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**Statement by Mr. Choi and Ms. Preston on Republic of Nauru
(Preliminary)
Executive Board Meeting
March 24, 2017**

As the Fund's newest member, our Nauruan authorities thank the IMF Mission team for the constructive dialogue, engaging policy discussions and comprehensive assessment of the challenges facing the Nauruan economy, in the first IMF Article IV consultation for Nauru. Authorities broadly agree with the staff's assessment of policy challenges and welcome suggested policy actions to ensure fiscal sustainability, enhance resilience to climate change and promote inclusive growth. We would like to convey our Nauruan authorities' appreciation to the Fund for policy advice and ongoing support. The authorities look forward to continued close engagement with the IMF.

Context:

With a population of around 12,500, Nauru is the world's smallest island nation and one of the most isolated countries in the world. Located in the Pacific Ocean, 42 kilometers south of the equator, Nauru is a significant distance from international markets. A coral reef surrounds the entire island, which is dotted with pinnacles. A rich deposit of phosphate was discovered in the early 1900s and phosphate mining has been a significant source of economic wealth over previous decades, but the economic life of phosphate mining is reaching its final stages. With support from development partners, authorities have established a new Nauru Trust Fund, aimed at supporting fiscal sustainability by saving windfall income and investing it in a trust that will generate revenue to support future generations.

The coral reef and significant volatility in sea levels make construction and repair of a seaport difficult. The seaport in Nauru is relied upon as a key gateway to facilitate access to international markets for exports of phosphate and to service demand for imported goods – critical, given the coastal soils make it difficult to produce food for domestic consumption. Problems with the seaport have impacted economic growth in recent years, lowering the volume of phosphate exports and causing supply shortages, which has added to higher

inflation. A climate proof seaport remains critical to future development and sustainability in Nauru. Authorities are hopeful that they will be able to secure the financing needed from donors and development partners to begin construction.

Nauruan authorities are actively searching for other avenues to diversify their economy and support future incomes and growth, noting staff's assessment that options are limited. With phosphate resources diminishing, and the scaling back of the Regional Processing Centre (RPC), future incomes to a large extent depend on the fortunes of the fishing industry and the long term success of the Nauru Trust Fund. Authorities have also been actively seeking to increase tourism to Nauru, working with Air Nauru to provide flights that link Nauru with the South Pacific.

Despite these challenges, the authorities are committed to a strong development and sustainability agenda for Nauru. Building on recent reforms, including in implementing a taxation system, the Government has committed to ongoing reforms to ensure fiscal sustainability and promote growth. Capacity constraints are considerable and continued progress on reforms requires ongoing support and technical assistance from donors and partners. The Government is committed to taking a prudent approach to economic management, as evidenced by their recent membership of the IMF and World Bank Group.

Economic Outlook:

Authorities welcome staff's positive assessment of Nauru's economic performance over the past few years. Real GDP grew at 20 percent annually on average during FY2011-14 and at around 10 per cent in FY 2016.

Looking ahead, authorities agree that the underlying drivers of economic growth are declining and risks are generally to the downside. Given the uncertainty over the timing and magnitude of the RPC scale down, authorities are considering policy options to assist with the adjustment. Authorities agree with staff recommendations to build additional fiscal buffers. They recognize the impact on growth and revenue and understand they will need to reduce spending as revenues decline given they have no ability to borrow from external markets and limited cash reserves. Authorities are continuing discussions with Australia about the nature of transitional support that could be provided as RPC operations are scaled down.

Fiscal Policy:

The authorities welcome the IMF's analysis of the fiscal position and will carefully consider its advice to ensure liquidity and sustainability. Reflecting on history, the current Government has underscored the importance of fiscal sustainability for Nauru over the medium term. Authorities agree that it is important to maintain adequate cash buffers and continue to make sufficient contributions to the Trust Fund. On debt management, authorities

will take steps towards ensuring future debt sustainability by reconciling and resolving legacy debts.

Authorities recognize the importance of saving more in FY 2017 while revenues from the RPC remain high. They agree with staff that expenditure restraint and prioritization is an important element of fiscal sustainability. Recently established fiscal responsibility targets will help guide decision making and monitor progress towards fiscal goals. Authorities note staff's suggestion that expenditure should be prioritized towards supporting health and education programs, while reducing spending on ad-hoc subsidies, travel, miscellaneous and special projects.

Authorities have recently made good progress in implementing a new tax system and are committed to the public financial management reforms outlined in their 2016 Public Expenditure and Financial Accountability assessment. The Nauru Revenue Office, Tax Division was re-established in 2014 and tax compliance and enforcement has increased. Several new taxes have been introduced to broaden the tax base including an employment and services tax and a business tax. Authorities recognize that to ensure long term sustainability of the tax system they will need to lower the personal tax-free threshold but consider this will take time and require community consultation and education. Authorities continue to focus on public financial management reform and recently implemented a new financial management information system to record financial transactions.

Transparency is improving with both the 2013-14 and 2014-15 government financial statements recently being submitted for audit and publication. Nauru has reactivated its membership of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and has committed to meeting the requirements of the Automatic Exchange of Information (AEOI) by September 2018. The Multilateral Agreement has been signed and ratified and Nauru currently is undertaking a 'Fast Track Phase 2' review to avoid a G20 black listing in July 2017.

Structural Reforms:

The authorities remain committed to their reform efforts and welcome staff's acknowledgement of the progress made in recent years, much of which has been made possible by the technical assistance provided by donors. Reforms to State Owned Enterprises (SOEs) have already had a noticeable effect. For example, the number, frequency and duration of power shortages on the island has declined due to increased operational efficiencies and targeted investments. In line with recommendations from ADB technical assistance, authorities will continue to pursue SOE reform priorities to ensure all SOEs can transition towards operating on a commercial basis and reduce fiscal risks and burdens. Financial sector reforms such as the establishment an agency of the Bendigo Bank in Nauru, have partially restored access to financial services. However, authorities remain concerned about financial inclusion and note that it is challenging for residents to transfer money

outside of Australia given Nauru's legacy black listing. This is impacting private sector development, trade and Nauru's ability to attract foreign skilled workers. Authorities are alive to the challenges associated with education and health outcomes for citizens in Nauru and developing policies to improve outcomes in these areas remains a top priority.

Authorities are at the forefront of challenges associated with Climate Change.

Financing and investment are needed to ensure that Nauru can review and implement climate strategies to ensure Nauru's sustainable development. The challenges associated with climate change can be overwhelming for a country as small and isolated as Nauru. Authorities thank staff for their practical approach in recommending actions that are achievable and readily implemented. Authorities agree that matching pipeline donor projects to Nauru's climate strategy would be a useful first step and would help identify priority areas for future investment and financing gaps. Authorities have re-established the National Development Planning Committee to advise Cabinet on climate priorities.

The Nauruan authorities thank staff for the policy advice and recommendations and look forward to continued engagement with the IMF.