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March 22, 2017

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

We thank staff for an insightful report and Mr. Choi and Ms. Preston for their informative Buff statement. Nauru is facing daunting challenges including large investment gaps particularly in seaport and energy infrastructure which are hindering more sustained and resilient economic growth. Key priorities include structural reform implementation, increasing the efficiency of state owned enterprises and the development of the financial sector to improve the business climate and the growth prospects for Nauru's economy. As we agree with most of the staff appraisal, we would highlight just a few points for emphasis and ask staff for additional clarifications.

We encourage the authorities to continue to strengthen their fiscal frameworks and build buffers to increase resilience. Continued strengthening of public financial management reforms and greater transparency is crucial to better institutionalize fiscal prudence. Looking at strengthening resilience to shocks, we welcome the authorities' commitment to building a trust fund and *we would welcome additional comments on staff's baseline projection for the principal value of the trust fund up to 2033. Is the target of A\$400 million realistic based on current projections?* Moreover, given uncertainty about the evolution of revenues in coming years, could staff comment on the design of the trust fund rules and *explain whether safeguarding an adequate cash reserve or contributing to the fund should take priority in case of an unexpected revenue shortfall?*

The dependence of Nauru's public finances on uncertain proceeds from the Australian Regional Processing Center (RPC) is a major source of risk to the outlook. We broadly concur with the staff's assessment highlighting uncertainty about future revenues and take note that staff's baseline scenario assumes that RPC-related revenues stay broadly unchanged after FY2018. *Could staff provide additional comments on what assumptions underpin this projection?* In addition, we note staff's comment that "the refugees work and operate businesses, such as restaurants" which suggests some integration of the very substantial number of refugees into Nauru's economy. *To gauge the economic impact beyond the fiscal*

revenues from the RPC, could staff provide an assessment of the number and scale of businesses operated by or employing refugees?

We take note of staff's assessment that the DSA indicates that Nauru's public debt is sustainable over the medium term but would highlight substantial uncertainty about this result and encourage the authorities to strengthen their debt management capacity.

Given long-standing external arrears, uncertainty about future fiscal revenues and no prospective market access, we would highlight uncertainty about the evolution of Nauru's public debt burden. In addition, we would note that the current value of the defaulted Yen bonds is subject to negotiations and any future plan to convert the Nauru Phosphate Royalty Trust losses into government debt would add to uncertainty about debt sustainability. Against this background, we fully concur with the importance of establishing sound public debt management in a timely manner, including the reconciliation and resolution of old debt through good faith negotiation with creditors.