

**EXECUTIVE
BOARD
MEETING**

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March 9, 2017

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Nauru—Staff Report for the 2017 Article IV Consultation—
Informational Annex**

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Questions:	Mr. Feridhanusetyawan, APD (202-631-8754) Mr. Massara, AFR (ext. 35468)
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***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**



REPUBLIC OF NAURU

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 7, 2017

Prepared By

The Asia and Pacific Department
(In consultation of other departments)

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FUND RELATIONS

As of January 31, 2017

Membership Status

Joined April 12, 2016; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	2.80	100.00
Total holdings of currency	2.12	75.71
Reserve position in the Fund	0.68	24.32

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	0.86	100.00
Holdings	0.18	21.06

Outstanding Purchases and Loans

None

Financial Arrangements

None

Projected Obligations to Fund

None

Exchange Arrangements

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.

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. Mr. Tubagus Feridhanusetyawan is the current resident representative.

WORLD BANK—IMF COLLABORATION

As of January 31, 2017

The World Bank (WB) and the IMF teams maintain a close working relationship and continues to have ongoing dialogue on Nauru's economic developments and policies. The joint IMF-WB membership mission to Nauru took place in May 2015, and the WB team has provided inputs for the first IMF Article IV consultations in January 2017. The teams agreed that Nauru's economic performance has improved in recent years driven by the Australian Regional Processing Center (RPC) to process asylum seekers, revenues from fishing license fees, and residual phosphate mining. However, Nauru continues to face daunting challenges in sustaining growth and ensuring fiscal sustainability due 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 worse than peers due to the high incidence of non-communicable diseases. In view of these, Nauru's policy priorities should focus on the following:

- **Ensuring fiscal sustainability.** In the absence of monetary policy, sound fiscal policy plays a critical role in preserving macroeconomic stability. Nauru's medium-term fiscal outlook is vulnerable to the RPC scaling down, which could entail a substantial decline in RPC revenue. With limited access to borrowing, government spending will have to adjust accordingly. Maintaining adequate cash buffers (in addition to the trust fund) is critical to ensure fiscal space to respond to shocks.
- **Implementing structural fiscal reforms.** The priorities include implementing tax and public finance management reforms to help support the needed fiscal adjustment and improve the efficiency of spending, and strengthening public debt management to ensure fiscal and debt sustainability and improve access to credit markets.
- **Improving resilience to climate change.** Nauru faces a number of long-term climate change challenges. These include rising sea levels, extreme tides, and coastal erosion, which threaten essential infrastructure and reduce the land area for agriculture. Therefore, developing a fiscal policy framework that can enhance economic resilience by integrating Nauru's climate change strategies in budget planning over the medium term is important.
- **Promote inclusive growth.** While Nauru's average per-capita income is higher than that of other Pacific Island Countries, it also has high levels of hardship and vulnerability, largely due to a lack of economic opportunities for the poorest and most vulnerable. The following reforms could be prioritized to promote inclusive job-creating growth, economic diversification, and private sector development: (1) rebuilding the seaport and energy infrastructure, (2) reforming the state owned enterprises, and (3) developing the financial sector. There is also scope to benefit more from labor mobility opportunities, although this will likely require reforms in both Nauru and in receiving countries. Addressing health-related challenges is critical to reduce economic and social burdens of non-communicable diseases in Nauru, including by disincentivizing the consumption of tobacco, alcohol, and sugary and salty foods, and by reallocating scarce health resources toward targeted preventative measures and primary care.

Nauru: Bank and Fund Implemented/Planned Activities in Macro-Critical Areas, 2016-18		
	Product	Expected/Actual Delivery
World Bank Work Program	<ul style="list-style-type: none"> Seasonal Worker Programme Development Evaluation 	<ul style="list-style-type: none"> June 2017
IMF Work Program	<ul style="list-style-type: none"> National Accounts Statistics Technical Assistance (TA) mission External Sector Statistics TA Mission Public Financial Management TA Mission Government Financial Statistics TA Mission 2017 Article IV Consultation 	<ul style="list-style-type: none"> June and September 2016 September 2016, planned follow-up in 2017/18 August 2016, December 2016 Planned in 2017 Mission in January 2017, Board Discussion in March 2017.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

As of January 31, 2017

The Asian Development Bank (AsDB) has been supporting the Government of Nauru with approved loans, grants, and technical assistance amounting to over US\$29 million. As of 31 December 2016, currently active grant projects amount to US\$14.8 million.

Partnerships

AsDB is a major development partner for Nauru in terms of infrastructure financing and supporting economic reform. AsDB continues to significantly scale up its program in Nauru, including through mobilizing significant co-financing. AsDB has enhanced its relationship with Nauru through the establishment in 2016 of a Development Coordination Office on island and works collaboratively with other development partners active in Nauru.

AsDB's approach and operations in Nauru are guided by the government's National Sustainable Development Strategy (NSDS) 2005-2025 and the AsDB Pacific Approach 2016-2020, which acts as the AsDB country strategy for Nauru. The AsDB program in Nauru contributes to the objectives of the Pacific Approach by: (i) reducing costs through infrastructure development; (ii) managing risk by strengthening public sector management; and (iii) enabling value creation through improving connectivity.

AsDB Supported Projects and Programs

AsDB continues to significantly scale up its program in Nauru through the increased Asian Development Fund (ADF) country base allocation, regional ADF financing, and co-financing. The Country Operations Business Plan 2017-2019 has a total envelope of US\$50.8 million, including co-financing.

Current AsDB activities include:

- **Port Development Project:** Developing a modern, safe and reliable port facility is the centerpiece of the AsDB program in Nauru. Project design work is currently being completed and the project is expected to go to the AsDB board for approval in 2017.
- **Electricity Supply Security and Sustainability Project:** A\$10.6 million grant-finance project, co-financed by the European Union and Australia, was approved in 2014 and is providing the Nauru Utilities Corporation (NUC) with two new fuel efficient generators and assisting to construct a new roof for the powerhouse. Following a first phase of institutional strengthening TA which corporatized the NUC, a second phase of TA for institutional strengthening and tariff reform is also under implementation.
- **Fiscal Sustainability Reform Program:** A\$3.9 million policy-based grant program, co-financed by the Australian Government, provided budget support to the government during 2016 and supported public finance reforms including, together with AsDB technical assistance, the establishment of the new Nauru trust fund.

- Financial Inclusion: A\$350,000 technical assistance project was approved in 2016 and will provide support to strengthen financial literacy and help bring new financial services to Nauru.
- Regional programs: AsDB provides a variety of support through its regional programs, which currently includes supporting the review and update of the National Development Strategy, preparing a new infrastructure strategy, and supporting public finance reform and SOE reform.

Future directions

The Port Development Project, which is expected to be submitted for board approval in 2017, will be the key focus of the AsDB country program going forward. A sub-regional undersea fiber optic cable project, which Nauru is pursuing in cooperation with the World Bank and the governments of the Federated States of Micronesia and Kiribati, is also planned for 2017 and will bring cheaper, faster, and more reliable internet to Nauru.

AsDB plans to continue to support fiscal sustainability with a policy-based grant program planned for 2018. AsDB is also preparing, and seeking co-financing for, a Solar Power Development Program planned for 2018. Finally, an urban development program is planned for 2019, contingent on mobilizing sufficient co-financing.

PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE (PFTAC) COUNTRY STRATEGY 2016–17

As of January 31, 2017

Nauru has been benefitting from the Pacific Financial Technical Assistance Centre's (PFTAC) technical assistance (TA) in recent years. In phase IV (FY2012–16) there were 24 missions, with the largest concentration in the public financial management (PFM) sector. Methodologies for producing more comprehensive and timely national income and balance of payments statistics were also developed.

Strategy 2017–19

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the results framework for the current PFTAC (Phase V) FY2017–22 funding cycle.

Public Financial Management

PFTAC has provided TA that included missions on: improving the budgeting process, asset management, accounting, valuation, and reporting; revising the financial instructions; and facilitating the 2016 PEFA self-assessment. PFTAC was also requested to assist Nauru in developing its PFM roadmap and adopting international public sector accounting standards in financial reporting.

Tax Administration

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) effective from July 1, 2016. The new BTA imposes a business profits tax, small business tax, non-residents tax, and an international transportation business tax.

Financial Supervision

No technical assistance was provided to Nauru for the last 3 years.

Economic Statistics

During June–September 2016, PFTAC twice assisted the Nauru Bureau of Statistics in its compilation of GDP estimates. There was a more comprehensive collection of annual source data for FY2014–15 and compilation of draft GDP by production estimates. Various aspects of methodology were also reviewed and improved. In September 2016, there was also a more comprehensive collection of annual source data for FY2014–15 and compilation of draft BOP estimates.

Macroeconomics

No technical assistance was provided to Nauru for the last 3 years.

STATISTICAL ISSUES

Nauru: Table of Common Indicators Required for Surveillance (As of January 31, 2017)	
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 during 2014-15 as part of the IMF membership preparation. The latest TA mission in September 2016 updated the GDP estimates, including by revising the deflators to reflect the fluctuation in phosphate prices, and produced new estimates of the resident population by incorporating refugees, asylum seekers, and expatriates living in Nauru. The TA report indicated some weaknesses, including the absence of activity surveys, sporadic or incomplete data collection, and limited data-sharing among agencies.</p>	
<p>Price statistics: The quarterly retail price index (2010=100) is produced with 3-month lag and derived based on a survey. There are no producer, wholesale, or trade price indices.</p>	
<p>Government finance statistics (GFS): Fiscal data are compiled monthly from the Financial Management Information System but they are not presented based on the standard GFS format. The authorities have indicated that improving GFS is their top priority as a new IMF member in order to meet the IMF standards. A GFS TA mission is scheduled for early 2017.</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. The latest TA in September 2016 updated some estimates, and found that the lack of actual data has continued to hamper data compilation and contribute to errors and omissions.</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.
III. Reporting to STA	
Nauru does not report data to STA for publication in <i>International Financial Statistics</i> or other data publications.	

Nauru: Table of Common Indicators Required for Surveillance
(As of January 31, 2017)

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange rates ¹	01/30/2017	01/31/2017	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	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing ⁴ —central government	11/2016	01/2017	M	Q	NA
Stocks of central government and central government-guaranteed debt ⁵	FY2015	01/2017	A	A	NA
External current account balance	FY2015	10/2016	A	A	NA
Exports and imports of goods and services	FY2015	10/2016	A	A	NA
GDP/GNP	FY2015	10/2016	A	A	NA
Gross external debt	FY2016	10/2016	A	A	NA
International investment position ⁶	FY2015	10/2016	A	A	NA

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).