



Concept Paper

Project Number: 52073-001
August 2019

Proposed Policy-Based Grant Nauru: Improving Public Investment Management Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 21 June 2019)

Currency unit	–	Australian dollar/s (A\$)
A\$1.00	=	\$0.6924
\$1.00	=	A\$1.4443

ABBREVIATIONS

ADB	–	Asian Development Bank
FMIS	–	financial management information system
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
NTF	–	Nauru Intergenerational Trust Fund
RPC	–	Regional Processing Center
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government of Nauru ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 30 June 2019.
- (ii) In this report, “\$” refers to United States dollars, unless otherwise stated.

Vice-President	Ahmed M. Saeed, Operations 2
Director General	Ma. Carmela D. Locsin, Pacific Department (PARD)
Directors	Xiaoqin Fan, Regional Director, Pacific Liaison and Coordination Office, PARD Emma Veve, Social Sectors and Public Sector Management Division, PARD
Team leaders	Jacqueline Connell, Senior Economics Officer, PARD Matthew Hodge, Senior Country Specialist, PARD
Team members	Marie Miel de Villa, Project Analyst, PARD Vino Jose, Senior Operations Assistant, PARD Roshan Ouseph, Counsel, Office of the General Counsel
Peer reviewer	Alexander Julian, Financial Sector Economist, Central and West Asia Department

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 52073-001	
Project Name	Improving Public Investment Management Program	Department/Division	PARD/PLCO
Country Borrower	Nauru Ministry of Finance, Nauru	Executing Agency	Ministry of Finance
2. Sector		Subsector(s)	
✓ Public sector management	Public expenditure and fiscal management	ADB Financing (\$ million)	
	Reforms of state owned enterprises		2.50
		Total	5.00
3. Strategic Agenda		Subcomponents	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change Information	
		Climate Change impact on the Project	Low
4. Drivers of Change		Components	
Governance and capacity development (GCD)	Public financial governance	Gender Equity and Mainstreaming	
Partnerships (PAR)	Bilateral institutions (not client government)	Some gender elements (SGE)	✓
Private sector development (PSD)	Official cofinancing Public sector goods and services essential for private sector development		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
General Intervention on Poverty	No		
SDG Targeting	Yes		
SDG Goals	SDG16		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		5.00	
Sovereign Stand-Alone Policy-Based Lending (Grant): Asian Development Fund		5.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		5.00	
Currency of ADB Financing: USD			

I. THE PROPOSAL

1. The proposed Improving Public Investment Management Program will help the Government of Nauru implement policy and institutional reforms to strengthen public expenditure and asset management, and the governance of state-owned enterprises (SOEs).¹ The program will support Strategy 2030's key operational priority of strengthening governance and institutional capacity.² It also reflects Strategy 2030's focus in small island developing states on reforming SOEs and strengthening public service delivery. The program is aligned with the Pacific Approach, 2016–2020 of the Asian Development Bank (ADB), and will build on 7 years of ADB technical assistance (TA) and policy engagement with the Government of Nauru.³

2. The proposed program will be financed through a single-tranche stand-alone policy-based Asian Development Fund grant in the amount of \$5 million. The program will be undertaken in concert with ongoing ADB policy dialogue and targeted TA to support the government as it undertakes difficult but necessary reforms under its National Sustainable Development Strategy, 2005–2025.⁴ ADB will mitigate the risk of weakening reform momentum after grant effectiveness through a post-program partnership framework.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Development context.** Nauru's remote location and diseconomies of scale raise operating costs, limit private sector development, and leave Nauru's institutions thinly resourced. This hampers efforts to deliver basic public services and leaves Nauru's narrow economy vulnerable to shocks. Following rapid economic growth averaging 17.6% during fiscal year (FY) 2013 to FY2017, gross domestic product (GDP) contracted by an estimated 2.4% in FY2018 as the Regional Processing Center (RPC) for asylum seekers scaled down and phosphate exports slowed.⁵ Economic performance is expected to remain weak. The International Monetary Fund (IMF) projects that GDP growth will average 0.5% during FY2019-FY2023.⁶ Public expenditure is heavily dependent on volatile sources of income such as fishing license fees and the RPC.

4. **Public expenditure and asset management.** Significant public investment has been made since 2012 in activities related to the RPC, and by development partners in a hospital redevelopment, education facilities, and electricity generators. More investment is planned,

¹ The program is included in ADB. 2018. *Country Operations Business Plan: 11 Small Pacific Island Countries, 2019–2021*. Manila.

² ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

³ ADB. 2017. *Pacific Approach, 2016–2020*. Manila; ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Nauru for the Fiscal Sustainability Reform Program*. Manila; ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Nauru for the Public Financial Management Reform Program*. Manila; ADB. 2018. *Technical Assistance Completion Report: Nauru Tariff and Subsidy Policy Reform*. Manila; ADB. 2017. *Technical Assistance Completion Report: Institutional Strengthening of the Nauru Utilities Corporation*. Manila; ADB. 2013. *Technical Assistance for the Establishment of the Pacific Regional Infrastructure Facility Coordination Office*. Manila; ADB. 2013. *Technical Assistance for the Pacific Private Sector Development Initiative, Phase III*. Manila; and ADB. 2013. *Technical Assistance for the Pacific Economic Management (Phase 2)*. Manila.

⁴ Government of Nauru. 2005. *National Sustainable Development Strategy, 2005–2025*. Yaren (revised 2009).

⁵ ADB. 2019. *Asian Development Outlook 2019*. Manila; and ADB. 2018. *Asian Development Outlook 2018*. Manila.

⁶ IMF. World Economic Outlook Database. <https://www.imf.org/external/pubs/ft/weo/2019/01/weodata/index.aspx> (accessed 13 May 2019).

including in a seaport.⁷ Yet the returns from this scaled-up investment risk being undermined by weaknesses in the management of public expenditure and assets. Low levels of budget transparency and outdated financial instructions do not support efficient public expenditure management. Inadequate procurement planning and monitoring, combined with Nauru's geographic isolation, often result in high unit costs of public procured goods and supply shortages. Without a central register of public asset information, the government cannot efficiently allocate financial resources across preventative maintenance and new capital investments. Inadequate maintenance spending can lead to premature asset failures.

5. **State-owned enterprises.** Nauru's SOEs manage large public assets to deliver important public services, contributing about one-half of GDP and one-third of employment.⁸ However, there is no overarching accountability framework or central unit in the government to monitor the performance of SOEs. Financial objectives are often mixed with unfinanced directives to deliver community service obligations, distorting SOE performance incentives. Only one-third of SOEs keep up-to-date financial information, which limits the government's ability to monitor their operations. Poorly performing SOEs absorb large amounts of scarce capital on which they provide low returns and divert government resources away from other critical investments.⁹ To build a sustainable economic future, Nauru needs to manage its public investments more effectively to ensure better value for money and better service delivery.

B. Policy Reform and ADB's Value Addition

6. **Reform achievements.** The government has pursued wide-ranging economic reforms supported by two ADB policy-based programs and related TA from ADB and other development partners.¹⁰ Reforms completed under the first policy-based program, the Public Financial Management Reform Program (2012), included (i) introducing a fully automated financial management information system (FMIS) to replace the existing manual one; (ii) establishing a revenue office, which has since implemented several new revenue measures; (iii) adopting a public procurement policy and outsourcing model; (iv) corporatizing the power and water utility; and (v) increasing women's representation on SOE boards.¹¹ Reforms completed under the second policy-based program, the Fiscal Sustainability Reform Program (2016), included (i) producing a government balance sheet through operationalizing further functions of the FMIS; (ii) producing quarterly financial reports for the minister of finance; (iii) approving and implementing an employment and services tax act, which generated revenue equal to 9% of GDP in its first full year; (iv) adopting a strategic plan and tariff reforms for the state-owned power and water utility, which reduced fiscal transfers and improved the electricity and water supply; and (v) establishing the Nauru Intergenerational Trust Fund (NTF), which has enabled the country to save both windfall public revenue and development partner contributions for future investments in public education, health, and infrastructure.¹²

⁷ ADB. 2017. *Report and Recommendation of the President: Proposed Grant and Administration of Grants to Nauru for the Sustainable and Climate-Resilient Connectivity Project*. Manila.

⁸ IMF. 2017. Republic of Nauru: Staff Report for the 2017 Article IV Consultation. *IMF Staff Country Report*. No. 17/82. Washington, DC.

⁹ ADB. Nauru SOE Diagnostic: Private Sector Development Initiative. Unpublished.

¹⁰ ADB. 2016. *Completion Report: Public Financial Management Reform Program in Nauru*. Manila; and ADB. 2017. *Completion Report: Fiscal Sustainability Reform Program in Nauru*. Manila.

¹¹ Appointing at least one woman to three SOE boards was a policy action of the Public Financial Management Reform Program. By 2014, five SOEs had at least one woman on the board, compared with one SOE in 2011.

¹² The NTF is intended to help smooth out windfall revenue in the medium term and replace or supplement volatile future revenue. Government of Nauru. 2018. *Intergenerational Trust Fund for the People of the Republic of Nauru: Annual Report 2018*. Yaren.

7. **Policy reform priorities.** ADB's two previous policy-based program completion reports highlighted that ongoing reforms, which build on past achievements, were needed to secure a sustainable improvement in Nauru's public finances, economy, and ultimately living standards. The reports recommended that future support should focus on public financial management, asset management policy, the NTF, and SOE performance (footnote 10). The proposed program will support reforms in these areas and incorporate lessons learned in tailoring ADB's support to Nauru's thin institutional capacity. This includes limiting reform to a small number of major actions that are linked to government strategy and underpinned by technical assessment, and coordinating with development partners to provide complementary TA.

8. **Reform area 1: Public expenditure management.** The indicative policy actions will consolidate and broaden earlier reforms to budget reporting, execution, and transparency; and assess the remaining weaknesses with public procurement. Indicative policy actions include

- (i) the cabinet approving a review of Nauru's public procurement system (including SOEs), which identifies reform options to strengthen public procurement;
- (ii) operationalizing further modules of the FMIS; approving new financial instructions on general principles, payments, and budget; and the publication of annual and quarterly budget reports for FY2019, and audited financial reports for FY2015 and FY2016 on the Ministry of Finance (MOF) website; and
- (iii) building the value of the NTF in line with the contribution guidelines.

9. **Reform area 2: Public asset management.** The cabinet approved the Infrastructure Asset Management Policy in 2018, which calls for the development of a central asset register and an integrated infrastructure management strategy to help the government achieve a better balance between its capital investments and maintenance spending. Indicative policy actions include

- (i) establishing a central asset register to convey the assets' condition, location, and financial information; and
- (ii) preparing an integrated infrastructure management strategy, which prioritizes public infrastructure investments in new capital, rehabilitation, and maintenance based on a set of economic and social criteria that includes gender.¹³

10. **Reform area 3: Governance of state-owned enterprises.** In line with IMF policy advice (footnote 8) and building on reforms completed by the power utility under the previous policy-based programs, MOF is committed to establishing an overarching policy, legal, and monitoring framework for SOEs to operate under. Indicative policy actions include

- (i) the cabinet approving an SOE policy, which establishes principles to guide SOE reform;
- (ii) the cabinet approving an overarching SOE bill (based on the SOE policy), which creates a framework for SOEs to be commercially successful while establishing accountability and reporting arrangements to the government as owner of the SOEs. The bill also includes a provision that SOEs promote gender equality in their employment practices, policies, and board memberships; and
- (iii) establishing a public enterprise monitoring unit to review SOE performance and provide advice to the responsible minister on issues including community service obligations, SOE director appointments and SOE restructure initiatives.

¹³ Among other factors, the prioritization exercise is expected to assess how various infrastructure investments improve local employment prospects for women, and improve general security and safety.

11. **ADB value addition.** ADB's strong relationship with the government has played an important role in identifying critical reforms. ADB is coordinating closely with other development partners, particularly the Governments of Australia and New Zealand, to provide complementary TA in the area of public investment management. Australia is providing in-line support to the MOF and the state-owned power utility to implement several program-related reforms. Complementing this, ADB is using regional TA to bring international expertise to support (i) a review of Nauru's procurement system, and (ii) analysis and preparation of an SOE policy and legislative framework.¹⁴ The Pacific Regional Infrastructure Facility, a regional TA facility administered by ADB, is sharing experience from other Pacific countries as it supports Nauru's public asset registry and integrated infrastructure management strategy. Reform implementation would be difficult and costly without ADB's analytical, technical, and financial support.

C. Impacts of the Reform

12. The program will help the government achieve the first two goals under its National Sustainable Development Strategy: (i) a stable, trustworthy, and fiscally responsible government; and (ii) the provision of enhanced social, infrastructure, and utilities services. The effect of the reform will be improved fiscal sustainability and public investment management.

D. Development Financing Needs and Budget Support

13. The government has requested a grant not exceeding \$5 million from ADB's Special Funds resources (Asian Development Fund) to help finance the program. The proposed grant size was determined after considering the country's development financing needs and the government's commitment to economic and fiscal reform. While not targeting an official annual budget balance, the government aims to maintain a fiscal cash buffer of at least 2 months of spending (equal to about 13% of GDP), excluding spending related to the RPC, as recommended by the IMF. Given significant revenue volatility projected in FY2020, the program grant will help the government to maintain this fiscal cash buffer above the IMF-recommended level. The program funding will also help to build the value of the NTF, which is critical for the country's long-term development financing needs (para. 6).

E. Implementation Arrangements

14. The MOF, as the executing agency, will oversee the implementation of agreed policy actions and will be responsible for the program's overall administration and records management. The implementing agencies will be the MOF and the Department of Infrastructure Development. The indicative program implementation period is from 1 March 2018 to 30 September 2019, when the indicative prior actions are targeted for completion. Nauru's national election will be held by the third quarter of 2019. To reduce the risk of weakened reform commitment by the government, ADB plans to complete grant negotiations with the new government, including finalization of the development policy letter. During grant effectivity, ADB will monitor the implementation of reforms according to a post-program monitoring framework.

¹⁴ ADB. 2013. *Technical Assistance for Pacific Economic Management (Phase 2)*. Manila; ADB 2013. *Technical Assistance for the Establishment of the Pacific Regional Infrastructure Facility Coordination Office*. Manila; and ADB. 2013. *Technical Assistance for Pacific Private Sector Development Initiative, Phase III*. Manila.

III. DUE DILIGENCE REQUIRED

15. ADB will conduct due diligence for the program in consultation with Nauru's development partners. This will include an assessment of the public sector focusing on its management and SOEs, and a risk assessment and risk management plan covering the country's public financial management systems. The program is expected to be classified as category C for environment, involuntary resettlement, and indigenous peoples; and to be classified as having some gender elements. Consultation will continue with development partners, including the IMF, which will include the request for an assessment letter.¹⁵

IV. PROCESSING PLAN

A. Risk Categorization

16. The program is categorized as low risk because (i) the grant does not exceed \$50 million, (ii) ADB has a sound track record in the country's public sector, (iii) the executing agency has demonstrated a reasonable level of ability in administering previous externally financed projects, and (iv) the operation is not classified as category A for safeguards.

B. Resource Requirements

17. ADB will use an estimated 4 person-months of international and 8 person-months of national staff time to prepare the program. ADB has fielded several consultation missions that have enabled considerable policy dialogue on the government's reform priorities. Regional TA will be available to support the program's policy actions (footnote 14).¹⁶ The Government of Australia and the Pacific Financial Technical Assistance Centre of the IMF are providing ongoing TA support for public finance management reforms.

C. Processing Schedule

Proposed Processing Schedule

Milestones	Expected Completion Date
Fact-finding mission	8–12 July 2019
Management review meeting	August 2019
Grant negotiation	October 2019
Board consideration	December 2019
Grant effectiveness	December 2019

Source: Asian Development Bank.

V. KEY ISSUES

18. ADB will pay particular attention during program processing and implementation to maintaining the government's commitment to program reform and managing the political economy, especially between election cycles. ADB will collaborate closely with development partners to ensure that TA is available to provide technical expertise and to supplement government capacity.

¹⁵ Initial Poverty and Social Analysis (accessible from the list of linked documents in Appendix 3).

¹⁶ The implementation and sustainability of reforms will also be supported through ADB's proposed Pacific Improving Public Financial Management Facility for Nauru, Solomon Islands, and Vanuatu.

DESIGN AND MONITORING FRAMEWORK
(Initial Draft)

Country's Overarching Development Objectives			
Stable, trustworthy, and fiscally responsible government (National Sustainable Development Strategy, 2005–2025) ^a			
Provision of enhanced social, infrastructure, and utilities services (National Sustainable Development Strategy, 2005–2025) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Reform Strengthened fiscal sustainability and public investment management	a. Government contributions to the NTF equal at least A\$75 million by June 2021 (June 2018 baseline: A\$47.13 million) b. Four SOEs prepare audited financial statements and submit their annual reports for FY2021 to the responsible minister by 31 December 2021 (December 2018 baseline: Two SOEs published audited financial reports)	a. 2021 Annual Report for the Intergenerational Trust Fund for the People of the Republic of Nauru b. Confirmed by ADB and a letter from the minister of finance confirming the submission of the annual reports and preparation of audited financial statements	Severe shock to government revenue results in lower or deferred contributions to the NTF Capacity constraints among SOE management prevent the timely preparation of annual reports and accounts
Reform Areas	Indicative Policy Actions		
1. Public expenditure management	By 30 September 2019: 1.1 Cabinet approves a review of Nauru's procurement system, which identifies reform options to strengthen public procurement (2017 baseline: Not approved) 1.2 Annual and quarterly in-year budget reports for FY2019 and audited financial reports for FY2015 and FY2016 published on the Ministry of Finance website (FY2017 baseline: Not available online) 1.3 Financial instructions approved on general principles, payments, and budget (2017 baseline: Not approved)	1.1 Cabinet decision 1.2 Government website, confirmed by ADB 1.3 Government website, confirmed by ADB	Leadership and political will to complete the reforms is lacking because of vested interests Capacity constraints and staff turnover reduce the quality of reform implementation

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Reform Areas	Indicative Policy Actions 1.4 Government builds the value of the NTF in line with the contribution guidelines	1.4 Budget documents and deposits in the NTF	
2. Public asset management	By 30 September 2019: 2.1 Government establishes a central asset register for managing public infrastructure assets to convey the assets' condition, location, and financial information (2017 baseline: Not applicable) 2.2 Cabinet approves the Nauru integrated infrastructure management strategy, which prioritizes capital investment, and rehabilitation and maintenance of public infrastructure based on a set of criteria that includes gender (2017 baseline: Not approved)	2.1 Letter from the minister of finance attesting to the establishment of the asset register, confirmed by ADB 2.2 Cabinet decision	
3. Governance of SOEs	By 30 September 2019: 3.1 Cabinet approves an SOE policy that establishes principles to guide SOE reform (2017 baseline: Not approved) 3.2 Cabinet approves an SOE bill that sets accountability, monitoring, and reporting responsibilities, and directs SOEs to promote gender equality through their employment practices and policies, and within memberships of boards (2017 baseline: Not approved) 3.3 Cabinet approves the establishment and resourcing of a public enterprise monitoring unit (2017 baseline: Not applicable)	3.1 Cabinet decision 3.2 Cabinet decision 3.3 Cabinet decision to establish the unit and a letter from the minister of finance confirming that the unit is resourced	

Budget Support

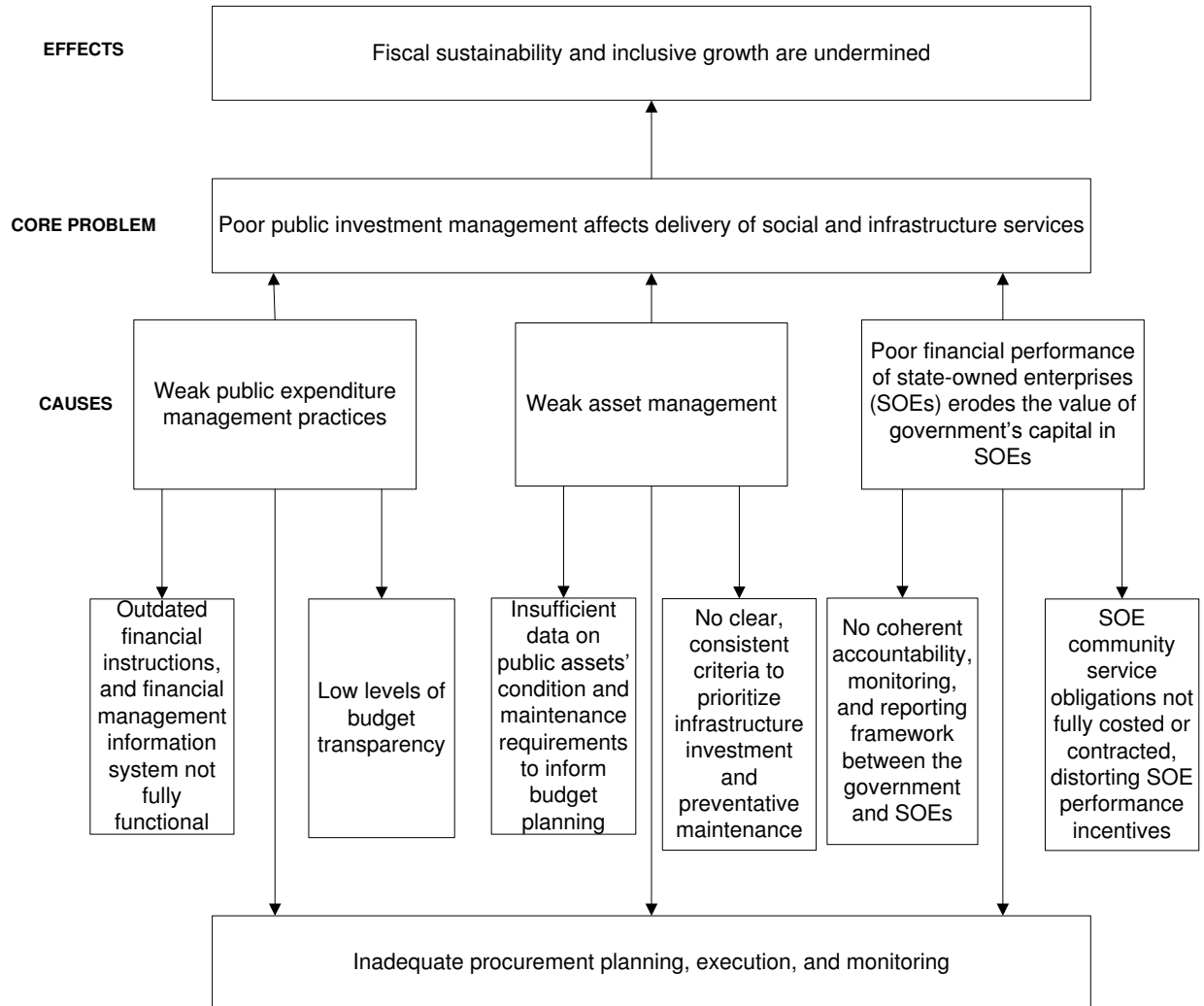
ADB: \$5 million (grant)

ADB = Asian Development Bank, FY = fiscal year, NTF = Nauru Intergenerational Trust Fund, SOE = state-owned enterprise.

^a Government of Nauru. 2005. *National Sustainable Development Strategy, 2005–2025*. Yaren (revised 2009).

Source: ADB.

PROBLEM TREE



Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=52073-001-ConceptPaper>

1. Initial Poverty and Social Analysis