27.9	28.2	28.9	29.1	30.6	32.2	34.1
Social expenditure	11.7	20.5	16.5	10.3	10.9	8.8	8.8	9.0	9.3	9.7
Subsidies and donations	3.2	11.0	8.1	3.8	14.2	19.0	19.0	13.9	13.6	13.5
Capital transfer	...	...	...	...	8.9	5.4	8.4	3.0	3.0	3.0
Other	8.9	7.6	14.3	36.3	45.4	48.1	47.7	30.1	30.3	30.3
Net acquisition of non-financial assets	12.6	14.6	17.2	19.3	28.3	23.6	23.6	16.0	16.2	18.5
Donor financed	12.6	14.6	17.2	19.3	10.6	14.4	14.4	13.0	13.2	15.5
Government capital expenditure	...	...	...	...	17.7	9.2	9.2	3.0	3.0	3.0
Net lending (+) / borrowing (-)	10.9	29.5	31.1	52.0	26.6	27.7	26.4	7.7	5.0	2.2
Including Nauru trust fund contribution	10.9	9.1	19.1	37.2	12.1	6.1	4.7	-13.8	-12.0	-14.9
Net financing	10.9	29.5	31.1	52.0	26.6	27.7	26.4	7.7	5.0	2.2
Net acquisition of financial assets	5.1	21.4	13.9	51.9	40.5	25.7	24.4	6.7	4.0	1.2
Changes in government deposit	5.1	-12.0	-5.7	30.6	20.2	4.1	-3.0	-20.5	-18.7	-21.6
Trust fund: Nauru contribution	0.0	20.4	11.9	14.8	14.6	21.6	21.6	21.5	17.0	17.1
Trust fund: Donor contribution	...	13.0	7.6	6.6	5.7	...	5.7	5.7	5.7	5.7
Net incurrence of financial liabilities	-7.4	-5.0	0.0	-2.6	6.1	-2.0	-2.0	-1.0	-1.0	-1.0
Statistical discrepancy	-1.6	3.1	17.2	-2.6	-7.8	0.0	0.0	0.0	0.0	0.0
(In percent of GDP)										
Total revenue and grants	93.5	114.9	121.8	129.3	141.7	134.7	135.9	103.2	101.0	99.6
Revenue	74.5	91.6	100.6	108.5	126.6	116.9	114.8	87.9	86.1	84.3
Of which: RPC revenue 2/	29.4	39.2	37.3	32.9	45.0	...	56.6	19.8	19.1	18.3
Tax revenue	21.7	23.0	21.2	29.6	32.4	42.4	41.8	32.6	32.2	31.9
Nontax revenue	52.8	68.7	79.4	78.9	94.2	74.5	73.0	55.3	53.9	52.3
Grants	19.1	23.3	21.3	20.8	15.1	17.8	21.1	15.3	14.8	15.4
Expenditure	83.1	93.4	100.5	96.8	125.6	118.4	120.5	98.8	98.2	98.4
Expenses	71.0	82.8	88.7	84.7	108.4	104.5	106.6	89.7	89.2	88.6
Of which: Non-RPC expenses	65.3	70.7	67.7	62.7	87.4	...	90.2	73.9	74.1	73.6
Compensation of employees	23.2	24.7	34.7	35.8	43.3	39.9	40.2	40.3	40.4	40.5
Goods and services	25.0	29.7	27.3	17.4	17.1	17.0	17.1	17.5	17.8	18.2
Social expenditure	11.2	14.9	11.3	6.4	6.6	5.1	5.1	5.1	5.1	5.1
Subsidies and donations	3.1	8.0	5.6	2.3	8.6	11.2	11.2	7.9	7.5	7.2
Capital transfer	0.0	0.0	0.0	0.0	5.4	3.2	4.9	1.7	1.7	1.6
Other	8.5	5.5	9.8	22.7	27.4	28.3	28.0	17.2	16.7	16.1
Net acquisition of non-financial assets	12.1	10.6	11.8	12.1	6.4	13.9	13.9	9.1	9.0	9.8
Net lending (+) / borrowing (-)	10.5	21.4	21.4	32.5	16.1	16.3	15.5	4.4	2.8	1.2
Including trust fund contribution	10.5	6.6	13.2	23.2	7.3	3.6	2.8	-7.9	-6.6	-7.9
Net acquisition of financial assets	4.9	15.6	9.5	32.5	24.5	15.1	14.3	3.8	2.2	0.7
Changes in government deposit	4.9	-8.7	-3.9	19.1	12.2	2.4	-1.7	-11.7	-10.3	-11.5
Trust Fund: Nauru contribution	0.0	14.8	8.2	9.2	8.8	12.7	12.7	12.3	9.4	9.1
Trust Fund: Donor contribution	...	9.4	5.2	4.1	...	...	3.3	3.3	3.2	3.0
Net incurrence of financial liabilities	-7.1	-3.6	0.0	-1.6	3.7	-1.2	-1.2	-0.6	-0.6	-0.5
Statistical discrepancy	-1.5	2.2	11.8	-1.6	-4.7	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP (in millions of Australian dollars)	104.3	137.5	145.3	160.0	165.3	170.2	170.2	175.4	180.8	187.9
RPC balance (in percent of GDP) 3/	23.7	27.1	16.4	10.9	38.0	...	40.2	4.0	3.9	3.3
Non-RPC balance (in percent of GDP) 4/	-13	-22.1	-11.8	-2.1	-31.8	...	-55.4	-15.2	-16.2	-16.6
Stock of government deposit (includes cash buffer)	25.9	13.9	8.2	38.8	59.0	...	57.8	39.0	21.5	0.5
In percent of GDP	24.8	10.1	5.6	24.2	35.7	...	34.0	22.2	11.9	0.3
In months of non-RPC current spending 5/	4.6	1.7	1.0	4.6	4.9	...	4.5	3.6	1.9	0.0
Cash buffer in Australian dollars	...	...	...	3.6	11.1	...	25.6	21.6	11.2	0.0
Cash buffer in months of non-RPC spending	...	...	...	0.4	0.9	...	2.0	2.0	1.0	0.0
Stock of Trust Fund	...	33.8	56.8	84.4	105.2	...	136.5	168.6	197.0	226.4
In percent of GDP	...	24.6	39.1	52.8	63.6	...	80.2	96.1	108.9	120.5
Stock of government debt (percent of GDP) 6/	105.8	79.6	76.7	74.3	62.1	...	59.9	58.2	56.5	54.4
External debt	45.8	34.0	33.6	30.6	28.7	...	28.5	28.3	28.1	27.7
Domestic debt	60.0	45.5	43.1	43.7	33.5	...	31.3	29.8	28.4	26.8

Sources: Nauru authorities and IMF staff estimates and projections.

1/ The fiscal year ends in June.

2/ Excluding reimbursement for RPC expenses.

3/ Includes only revenue and expense items directly related to RPC.

4/ Non-RPC revenue plus current grants or budget support minus non-RPC expenses.

5/ In FY2024, the stock of government deposit would have been -2.1 months of non-RPC current spending in the absence of the government borrowing A\$24.9 million to finance the cash shortfall.

6/ Including the defaulted Yen bond and the government's liability to Bank of Nauru's liquidation.

Annex I. Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
<p>Fiscal Policy Ensure fiscal liquidity and sustainability by maintaining adequate cash buffers and contributing to the trust fund.</p> <p>Implement tax and public financial management reforms to control spending and support the fiscal adjustment.</p> <p>Strengthen public debt management to ensure fiscal and debt sustainability.</p>	<p>The fiscal surplus is estimated at 16.1 percent of GDP in FY 2019. Surpluses have been used to contribute to the Trust Fund, build government deposits, and reduce arrears. In FY2019 government deposits increased to 35.7 percent of GDP, and the Trust Fund to 64 percent of GDP (A\$105.2 million). Further efforts are needed to better prioritize expenditures in line with the National Development Strategy.</p> <p>The authorities have introduced an employment and services tax and a business profit tax and have made improvements in customs and tax administration. Plans are underway to introduce a consumption tax. The tax reforms increased tax revenues, though not at a level sufficient to offset the projected decline in RPC revenue. Further efforts are needed to better prioritize expenditures. Fiscal transparency has improved with budget documents now published online.</p> <p>Debt remains high. The authorities are reconciling old debts and seeking a resolution with creditors on the yen bonds.</p>
<p>Structural Reforms Implement structural reforms that would promote inclusive growth, economic diversification, and private sector development. Priorities include rebuilding the seaport and energy infrastructure, reforming state-owned enterprises, developing the financial sector, and addressing health-related challenges.</p>	<p>Construction of the new seaport is expected began in early 2019, co-financed by the government, the ADB, Australia, and the Green Climate Fund. On SOE reform, the utility corporation has so far managed to produce and distribute power without losses in FY2018 and FY2019, eliminating the need for budgetary producer subsidies. However, monitoring and governance of state-owned enterprises remain a challenge due to lack of financial statements Work on strengthening the AML framework is progressing and there have been impressive gains in financial inclusion through Bendigo bank. Steps have been taken to improve health outcomes by focusing on primary healthcare improvement, with assistance from development partners, including the digitalization of patient records; and adopting preventive measures.</p>
<p>Climate Policies Develop a fiscal policy framework that would enhance economic resilience by integrating climate change strategies in budget planning.</p>	<p>Nauru is actively engaged with development partners on mitigation and adaptations measures. However, progress in integrating climate change strategy into budget planning is lagging due to capacity constraints and lack of coordination between agencies.</p>

Annex II. External Sector Assessment¹

Assessment: Staff assess Nauru's external position in FY2018 as substantially weaker than medium-term fundamentals and desirable policies. However, the uncertainty around this assessment is high, given that the analysis is hampered by data limitations and the high volatility of external inflows.

Approach to assessment: Nauru's current account developments are mostly driven by exogenous factors: RPC operations, fishing license fees, operational capacity of the seaport, and donor inflows. Given the volatility of some of these factors and data limitations, it is difficult to assess Nauru's external sector under EBA-Lite methodologies. The assessment is mostly factual, and only the EBA-Lite current account methodology is applied with some assumptions.

Goods and services balance: Nauru's historical trade balance has been influenced primarily by phosphate exports. Given the dwindling phosphate production and continued dependence on imports, the goods and services deficit worsened to 53 percent of GDP (7 percent of GDP increase) in FY2018 compared to FY2017. Estimates indicate a further decline in phosphate exports in FY2019, resulting in a widening of the goods and services deficit. The deficit is expected to average around 54 percent of GDP over the medium term, amidst uncertainties surrounding secondary phosphate mining.

Other flows: The trade deficit has been financed by large surpluses in the income account. In FY2018, the income account balance declined to 48.7 percent of GDP (10 percentage points of GDP decline), driven by a drop in RPC revenues. In FY2019, the decline in RPC revenues is estimated to have been offset by a 12 percent of GDP increase in fishing revenue resulting in a spike in the income account balance to 64 percent of GDP. Nonetheless, this is expected to drop to an average of 50 percent of GDP over the medium term given the expected scaling down of RPC operations and normalizing fishing revenues.

Current account: The current account recorded a deficit of 4.6 percent of GDP in FY2018, which is weaker than fundamentals based on the EBA-Lite current account model. The cyclically adjusted current account deficit of 3.7 percent of GDP is assessed against a cyclically adjusted current account balance norm of 7.1 percent of GDP, resulting in a current account gap of -10.8 percent of GDP. Nonetheless, the current account balance is estimated to have turned around in FY2019 to a surplus of 5 percent of GDP.

REER: Nauru's main current transactions are not significantly affected by REER fluctuations, including phosphate exports and RPC operations. Moreover, import dependence is high. As a result, the REER plays a limited role in achieving external balance. The EBA-Lite REER model could not be used for the assessment given data limitations. Although Nauru's NEER appreciated in FY2018 in line with the appreciation of the Australian dollar against the US, the REER depreciated in line with the moderation in inflation.

External sustainability: In the absence of monetary and exchange rate policies, Nauru relies on fiscal policy and structural reforms to ensure external sustainability. Nauru's recent strong fiscal performance with a corresponding build-up in government deposits has supported external sustainability. While the trust fund accumulation (contributing to large positive IIP) also promotes external sustainability, it cannot be drawn from until FY2033. Under staff's baseline scenario, the current account is expected to remain in a deficit of about 4 percent of GDP on average over the medium term due to collapsing phosphate exports, declining RPC income and normalizing fishing revenue. In addition, the worsening fiscal position poses a risk to external sustainability. A fiscal adjustment would provide some cushion to Nauru's external sustainability (the current account deficit improves to about 3.6 percent of GDP on average in the medium term in the

¹ Prepared by Reshika Singh.

adjustment scenario); although not enough to offset the pressures from slowing RPC operations and a halt in phosphate production. Nauru's competitiveness is constrained by several factors: a limited exports base, infrastructure bottlenecks, remoteness, and high transport costs. The country is also vulnerable to global commodity prices due to its heavy reliance on imported goods. The EBA-lite external sustainability approach could not be used due to data limitations.

Policies: Maintaining prudent fiscal policy over the medium term would help build-up fiscal buffers and preserve the external balance. Also, resolving long-standing arrears associated with the yen bond remains key to maintaining external debt sustainability and improving Nauru's reputation in external credit markets. Prudent management of the loan from Taiwan POC taken on behalf of the Nauru Phosphate Corporation (Ronphos) to fund the purchase of equipment for secondary phosphate mining is critical. Future borrowings on behalf of SOEs should be discouraged to minimize risks to external debt sustainability. Improvements in the seaport and power infrastructure may provide some impetus for improvements in the export base. But these efforts would need to be complemented by (i) state-owned enterprise reform, which is critical to improving competitiveness, (ii) promotion of private sector development, and (iii) policies to safeguard fiscal sustainability.

The use of the Australian dollar as the legal tender remains appropriate. It provides a nominal anchor. In view of the close linkages with Australia, limited institutional capacity, and a small economic size, the costs of running an independent monetary institution are likely to be significantly higher than the benefits.

Annex III. Risk Assessment Matrix 1/

Likelihood and Sources of Risks	Expected Impact if Risk is Realized (high, medium or low)	Policy Recommendations
Medium Changes in the Australian policy on the Regional Processing Center (RPC) in Nauru.	High Policy changes that lead to more rapid RPC scaling down would reduce growth and fiscal revenue.	Maintain prudent fiscal policy and build sufficient fiscal buffers to minimize the adverse impact on growth and mobilize donor support if needed.
Medium High and volatile commodity prices	High Volatile global commodity prices could result in sharp swings in inflation. Higher commodity prices would weaken the external position due to higher imports that would widen the trade balance and dampen consumption and investment. On the flipside, while low commodity prices could benefit Nauru as a net importer, fishing revenue could be affected, with adverse impacts on the budget and the current account balance.	Expand efforts to diversify the export base.
Medium Delays in fiscal reform	High Delays in implementing tax and public financial management reforms would jeopardize fiscal sustainability.	Seek technical assistance from donors and monitor the reform progress on a regular basis in consultation with development partners.
Medium Delays in implementing structural reforms.	High Delays in implementing infrastructure projects and reforming state-owned enterprises would lower growth prospect and threaten fiscal sustainability.	Work with development partners to prioritize the reform agenda, strengthen project selection and implementation, and improve the business climate to stimulate private sector development.
Medium/low Higher frequency and severity of natural disasters	High Extreme weather conditions could damage the seaport and other infrastructure, hampering trade and growth. Climate change could also lead to relocation of the tuna stock, reducing revenues from fishing license. Coping with climate change effects would further strain the budget.	Enhance ex-ante adaptation measures (improving infrastructure, fiscal buffers, and planning) and seek global/regional climate change financing opportunities.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Nonmutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex IV. Debt Sustainability Analysis¹

Staff assess debt as unsustainable under current policies. Sound fiscal and public debt management policies and policies to generate and diversify economic activity would help ensure debt sustainability and improve Nauru's access to credit markets.

1. Total public debt is estimated at 86.8 percent of GDP (A\$138.8 million) in FY2018 and is mostly denominated in local currency. External public debt is estimated at A\$49 million (30.6 percent of GDP) comprising mostly of the defaulted yen bonds (A\$38.2 million), loans from the EXIM bank (A\$3.9 million), and miscellaneous debt that includes overdue membership obligations to international organizations (A\$6.8 million).² Domestic public debt is estimated at A\$69.9 million (43.7% of GDP), made up of long-standing arrears from the Bank of Nauru liquidation and from the Nauru Phosphate Corporation (RONPHOS).³ The total debt stock includes an estimate for SOE debt, of which a significant portion is for financing secondary phosphate mining and also includes legacy debt relating to the Nauru Phosphate Royalty Trust (totaling A\$21 million).

2. Public debt remains very high and is assessed as unsustainable under existing policies. Under the baseline scenario, the public debt-to-GDP ratio is expected to decline temporarily as the government runs down deposits. Once these deposits are depleted, public debt is projected to begin rising sharply from already high levels. Given this and the government's existing arrears, debt is considered unsustainable under current policies. Although Nauru has accumulated a large amount of assets in the Trust Fund (around 64 percent of GDP), these cannot be withdrawn or used as a buffer to mitigate the high level of debt.⁴ The level of debt is vulnerable to the RPC scaling down, lower than expected fishing revenues, and increased commodity prices.

3. The standardized alternative scenarios show improving debt dynamics. Debt would fall to a more sustainable level of 38.9 percent of GDP by 2024 if real GDP growth, the primary balance, and real interest rates are set to their ten-year historical average. If the primary balance is set at the projected 2019 level for the entire projection period, public debt would fall but still hover at around 60 percent of GDP by 2024. However, attaining the improved dynamics is highly unlikely over the medium term as the key macro indicators in the alternative scenarios reflect a period of unusually strong economic activity with phosphate mining and exports at a peak.

¹¹ Prepared by Ananya Shukla and Medha Madhu Nair. The MAC DSA is used because Nauru is upper middle income although it does not have market access.

² The bonds of about A\$16 million face value were issued in Japan in the late 1980s but were subsequently defaulted and sold in the market in the mid-1990s. The estimated current value is subject to negotiations.

³ Domestic public debt does not include the SOE debt numbers and unconsolidated debt relating to NPRT. The SOE debt numbers were calculated separately and added to the total debt stock.

⁴ The trust fund is perpetual, the charter does not provide for withdrawals in the short run or in the forecast horizon and hence, has little or no bearing on improving the debt trajectory.

4. Sound fiscal and public debt management policies to generate and diversify economic activity would help promote debt sustainability. Maintaining prudent fiscal policies and diversifying sources of revenue will remain critical in promoting fiscal and debt sustainability. Debt falls to 66.4 percent of GDP in 2024 under a proposed fiscal adjustment scenario. Under this scenario, staff proposes reducing expenditure by 5 percent of GDP and increasing revenue by 1 percent of GDP on average over the medium term, compared to baseline. These measures would yield a reduction of about \$25 million in borrowing in 2024 compared to the baseline. The public debt path would nonetheless remain vulnerable to large shocks, especially to GDP growth, as shown in the stress tests.

5. Reducing long-standing arrears and improving accounts transparency remains critical in building credibility and expanding access to international credit markets. A significant amount of Nauru's debt is in the form of old debt or arrears. Ongoing negotiation with the yen bond holders and consolidation of the liabilities associated with the Bank of Nauru should be expedited to resolve these debts. Identifying amounts owed by SOEs, including outstanding royalty payments to landowners by the Nauru Phosphate Trust Fund and RONPHOS, is critical for a full consolidation of debt obligations and to adequately budget for repayments.

Authorities Views'

6. The authorities broadly agreed with the staff's assessment on debt. They expressed their commitment to a prudent fiscal policy stance. The authorities acknowledge that continuing on the same trajectory could prove harmful to the economy and have agreed to take steps to reign in the debt levels, especially with respect to increasing debt taken on by SOEs. The authorities also highlighted the role of financial support from bilateral and multilateral donors in meeting infrastructure needs.

Table 1. Nauru: External Debt Sustainability Framework 2014–2024
(In percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing non-interest current account 6/
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024		
Baseline: External debt	420	45.8	34.0	33.6	30.6	34.6	34.3	33.8	33.2	32.5	31.8	2.5	
Change in external debt	-10.8	3.8	-11.8	-0.4	-3.0	4.0	-0.3	-0.5	-0.5	-0.8	-0.7		
Identified external debt-creating flows (4+8+9)	-93.5	33.4	-5.2	-15.2	1.6	-2.8	5.6	6.7	6.8	6.8	7.0		
Current account deficit, excluding interest payments	-25.9	20.6	-2.3	-12.7	4.4	-5.0	3.0	4.1	4.0	3.8	3.8		
Deficit in balance of goods and services	13.8	73.4	42.6	46.4	53.3	59.3	58.1	55.9	53.8	51.4	50.1		
Exports	79.2	52.5	52.5	35.8	26.0	20.0	19.9	20.1	20.4	20.7	20.6		
Imports	92.9	125.9	95.1	82.2	79.3	79.3	77.9	76.1	74.2	72.1	70.6		
Net non-debt creating capital inflows (negative)	-64.9	3.5	2.8	0.4	1.0	2.3	2.6	2.9	3.2	3.5	3.8		
Automatic debt dynamics 1/	-2.6	9.3	-5.6	-2.9	-3.8	-0.1	0.1	-0.3	-0.4	-0.5	-0.6		
Contribution from nominal interest rate	0.7	0.8	0.3	0.0	0.1	0.3	0.3	0.1	0.1	0.1	0.0		
Contribution from real GDP growth	-13.5	-1.7	-1.2	1.7	-1.7	-0.3	-0.2	-0.4	-0.5	-0.6	-0.6		
Contribution from price and exchange rate changes 2/	10.2	10.3	-4.7	-4.7	-2.2	...	...	...	...	...	...
Residual, ind. change in gross foreign assets (2-3) 3/	82.6	-29.6	-6.6	14.8	-4.6	6.8	-6.0	-7.2	-7.4	-7.6	-7.6		
External debt-to-exports ratio (in percent)	53.1	87.3	64.8	93.9	117.7	173.0	172.4	167.7	162.8	157.0	154.7		
Gross external financing need (in billions of US dollars) 4/	-0.02	0.02	0.00	-0.01	0.01	-0.01	0.00	0.01	0.01	0.01	0.01		
In percent of GDP	-22.1	23.5	-0.4	-12.7	6.1	10-Year	10-Year	10-Year	10-Year	10-Year	10-Year		
						-0.01	0.00	0.01	0.01	0.01	0.01		
						-4.5	3.5	4.4	4.3	4.2	3.8		
Scenario with key variables at their historical averages 5/						34.6	-1.7	-33.8	-61.8	-86.0	-107.1	11.1	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Nominal GDP (US dollars)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1		
Real GDP growth (in percent)	27.2	3.4	3.0	-5.5	5.7	10.6	11.0	1.0	0.6	1.1	1.5		
GDP deflator in US dollars (change in percent)	-16.2	-19.7	11.4	15.8	7.1	4.0	19.2	-5.6	0.3	2.0	1.5		
Nominal external interest rate (in percent)	1.4	1.5	0.7	0.0	0.5	1.6	1.0	0.8	0.3	0.3	0.3		
Growth of exports (US dollar terms, in percent)	-6.0	-45.0	14.9	-25.4	-17.8	5.6	38.8	-26.7	0.3	4.5	5.3		
Growth of imports (US dollar terms, in percent)	31.5	12.5	-13.3	-5.4	9.2	17.1	33.2	-4.6	-0.8	0.6	0.5		
Current account balance, excluding interest payments	25.9	-20.6	2.3	12.7	-4.4	25.6	28.2	5.0	-3.0	-4.1	-4.0		
Net non-debt creating capital inflows	64.9	-3.5	-2.8	-0.4	-1.0	1.5	22.6	-2.3	-2.6	-2.9	-3.2		
1/ Derived as $(1 - g - r(1+g))/(1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic currency denominated debt in total external debt.													
2/ The contribution from price and exchange rate changes is defined as $(r(1+g) + e a(1+g))/(1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).													
3/ For projection, line includes the impact of price and exchange rate changes.													
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.													
5/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.													
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.													

1/ Derived as $(I - g - r(1+g))/(1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate.

e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+g)/(1+g+r+gr)]$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$), and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

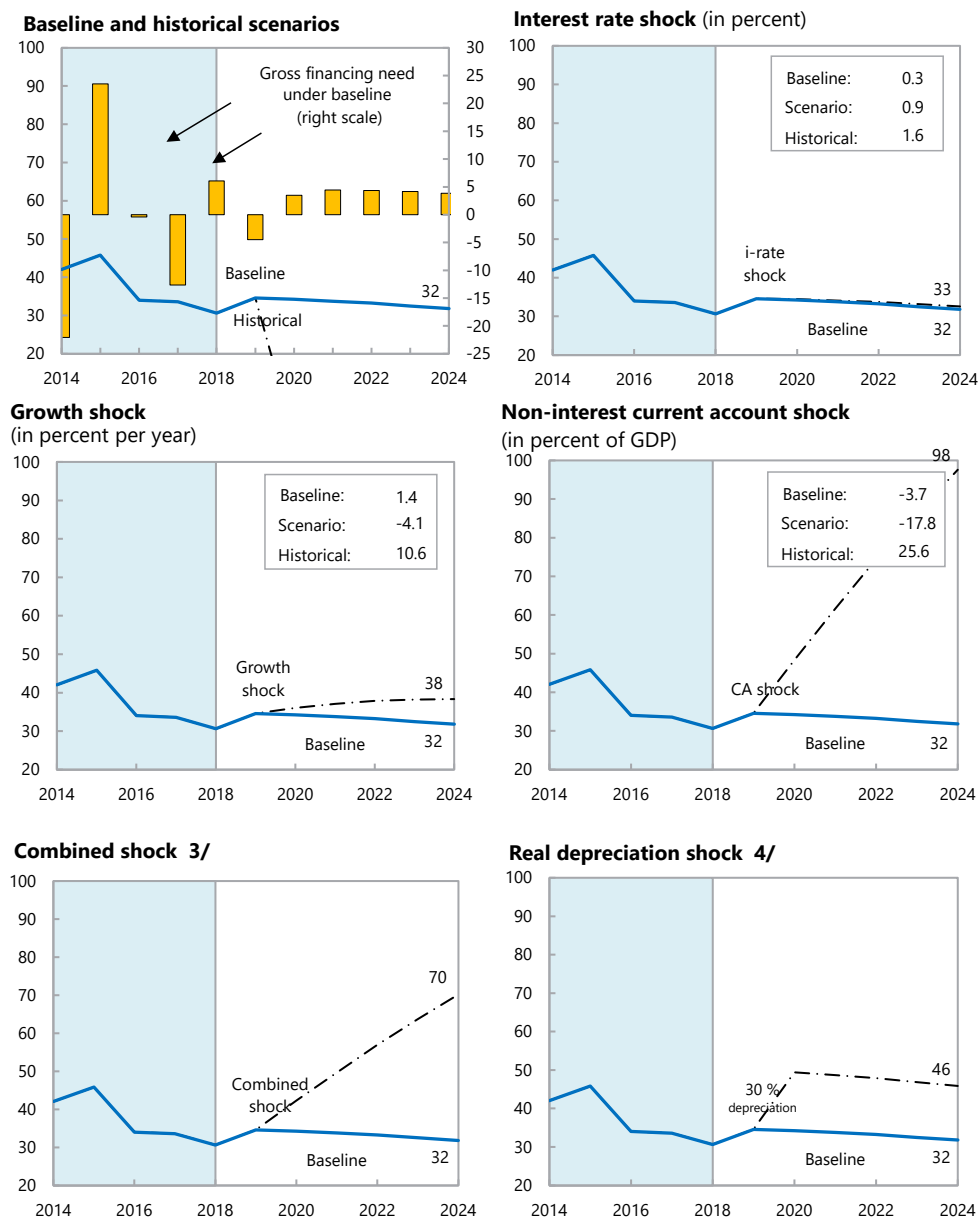
4/ Defined as current account deficit, plus amortization on medium- and long-term debt at end of previous period.

5/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Nauru: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDB)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks.

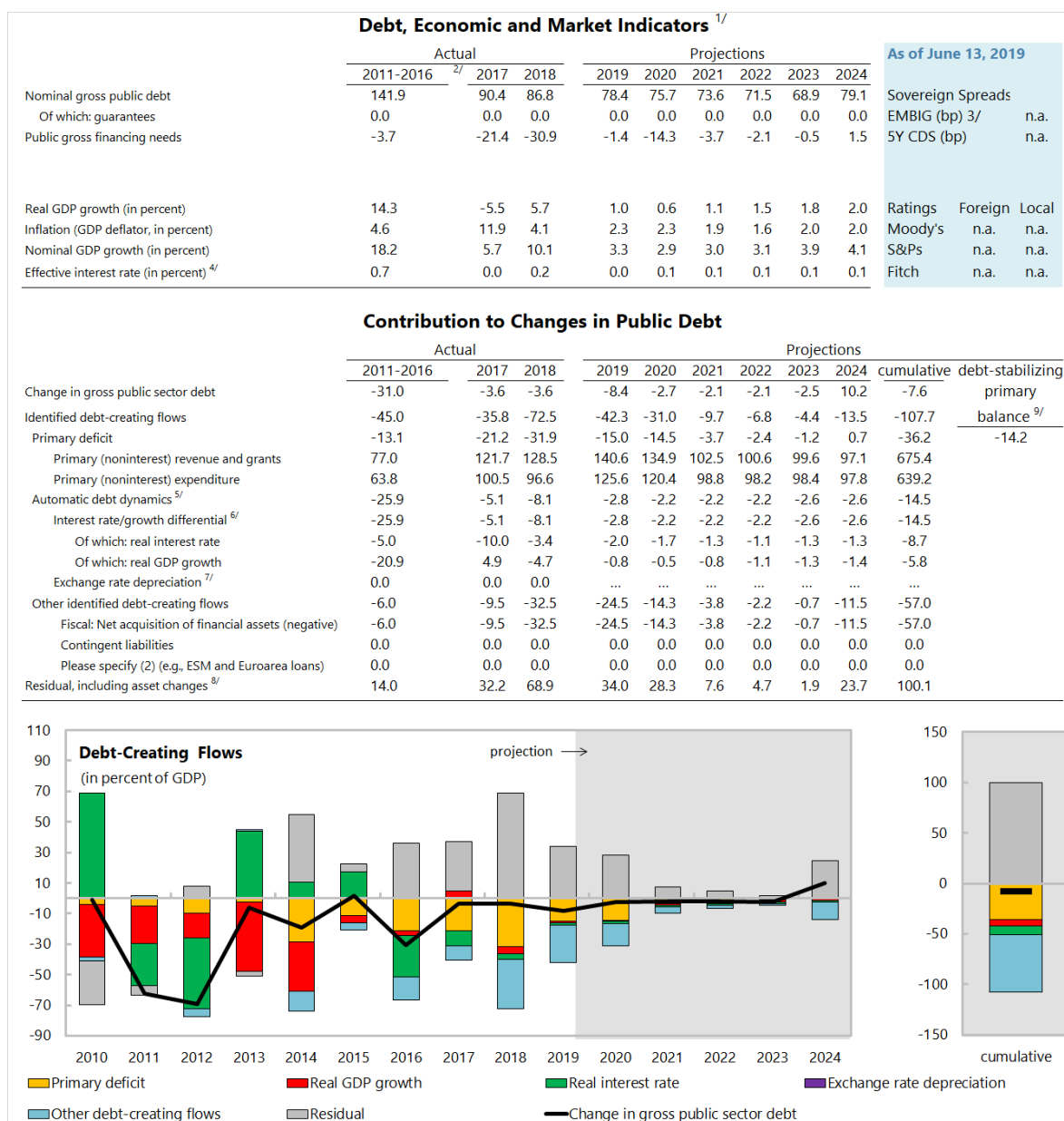
Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

Figure 2. Nauru: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario
(In percentage of GDP otherwise indicated)



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as Arrears.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

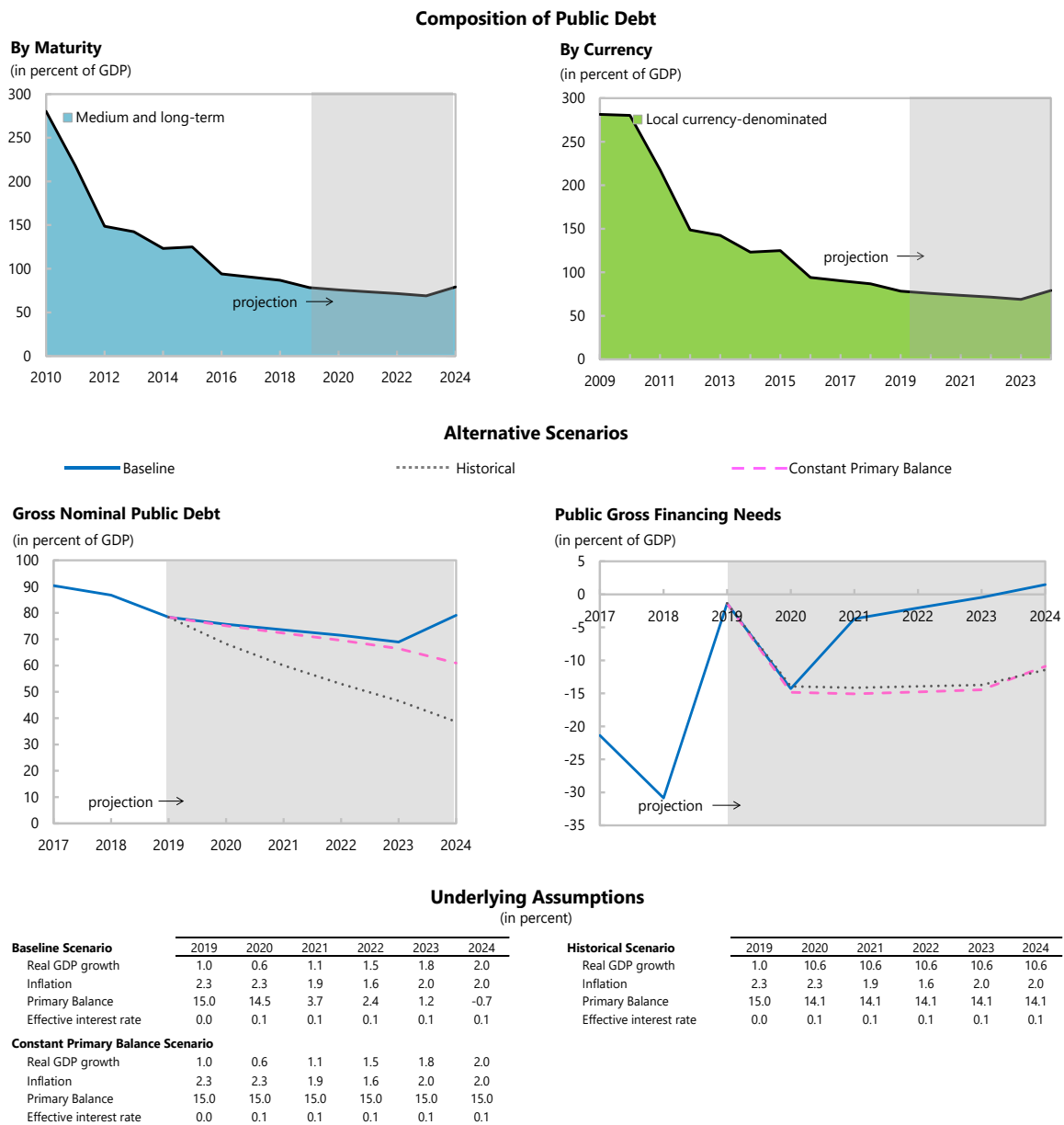
5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

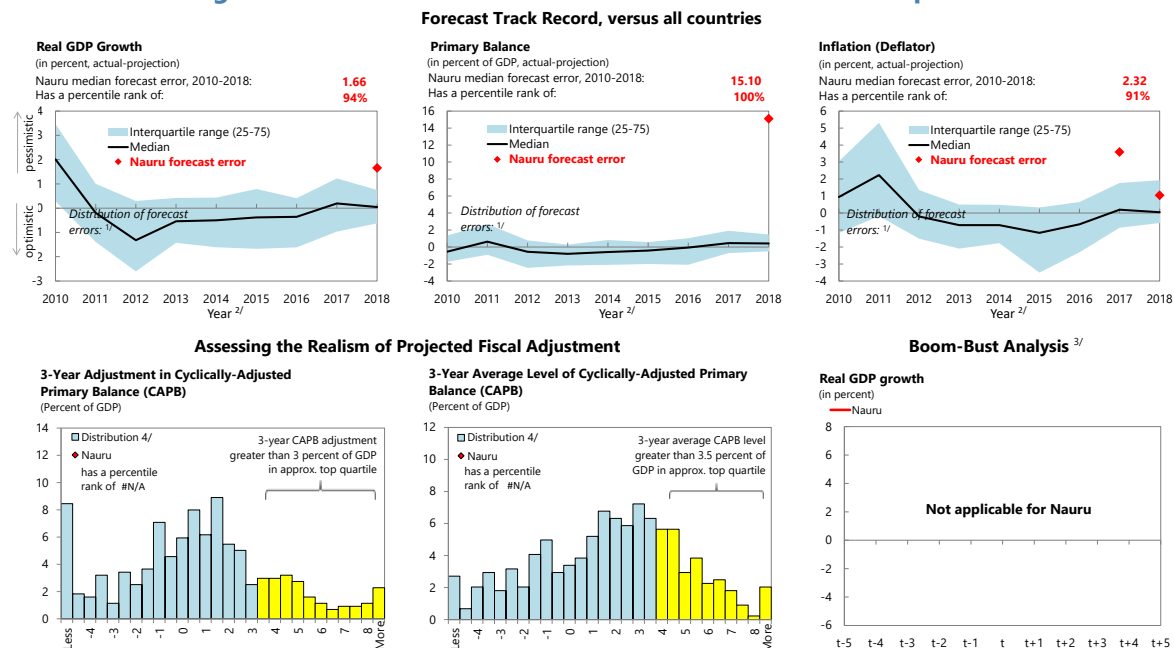
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 3. Nauru: Public DSA – Composition of Public Debt and Alternative Scenarios

Source: IMF staff.

Figure 4. Nauru: Public DSA – Realism of Baseline Assumptions

Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

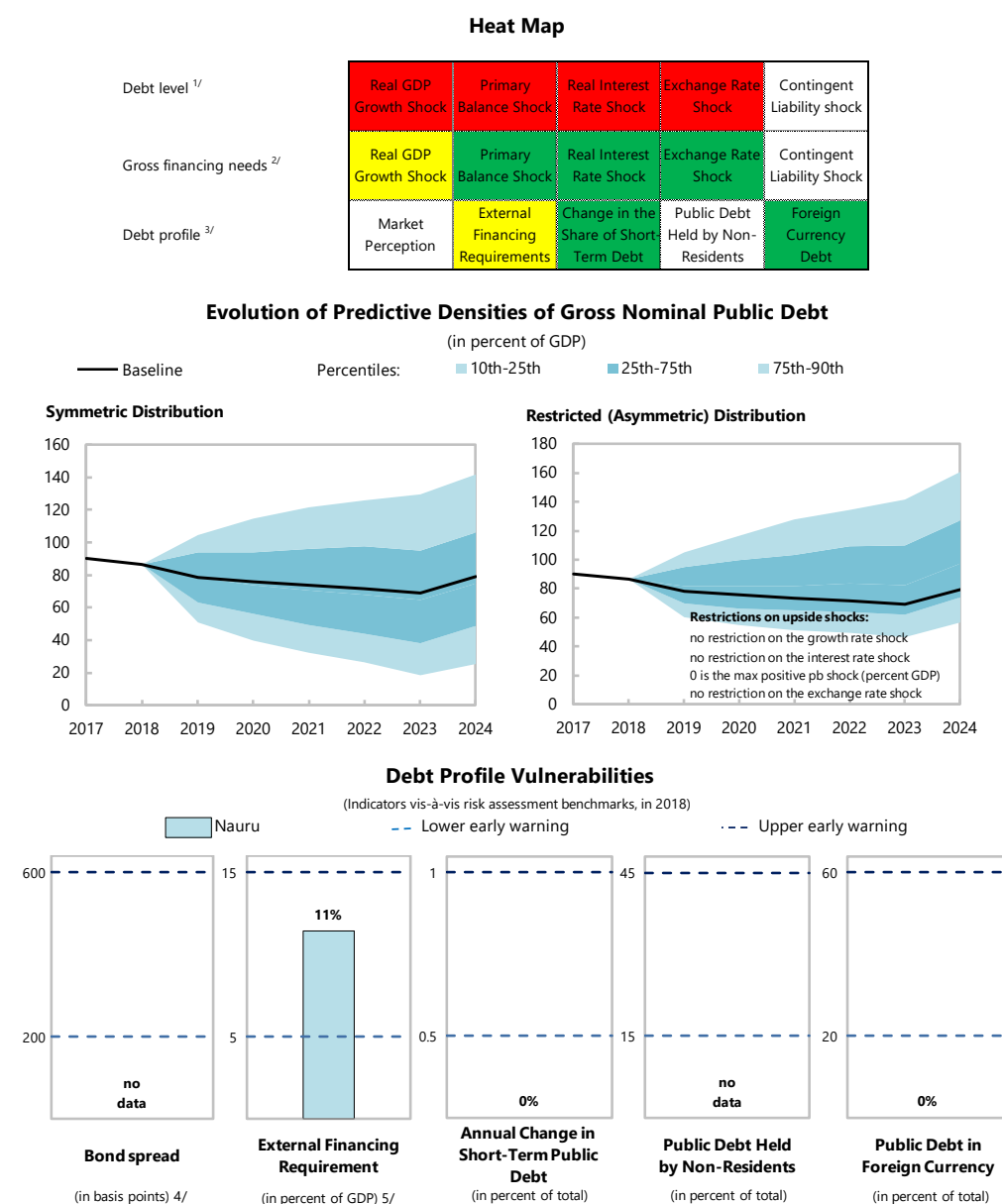
3/ Not applicable for Nauru, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 5. Nauru: Public DSA – Stress Tests



Figure 6. Nauru: Public DSA Risk Assessment



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

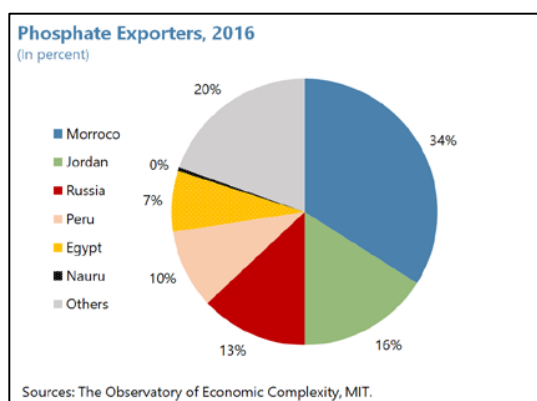
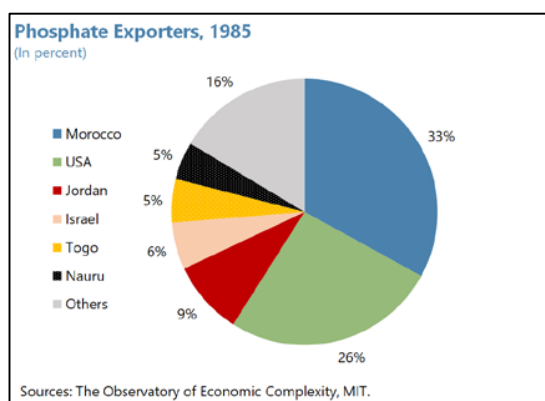
4/ Long-term bond spread over German bonds, an average over the last 3 months.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex V. Secondary Phosphate Mining¹

1. Context: Phosphate rock has been Nauru's primary export commodity since 1906, when it was first mined, allowing the small island nation to become one of the world's richest in GDP per capita terms by 1980. Primary phosphate reserves, however, are now exhausted and the authorities are assessing the feasibility of mining secondary or remnant phosphate. Initial estimates by RONPHOS, the state-owned phosphate corporation, suggest that around 60 million tons of phosphate remains between the island's limestone pinnacles that can be mined using newer methods to generate 500,000 tons per annum in exports over the next 20–30 years. Their business case estimates a ramp up period of 15 months and a capital injection of A\$20 million. Their analysis, however, also acknowledges the potential risks associated with undertaking this project, including but not limited to, the quality of phosphate extracted, the environmental costs associated with mining deeper into the ground, and the infrastructural and labor costs and constraints of the project. As such, the viability of the project remains uncertain and contingent on further in-depth study.

2. Global Landscape: Given continued population growth, global demand for phosphate is projected to remain strong. The United States Geological Service (USGS) 2018 estimates that world consumption of phosphate is expected to increase incrementally to 48.9 million tons in 2020 from 44.5 million tons in 2016. Key players in the phosphate exports market include Morocco, Jordan, Russia, Peru, and Egypt, together accounting for 80 percent of all phosphate exports.² Nauru held about 5 percent of the global export share in 1985 and now constitutes <1 percent. World resources



of phosphate rock exceed 300 billion tons. As such, there are no imminent shortages, and prices are expected to remain stable. Recent studies have shown that global concentrations of high-grade phosphate rock (i.e. with high P₂O₅ content) have been steadily

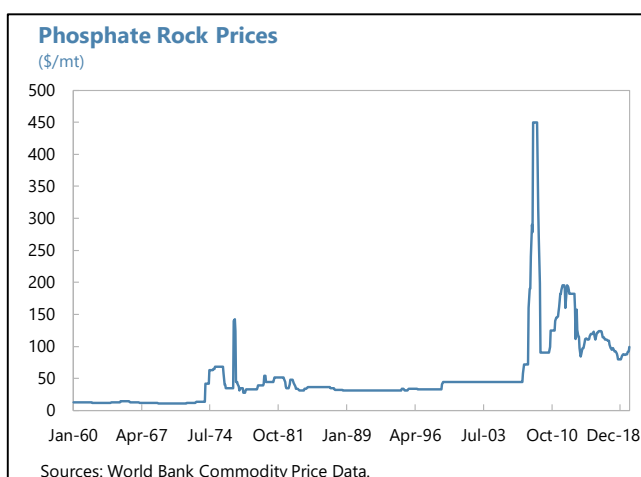
¹ Prepared by Ananya Shukla.

² Based on 2016 data from the Observatory of Economic Complexity, MIT.

declining. Mining phosphate rock with lower P₂O₅ content is more water and energy intensive and contains a higher level of impurities, thus reducing the economic efficiency of extracting it.³

3. Outlook for Nauru: The easily extractable and high-quality phosphate in Nauru has all been mined, and the current estimates of phosphate remaining on the island may not be accurate both in terms of quantity and quality. Secondary phosphate mining poses several risks namely:

- 1) the proposed backfilling and drilling of the limestone pinnacles are new steps in the mining process, not attempted before, and not proven in effectiveness.
- 2) the seaport infrastructure is at the end of its design life and not suited for shipping phosphate.
- 3) funding for the purchase of necessary equipment and infrastructure is difficult to obtain, and loan repayments are vulnerable to changes in global phosphate prices, greater than expected impurities in the mined phosphate, and inability to reduce operational and production costs.
- 4) undertaking secondary mining will be extremely water intensive and, given Nauru's lack of groundwater supplies, may be expensive.
- 5) Nauru is an oil importer, and vulnerable to fluctuations in the global commodity markets, and may not be able to sustain the energy needs of this mining process.
- 6) the processing of lower grade phosphate also poses significant health and environmental risks including the production of toxic heavy metals such as cadmium and uranium, along with additional air, water, and noise pollution.
- 7) most of the island is already uninhabitable due to the years of phosphate mining, and there is a complete lack of agricultural production or biodiversity. Further mining poses a threat to the remaining areas and to the land rehabilitation work underway.



A parallel to Nauru is the case of Christmas Island, which recently halted further phosphate mining given biodiversity and other environmental concerns. The company, Phosphate Resources Limited, has been mining phosphate on the island for more than 100 years and recently sought permission to conduct exploratory drilling in a new area of the island, but the federal government rejected the demand given the potential impact on the island's environment.

³ Van Kauwenbergh, 2010; Schroder et al., 2009; UNEP, 2011.

Annex VI. IMF Capacity Development in Nauru

Nauru: IMF Capacity Development		
Provided by:	Topic:	Period:
PFTAC	Statistics - National Accounts	July 2018
CDOT	Statistics - External Sector Statistics	October 2018
PFTAC	PFM – Transition to IPSAS Cash Reporting	February 2019
PFTAC	Revenue – Review of tax administration reforms	April 2019
PFTAC	Statistics - National Accounts – Building independent compilation capacity	August 2019
PFTAC	Revenue – Review organizational arrangements and core tax functions	September 2019



INTERNATIONAL MONETARY FUND

REPUBLIC OF NAURU

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 6, 2020

Prepared By

The Asia and Pacific Department
(In consultation with other departments).

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FUND RELATIONS

(As of December, 2019)

Membership Status: joined April 12, 2016; Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	2.80	100.00
IMF's Holdings of Currency	2.12	75.71
Reserves Tranche position	0.68	24.32

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	0.86	100.00
Holdings	0.18	20.96

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDR):

Forthcoming					
	2019	2020	2021	2022	2023
Principal					
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Exchange Arrangements

The de jure and de facto exchange rate arrangements are classified as no separate legal tender. Nauru's legal tender is the Australian dollar. There is no central monetary institution. Nauru has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Technical Assistance

Nauru has been benefitting from the Pacific Financial Technical Assistance Centre's (PFTAC) technical assistance (TA) in recent years with the largest concentration in the public financial management (PFM) sector. Technical assistance provided by PFTAC has assisted with the introduction of a Revenue Administration Act and an Employment and Services Tax Act, both of which became

effective from October 1, 2014. Further legal TA, by way of PFTAC funding, facilitated the introduction of a Business Tax Act (BTA). The new BTA imposes a business profits tax, small business tax, non-residents tax, and an international transportation business tax. Methodologies for producing more comprehensive and timely national income and balance of payments statistics have also been developed.

Resident Representative:

The Regional Resident Representative Office for Pacific Islands is based in Suva, Fiji and was opened on September 13, 2010. The office covers Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Ms. Leni Hunter is the current resident representative.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS (IFIs)

Information on the activities of other institutions in Nauru can be found at:

- World Bank Group:
<https://projects.worldbank.org/en/projects-operations/projects-list?searchTerm=nauru>.
- Asian Development Bank:
<https://www.adb.org/countries/nauru/main>.
- Pacific Financial Technical Assistance Center:
https://www.pftac.org/content/PFTAC/en1/reports11.html#tab_5.

STATISTICAL ISSUES

Nauru: Table of Common Indicators Required for Surveillance As of December, 2019	
I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision has serious shortcomings that significantly hamper surveillance. Nauru became an IMF member in April 2016, and during the membership preparation in 2014-15, the authorities compiled data with the support of Pacific Financial Technical Assistance Centre technical assistance (PFTAC TA). Most macroeconomic data remain unpublished even though they are provided to staff. Despite additional recruitment, the capacity of the National Bureau of Statistics (NBS) is limited, and Nauru has continued to rely on technical assistance and donor support in compiling data.</p>	
<p>National accounts: Annual GDP estimates have improved with the support of PFTAC TA. The latest TA mission in May 2019 assisted the NBS with the implementation of new data sources for the compilation of annual GDP. The TA report indicated that the NBS should increase the number of staff for compiling the macroeconomic statistics, and improve data sources during the next rebase of national accounts in 2021.</p>	
<p>Price statistics: The NBS compiles the quarterly CPI with the reference year 2015. However, the latest PFTAC TA in 2019 found that the CPI data has some shortcomings related to the prices of imported motor vehicles. There are no producer, wholesale, or trade price indices.</p>	
<p>Government finance statistics (GFS): The MoF with the assistance of contractual expatriates currently aim to compile and disseminate GFS. Nauru reported budgetary central government GFS for the first time in 2018 with significant assistance of PFTAC. The lack of timely, accurate and quality data continues to hamper the progress of GFS compilation. The MoF relies on TA from PFTAC to ensure data are compiled and disseminated.</p>	
<p>Monetary and financial statistics: There are no monetary and financial data statistics available since the financial sector is still in early stage of development. Nauru uses the Australian dollar as legal tender and does not have a central bank. There was no bank in Nauru over the past decade until Bendigo Bank agency opened in Nauru in June 2015. The agency provides financial services (mainly deposits, but no loans and no foreign exchange transactions) on behalf of Bendigo and Adelaide Bank Limited of Australia.</p>	
<p>External sector statistics (ESS): The annual balance of payments and international investment position statistics were compiled for the first time in 2014 with the support of PFTAC as part of the IMF membership preparation. Recent external sector statistics (ESS) technical assistance (TA) mission (June 2019) found important shortcomings in the data sources used for the compilation of ESS, especially in the formatting of custom data, and the coverage of private sector corporations and the Nauru Super Pension (NSP) scheme transactions and positions.</p>	
II. Data Standards and Quality	
At present, Nauru does not participate in any of the IMF's Data Standards Initiatives.	No data ROSC are available.

**Nauru: Table of Common Indicators Required for Surveillance
(As of December, 2019)**

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange rates ¹	12/04/2019	12/04/2019	D	NA	NA
International reserve assets and reserve liabilities of the monetary authorities ²	12/2016	01/2017	M	Q	NA
Reserve/base money ³	NA	NA	NA	NA	NA
Broad money ³	NA	NA	NA	NA	NA
Central bank balance sheet ³	NA	NA	NA	NA	NA
Consolidated balance sheet of the banking system	NA	NA	NA	NA	NA
Interest rates	NA	NA	NA	NA	NA
Consumer price index	09/2016	01/2017	Q	Q	Q
Revenue, expenditure, balance and composition of financing ⁴ —general government ⁵	FY 2018	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing ⁴ —central government	FY2018	09/2019	M	Q	NA
Stocks of central government and central government-guaranteed debt ⁵	FY2018	09/2019	A	A	NA
External current account balance	12/2018	7/2019	A	A	A
Exports and imports of goods and services	12/2018	7/2019	A	A	A
GDP/GNP	FY2015	10/2016	A	A	NA
Gross external debt	FY2016	10/2016	A	A	NA
International investment position ⁶	12/2018	6/2019	A	A	A

¹ Nauru uses the Australian dollar as its legal tender.

² Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by the IMF Staff Representative
January 22, 2020**

This statement contains information that has become available since the staff report was circulated to the Executive Board. This information does not alter the thrust of the staff appraisal.

1. A fourth supplementary budget for FY2019/20 was issued on 20 December 2019, to appropriate A\$17.6 million (10 percent of GDP) in additional revenue. The revenue was mainly due to Australian Regional Processing Centre (RPC) for asylum seekers operations and included A\$5.3 million in additional RPC hosting fees and a A\$10.2 million payment for reimbursable RPC costs. The government also received a dividend paid by a telecom company (A\$1.5 million). The supplementary budget is expected to have a negligible impact on GDP growth and other key variables as fiscal multipliers are low given Nauru's openness.

- **Most of the additional revenue has been appropriated as new spending,** including A\$10.9 million for operational costs at the Department of Multicultural Affairs (which has responsibility for the RPC). A further A\$4.2 million was paid in SOE subsidies and a windfall payment to government workers. The supplementary budget included a Nauru Trust Fund contribution of A\$ 0.6 million, and the remaining A\$2.0 million was spent on other areas.
- **Staff has treated the revenue increase as windfall revenue, in the absence of further information.** However, the revenue gain over the four supplementary budgets has been significant, increasing revenue in FY2019/20 by 60 percent above the initial Approved Budget. The supplementary budgets have included total appropriations of A\$86 million (50.5 percent of GDP) for FY2019/20, comprised of new spending (A\$73.6 million) and appropriations to the Nauru Trust Fund and Fiscal Cash Buffer (A\$12.4 million).
- **While the revenue gains are positive, supplementary budget appropriation in FY2019/20 has included little spending on core areas of education and health.** Of the newly appropriated expenditure in FY 2019/20, 2 percent of GDP (A\$3.6 million) was spent on health and less than 1 percent of GDP (A\$0.4 million) was spent on education. Staff reiterates the advice to set aside windfall revenues for appropriation in the normal budget cycle rather than through a supplementary budget process. Windfall revenues should be used to boost resources for carefully planned spending.

2. The authorities are making progress on public financial management reforms. Following the Article IV discussions, the authorities have communicated that the financial statements for FY2016/17 have been submitted for audit and published on the official website. They are continuing efforts to improve bank reconciliation and have engaged a consultant to map the financial management information system (FMIS) to support GFS reporting. Other work is continuing to improve internal audit, establish a Finance and Audit Risk Committee, and recruit new staff to oversee reconciliation and SOE performance.

**Statement by Nigel Ray, Executive Director for Nauru
and Anna Park, Advisor to Executive Director
January 22, 2020**

Nauru is the world's smallest island nation with a population of around 12,500, on an island of 21 square km, located 40 km south of the equator, in the Pacific Ocean. The nearest neighbor is 300 km away. As a result, lack of scale and remoteness pose challenges for economic growth and development. Nauru's sources of revenue are narrow and uncertain. Phosphate mining activity has underpinned incomes since the early 1900s but is reaching the end of its economic life, while fees from fishing licenses can be volatile. The island's central plateau has been heavily mined, and the population is concentrated around the narrow coastal fringe, increasing vulnerability to climate change. Limited land availability contributes to a reliance on imported food and high incidence of non-communicable diseases.

Despite these challenges, progress is being made with the support of development partners. The establishment of a new Nauru Trust Fund is supporting fiscal sustainability by saving windfall income and investing it in a trust that will generate revenue to support future generations. Reforms at the Nauru Utility Corporation have improved the reliability of water and electricity provision. Important infrastructure projects, like the construction of a new port and undersea cable project, will encourage increased trade and economic activity. Banking services were re-established in 2015 (after almost 15 years without a functioning bank), and almost all adults now have access to a bank account. Improving school attendance and education and health outcomes is a priority for the government.

The authorities agree with staff's analysis and near-term outlook, and with the broad thrust of the advice. Nauru joined the IMF in 2016 and this is its second Article IV consultation. The authorities value the advice and technical assistance received from the Fund and look forward to further constructive engagement in future. They also welcome the coordination between IMF staff and the Asian Development Bank, who were invited to join relevant meetings, facilitating knowledge sharing and making best use of the authorities' time.

Economic diversification and sustainable development

The authorities agree that broadening Nauru's sources of income is a key policy priority. But lack of scale, remoteness, limited arable land, the physical environment and infrastructure and capacity constraints pose challenges for economic diversification. Continued progress in this area requires ongoing support and technical assistance from donors and partners. The authorities would welcome further practical policy advice from the Fund on potential avenues for diversification. The authorities agree that private sector development may have a role to play and are open to reassessing measures that act as barriers to private sector growth. Nauru faces challenges associated with climate change and, with the support of development partners, work is underway on mitigation and adaptation measures.

Prudent and sustainable fiscal management

The authorities welcome the IMF's analysis of the fiscal position and will carefully consider the advice to ensure sustainability in the next budget. They understand that if revenues were to fall sharply, there would be a need to adjust spending. Strengthening revenues is also a priority. The authorities agree that any new revenue measures would need to be carefully designed and communicated in a context where most Nauruan citizens have not previously had to pay taxes. Strengthening revenue administration and compliance will also play a role, and ongoing IMF technical assistance in this area is appreciated.

The authorities are committed to maintaining fiscal discipline while making necessary investments in productive and social sectors. Under Nauru's fiscal framework, the budget balance must be positive and sufficiently large to meet the annual Trust Fund contribution. The authorities are also committed to maintaining a cash buffer for liquidity management purposes. The authorities will carefully consider staff advice to limit use of supplementary budgets but note that some flexibility in the framework is appropriate to respond to large and unpredictable variations, given the narrow revenue base. On debt management, the authorities are mindful of the need to take steps towards ensuring future debt sustainability by reconciling and resolving legacy debts.

Enhancing governance

The authorities are committed to improving public financial management to enhance fiscal discipline and improve the quality of public spending. The online publication of fiscal documents has been an important step forward, and work is underway to improve the quality of fiscal data. The authorities agree that some state-owned enterprises could pose fiscal risks and plan to progress public enterprise reforms and establish a new SOE monitoring unit. The authorities are also working to strengthen Nauru's AML/CFT framework; preparations are underway for the 2022 APG-FATF Mutual Evaluation.