Country Economic Report

November 2007

Nauru

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 November 2007)

Currency Unit	–	Australian dollar (A$)
A$1.00	=	$0.93
$1.00	=	A$1.07

ABBREVIATIONS

ADB	–	Asian Development Bank
BON	–	Bank of Nauru
GDP	–	gross domestic product
GFS	–	government finance statistics
IOM	–	International Organization for Migration
MOU	–	memorandum of understanding
NPC	–	Nauru Phosphate Corporation
NRC	–	Nauru Rehabilitation Corporation
NSDS	–	National Sustainable Development Strategy
RONPhos	–	Republic of Nauru Phosphate Corporation
SNA	–	system of national accounts
SOE	–	state-owned enterprise

NOTES

(i) The fiscal year (FY) of Nauru ends on 30 June.
(ii) In this report, "$" refers to US dollars, unless otherwise stated.

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EXECUTIVE SUMMARY

Nauru is one of the world's smallest countries and arguably one of the most remote. Consisting of a single island of 21 square kilometers, Nauru has a central plateau 40–60 meters (m) above sea level with a surrounding strip of coastal land 150–300 m wide, where most of the population of approximately 9,000 live.

Despite the disadvantages presented by a small size and remoteness, the export of phosphate had seen Nauru accumulate substantial offshore assets that peaked at approximately $1 billion. But a decline in phosphate mining that began in the late 1980s, combined with poor management of the country's offshore assets and public expenditure, led to a dramatic deterioration in its economic and fiscal position.

Assets held in public trust funds were run down by the Government as it borrowed against them and used the proceeds to fund recurrent expenditure. When this source of funding was exhausted, the Government was unable to either service foreign loans or fully fund recurrent expenditure. Nauru is now undergoing a period of intense change as it adjusts to a much lower standard of living. Recent levels of gross domestic product (GDP) per capita of approximately $2,500 have remained above that seen in some of Nauru's neighbors. But incomes are at a risk of falling further given pressure on the size of the public sector.

The ratio of public external debt to gross domestic product (GDP) is extremely high at the order of 1,000%. There are also large debts within Nauru, notably to civil servants for unpaid wages and salaries, between the government-owned enterprises and the Government and to deposit holders in the national bank, the Bank of Nauru. In total, local debts are of the order of 1,700% of GDP. The Bank of Nauru ceased operations in the late 1990s and there is no formal finance sector.

Nauru has been provided a window of opportunity to implement reforms through support provided by the Australian Government. In 2002, a memorandum of understanding was agreed between the two countries with respect to the establishment of a refugee processing center. This agreement provided a source of income and bolstered the budget at a time when essential services were under severe stress. Australian aid (approximately A$20 million per year) is being used to refurbish infrastructure and address health and education needs. In the absence of Australian and other donor assistance, Nauru would by now have been in a state of total economic collapse.

Phosphate mining also recommenced in FY2007, albeit on a very small scale. But significant increases are expected over the medium term as infrastructure bottlenecks are relieved. More importantly, studies have concluded it is commercially feasible to commence mining of secondary phosphate reserves. Primary phosphate reserves are estimated to be sufficient to support 5 years of mining, while secondary phosphate reserves may equal a 30-year supply, possibly worth as much as A$1 billion.

Reforms need to be adopted and maintained if the country is to have a sustainable economic future. A reformist government was elected in 2004. Among other initiatives, the Government has:

(i) balanced the budget;
(ii) begun to restructure departments and the state-owned enterprises, putting them on a more commercial footing;

(iii) implemented significant wage cuts and a large-scale redundancy for public sector employees;
(iv) enacted and enforced legislation abolishing the offshore banks used by various criminal syndicates for money laundering (as a result, Nauru was removed from the Financial Action Task Force blacklist); and
(v) developed a National Sustainable Development Strategy with wide community involvement.

There are a range of other issues that need to be addressed, the foremost of which is the need to develop a response to Nauru's extremely high level of international and domestic debt. Attempts to repay even a relatively small share of the external debt could place severe pressure on the budget, potentially absorbing any fiscal surplus offered by the renewal of phosphate mining, and compressing public expenditure on essential services. Uncertainty over whether unpaid public salaries or deposits in the national bank will be honored has the potential to fuel political instability and deter reform efforts. Nauru's debt could serve to prevent economic recovery, given the debt-to-GDP ratio of 2,700%.

There is an associated need to clean up the failed financial institutions and to begin re-establishing financial credibility in international markets. The Bank of Nauru has been out of operation for almost 10 years, and the Republic of Nauru Insurance Company is also bankrupt and unable to offer insurance policies. Independent receivers need to be appointed to wind up the Bank of Nauru, the Nauru Insurance Corporation and the finance corporation (Republic of Nauru Finance Corporation).

More broadly, deep-seated governance reforms are essential requirements for Nauru's development. The absence of accountability and transparency, particularly of public corporations, was central to Nauru's severe economic deterioration; concerted, corrective action is required to achieve a sustainable improvement in performance.


166°55'E
166°57'E
SOUTH PACIFIC OCEAN
NAURU
0°30'S
0°33'S
Ronawi
Anna
ANETAN
EWA
Anabar
Baiti
ANABAR
Uaboe
BAITI
Ijuw
Nibok
IJUW
UABOE
Ganokoro
Arijejen
NIBOK
DENIGOMODU
Yangon
Anibare
ANIBARE
BUADA
AIWO
Anibare Bay
Buada Lagoon
Buada
Boe
BOE
MAKWA
MENENG
YAREN
Runway
Nauru Aerodrome
Meneng
N
0 0.5 1.0 1.5
Kilometers
National Capital
District/Town
Road
Railway
Topside
District Boundary
International Boundary
Boundaries are not necessarily authoritative.
150°00'E
170°00'W
North Pacific Ocean
20°00'N
PACIFIC REGION
International Dateline
Philippine Sea
MARSHALL ISLANDS
REPUBLIC OF PALAU
FEDERATED STATES OF MICRONESIA
0°
NAURU
KIRIBATI
INDONESIA
PAPUA NEW GUINEA
SOLOMON ISLANDS
TUVALU
SAMOA
Coral Sea
VANUATU
COOK ISLANDS
REPUBLIC OF THE FIJI ISLANDS
TONGA
20°00'S
AUSTRALIA
South Pacific Ocean

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I. INTRODUCTION

A. Geography and Environment

1. Nauru is located on the summit of an ancient volcanic sea mount. It is 41 kilometers (km) south of the equator, some 2,000 km east-northeast of Papua New Guinea, and 300 km due west of the nearest island, Banaba in Kiribati.

2. The island is surrounded by deep water and has no protective outer reef or natural harbor. It is skirted by a narrow coral reef, which is exposed at low tide and dotted with vertical coral outcrops. It is about 4 km in diameter and 21 square kilometers (km^2) in area. It consists of a central plateau 40–60 meters (m) above sea level, bordered by a wooded escarpment, below which lies a strip of coastal land 150–300 m in width. The plateau area, known locally as "topside", consists mainly of previously mined land; it forms an inaccessible landscape of jagged, closely spaced coral pinnacles, each about 5 m high, interspersed with weeds and low shrubs. Buada lagoon lies southwest of the plateau, surrounded by an area of fertile land and residential housing. The population is concentrated in the coastal strip and around Buada lagoon.

3. Nauru is not subject to tropical cyclones. Cyclones form further south (south of 5° latitude) and move away from the equator. The country does, however, occasionally suffer from cyclonic storm surges that inundate low-lying areas along the coastal strip. As with other Pacific island countries, it is strongly influenced by the El Niño southern oscillation phenomenon. El Niño years are wet and stormy with up to 4,000 millimeters (mm) of rain per year. La Niña years are drier and often bring prolonged drought periods, when rainfall averages about 1,000 mm per year. While recent years have seen slightly lower than average rainfall, there are insufficient data to draw any strong conclusions about the impacts of climate change.

4. The island has abundant mineral and marine resources. Geologically, it consists of a 500 m column of limestone that sits atop the seamount and is interlaced with high-grade marine phosphate. Nauru's 200 nautical mile exclusive economic zone (EEZ) encloses a maritime zone of some 430,000 km^2, making it about the 40th largest in the world.[1]

B. Population

5. The resident population of Nauru was 9,872 at the time of the 2002 Census, including 7,572 indigenous Nauruans and 2,300 others, mainly workers and their families from Kiribati (1,157), Tuvalu (307), and the People's Republic of China (512).[2] Between 1992 and 2002, net outward migration equaled about 218 per year, roughly evenly split between Nauruan and non-Nauruan. No official figures on migration have been compiled for the period since 2002. However, anecdotal reports suggest that the rate of emigration has increased, particularly among the non-indigenous residents. The Chinese residents have been gradually selling their assets and moving to the People's Republic of China as the demand for restaurant services has declined with the Nauruan's falling incomes.

6. More recently, in 2006 the Government repatriated almost all of the remaining Tuvaluan and I-Kiribati workers (some of whom were second and third generation residents), following

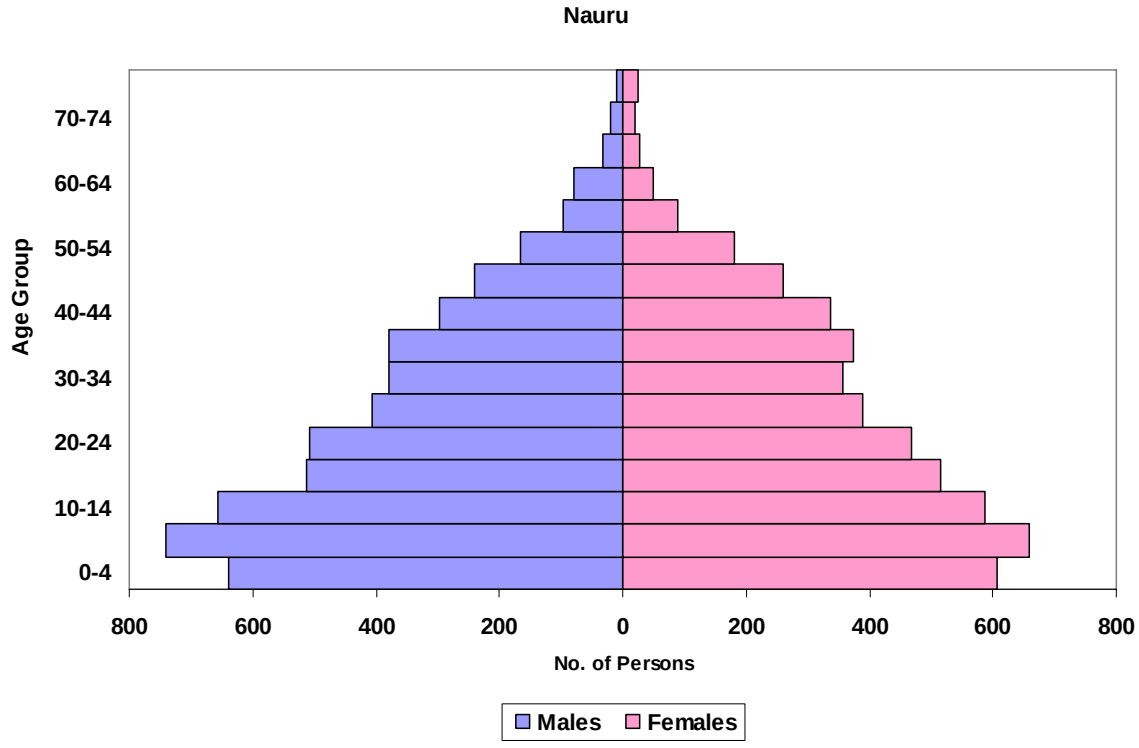
[1] The area is provisional until a formal Exclusive Economic Zone is declared. Nauru shares maritime boundaries with Kiribati and the Marshall Islands and exact allocations are yet to be agreed.

[2] The 497 non-Nauruans born in Nauru were allocated across categories.

large scale redundancies from the Republic of Nauru Phosphate Corporation (RONPhos) and government departments. It is estimated that approximately 1,500 people departed during the repatriation. A mini-Census conducted in December 2006 indicated a population of 9,275 persons as at end-2006.

7. Nauru has a high total fertility rate with an average of 3.9 births per woman, and an implied natural population growth of around 2.5% per year, suggesting a doubling of population every 28 years (in the absence of migration). However, it also has a high mortality rate. The combination of past high birth rates and high mortality rates has skewed the population distribution toward children and young adults (Figure 1). The birth rate has fallen in recent years, particularly in 2005 when it fell to around half the normal rate. The reasons for this are not clear, but it seems likely to have been a cyclical phenomenon associated with reduced incomes and increased hardship among some sections of the population. There were no previous signs of a significant trend decline. If mortality rates are reduced and fertility rates remain at historical levels, the population could grow rapidly.

Figure 1: Population Distribution of Indigenous Nauruans



Source: Secretariat of the Pacific Community. "Pacific Island Populations 2004"[3]

8. Most of the habitable land is located at fringes of the island, and anecdotal evidence indicates that Nauru already has one of the highest population densities in the Pacific. Population density has fallen recently with the repatriation of non-Nauruan workers. However, population pressure is likely to increase rapidly in the absence of either higher levels of emigration or reduced levels of natural increase. Greatly increased emigration seems unlikely,

[3] Available: *www.spc.int*.

given the Nauruans' pride in their heritage—96% of Nauruans use Nauruan as the main language at home[4]—and apparent reluctance to migrate. Despite the current decline in the economy, only a small number of Nauruans leave the island each year. The current reduction in birth rates also seems unlikely to continue. For cultural and religious reasons, the Government does little to encourage active family planning.

C. Historical Background

9. Nauru is believed to have been first occupied around 3,000 years ago during the initial eastward migration that settled Micronesia and Polynesia. From that time until the arrival of Europeans, the island supported a stable population of around 1,800 people, whose diet consisted mainly of fish and pandanus fruit. The island was first sighted by Europeans in 1798 when the whaler Captain John Fearn chanced upon it during a voyage between New Zealand and China, and named it "Pleasant Island". From the 1830s onwards, the island was frequented by whalers who used it as a source of fresh supplies. The whalers brought with them European diseases that decimated the population. They also bought guns and alcohol, which were traded with the islanders for food. In 1878, a 10-year civil war began between the 12 tribes, with devastating effect on the population (which fell from 1,400 to 900). The civil war ended when the island was annexed by Germany as part of its New Guinea and Marshall Islands territory under an Anglo-German treaty of 1888.

10. In 1899, Albert Ellis, an Australian analyst at a British prospecting firm in Sydney, discovered that a rock from Nauru that was holding open his door was rich in phosphate. In 1900, he traveled to Nauru to confirm the finding. In 1906, the Pacific Phosphate Company began mining under agreement with the German administration.

11. In 1914, with the outbreak of the First World War, Australian troops occupied the island. The German residents were subsequently deported. At the end of the war, the island became a mandated territory under the League of Nations. The League granted joint trusteeship to Australia, New Zealand, and United Kingdom. In 1919, the three governments negotiated and signed the Nauru Island Agreement, creating the British Phosphate Commission. Like many other Pacific islands, the country was also devastated by Spanish influenza in the same year.

12. In August 1942, the Japanese occupied the island, beginning 3 years of extreme hardship for the islanders. The island was subject to bombing by the Americans in 1943. In the same year, 1,200 Nauruans were deported to the Chuuk islands to work as laborers, and 463 died.

13. In 1947, the Trusteeship was re-established under the auspices of the United Nations and Australia. The Trusteeship Council of the United Nations replaced the Permanent Mandates Commission of the League of Nations. Nauru gained self government in 1966 and became fully independent on 31 January 1968, with Hammer DeRoburt (one of the workers deported to Chuuk) becoming the first President.

[4] Bureau of Statistics, Government of Nauru. 2005. *Census Report 2002.* Nauru (p. 26).

D. Political Organization and Government

14. Nauru is a Westminster-type constitutional democracy.[5] The Government has two branches: the executive, consisting of a president and his cabinet; and the legislature, consisting of a unicameral parliament with 18 members elected every 3 years. The President performs the functions of both the head of state and head of government.

15. The legal system is rather complicated for such a small country, and includes (i) a supreme court presided over by a chief justice; (ii) an appellate court; (iii) lower courts consisting of a district court; and (iv) a family court presided over by a resident magistrate who is also a registrar of the Supreme Court. The Supreme Court deals exclusively with constitutional matters. Appeals can be made from the appellate court to the high court of Australia, but in practice this rarely happens. The chief justice also presides over a public service appeals tribunal and a police tribunal.

16. For the first two decades following independence, Nauru's political system was very stable. Hammer DeRoburt served as President for most of the period from 1968 to 1989 (apart from a brief period in 1977). However, from 1990, the nation was plagued by political instability, and Nauru had 21 changes of administration between 1989 and 2004. The last 2 years of this period were particularly tumultuous. Following riots at the Refugee Processing Center at the start of 2003, the Government was voted down in a no-confidence motion, which was followed by a brief period of lawlessness during which the State House (the presidential residence) was burned down. Following the death of President Dowiyogo from renal failure in March 2003, President Ludwig Scotty was elected in May. Scotty briefly lost power to former President Rene Harris but regained it in June 2004. During this period, David Adeang (the minister for finance and minister for foreign affairs and trade) and Kieren Keke (the minister for health and minister for transport) were arrested and charged with sedition. On returning to power, Scotty appointed a young, pro-reform Cabinet and indicated his intention to address the long-term issues facing Nauru. A stalemate developed in Parliament in September 2004, leading the President to call another election in October 2004.

17. Scotty's pro-reform government won in a landslide at the election. All nine government members of Parliament were returned to Parliament, while the opposition retained only two seats, with the remaining seven seats won by young reform-minded candidates. The results indicated strong support for change. However, debate remained about the pace of change and the type of reform, with for example the fiscal year (FY) 2007 budget passing by only one vote. A national election held in August 2007 returned the pro-reform Government.

[5] Westminster is the name given to the system of parliamentary democracy used in countries such as Australia, Canada, New Zealand, and the United Kingdom, with governments formed in democratically elected lower houses, separation of powers between executive and judiciary, and an independent public service.

II. THE ECONOMY

A. Overview

18. The economy of Nauru is dominated by the Government and its many state-owned enterprises (SOEs) and agencies. There is little in the way of formal, private sector activity. There are a number of historical reasons for this, including most importantly the way phosphate mining proceeds were dispersed to the population. Rather than being used for direct transfers such as wage subsidies, the money not allocated to the trust funds was dispersed through the provision of free services (e.g., electricity, water, housing and, in the case of Air Nauru, heavily subsidized air fares), and the provision of jobs virtually on demand for Nauruans in government departments and agencies. These jobs were paid at a high rate—for example, the (tax-free) minimum wage in 1994 was A$9,500 per annum—a level that far exceeded likely labor productivity levels. Low levels of labor productivity in turn were due to a lack of expenditure on education and training. The high wages available for low skilled work in the public sector reduced the incentive of Nauruans to engage in other activities or to develop their own skills, and reduced the prospective returns on private investment for anyone contemplating starting a business. The availability of high wages and free services on the island consequently stifled the development of private sector activity.

19. Adding to the problem was the complex system of land tenure. In Nauru, each piece of land has a large number of owners—both individual and family.[6] Non-Nauruans are not allowed to own land. The system of joint ownership means there is no real estate market, which dampens the incentive of individual occupants to maintain or improve the housing stock. In fact, very little of Nauru's capital stock is individually owned, and lack of maintenance is pervasive. The system of land ownership also appears to be part of the reason local market gardens have not developed, despite the recurrent lack of fresh fruit and vegetables on the island. The development of business activity is further constrained by the need for any business operated on the island by a non-Nauruan to have a Nauruan licensee.

20. These institutional features have resulted in restaurant and retail services being the only substantial private sector activity to develop in Nauru. As incomes of the native Nauruans have fallen, demand for these services has decreased; many of the restaurants and shops have closed, or are in the process of doing so.

B. Structure of the Economy

21. Phosphate mining provided the main source of the nation's income until the late 1980s, with production running at around 2 million tons per year in the 1970s and early 1980s. However, the industry contracted substantially over the 1980s, with the performance of other industries becoming relatively more important to the economy. Table 1 shows the estimated gross domestic product (GDP) by industry.

[6] The traditional system of interlocking claims and connections with particular pieces of land was probably much simpler when the population was at its original size of around 1,800. However, the population has more than quadrupled since that time, leading to an incredibly complex system of land rents (each portion of which has to be paid individually), and difficult negotiations for any proposal that involves the use of land.

Table 1: GDP by Industry (Value Added) at Current Prices

Item	FY2004 (A$ million)	FY2005 (A$ million)	FY2006 (A$ million)	FY2006 % of GDP
Agriculture	3.7	4.0	3.9	10.6
Mining	2.7	0.6	0.7	1.9
Manufacturing	0.1	0.1	1.9	5.2
Electricity, Water	(5.7)	(5.4)	(2.8)	(7.6)
Construction	1.2	1.1	2.5	6.8
Commerce, etc.	8.0	7.0	7.6	20.6
Wholesale and Retail	4.3	3.6	4.3	11.7
Vehicles	0.3	0.3	0.3	0.8
Accommodation	2.4	2.4	2.4	6.5
Restaurants	1.0	0.7	0.6	1.6
Transport, Communication	10.5	7.6	3.4	9.2
Finance and Business Services	1.1	1.1	1.1	3.0
Public Administration and Services	13.0	13.9	14.9	40.4
Personal, Other Services	0.3	0.3	0.3	0.8
Ownership of Dwellings	3.2	3.2	3.2	8.7
Government Consumption of Capital	0.3	0.3	0.3	0.8
GDP at Market Prices (A$ million)	38.4	34.0	36.9	100.0
Memo items:				
GDP at market prices excluding pending salaries for general government				
- A$ million	29.7	24.5	28.5	77.3
- ratio to GDP at market prices, %	77.4	72.0	77.3	–

FY = fiscal year, ( ) = negative, GDP = gross domestic product.
Sources: Budget papers for FY2005, FY2006, and FY2007; National Statistics Office, Department of Finance, other government departments and state-owned business enterprises.

22. Until recently, the salaries of public sector staff were not fully paid. An unpaid component instead accumulated as a government liability. The unpaid salaries are included in the estimate of GDP, in accordance with the United Nation's system of national accounts (SNA) requirement that pending salaries be valued at their full amount, and equaled 23% to 28% of GDP from FY2004 to FY2006.

23. Government reforms have led to a dramatic reduction in the size of public administration (including education and health services), with public administration's share of GDP forecast to fall from 43.7% in FY2006 to approximately 30% in FY2007. However, even with these reductions, public administration remains significant as a percentage of the economy, given the lack of development of other sectors. Construction, agriculture, and fishing are all underdeveloped, and finance and insurance are entirely absent. Construction activity is undertaken mainly by foreign workers employed on aid projects. The need for reform of the public utility is highlighted by the current negative value added of the electricity and water industry. This is a result of the negative operating surplus of the supplier, the Nauru Phosphate Corporation (NPC).[7] The collapse of Air Nauru and the consequent loss of its profitable routes has had a large negative impact on transport value added, highlighting the importance of running the new airline on a fully commercial cost-recovery basis.

24. GDP per capita was estimated at A$3,375 to A$3,800, or $2,400 to $2,715, from FY2004 to FY2006 (current prices). GDP per capita excluding pending salaries, which in this

[7] Detailed analysis of the problems with the utilities and proposals for reform can be found in the ADB technical assistance report (ADB. 2005. *Technical Assistance to Nauru for the Reform of the Nauru Phosphate Corporation*. Manila) and the comprehensive final report by Power Planning Associates on the Reform of the Nauru Phosphate Corporation, June 2006. The NPC was formerly responsible for supplying power and water on the island.

case is the more meaningful measure of income levels, was estimated at A$2,428 to A$2,946, or $1,733 to $2,102, over the same period (current prices).[8]

C. Labor Force, Employment, and Wages

25. Until recently, employment in Nauru was dominated by government departments and public enterprises, particularly the NPC. At the time of the 2002 census, SOEs employed about 2,000 people, 1,500 of whom worked at the NPC. Government departments and directorates employed around another 1,500, while the remainder of the workforce was mainly employed in restaurants, the retail trade, aid agencies, or the Refugee Processing Center. Unfortunately, data on the employment status of non-Nauruans do not seem to have been compiled from the census. Indigenous Nauruans had a relatively high labor force participation rate of 76.7% (partly because of the age profile of the population, as there are very few retirees) but also a high unemployment rate of 22.7%.

26. The occupational structure of the indigenous population is shown in Table 2. While 211 people were counted as professionals, data collected on educational qualifications show only 27 with an undergraduate university degree or higher. The occupational classifications are heavily skewed towards the unskilled, and there are critical shortages of key professions such as accountants, lawyers, managers, engineers, and doctors. The lack of accountants and lawyers is a problem given the heavy legislative and accountability requirements of running a sovereign government with its many departments and SOEs. It is very difficult, for example, to find properly qualified people to constitute the various boards of the SOEs.

Table 2: Occupational Profile, 15–55 Year Age Group
(persons)

Occupation	Total	Male	Female
Legislators, senior officials	54	45	9
Professionals	211	56	155
Technicians	178	115	63
Clerks	486	97	389
Service workers	417	254	163
Agriculture and fishery	19	16	3
Craft and trades	411	382	29
Plant and machine operators	177	161	16
Unskilled sales and services	443	278	165
Not applicable	0	0	0
Not specified	1,721	623	1,098
Total	**4,117**	**2,027**	**2,090**

Source: Bureau of Statistics, Census 2002.

27. Since 2002, the unemployment situation among indigenous Nauruans has worsened, particularly in 2006, when RONPhos experienced redundancies and the Department of Works was closed. By way of comparison, the unemployment and underemployment situation in Nauru today is probably worse than it was in Western countries during the depression of the 1930s. The Government has almost run out of money, is no longer able to borrow overseas, and has been forced to downsize. At the same time, despite the aid money being spent in Nauru, there is little in the way of demand being generated for local private sector activity or employment.

[8] It is the more meaningful measure as it better reflects the economy's ability to pay for expenditure. Under the usual measure of GDP, Nauru could increase its GDP by announcing pay increases and returning to the practice of 'paying' public sector staff more than can be afforded. In which case, the estimate of GDP would lack economic meaning.

Moreover, the repatriation of non-Nauruan workers has left shortages of skilled operators at the mine, and reduced the skill levels of the workforce generally.

28. The Government introduced new pay scales that became effective on 1 July 2006, although full cash payments under the new scales did not commence until April 2007. An A$8 per fortnight pay rise was provided on 1 July 2007, bringing the new minimum salary to A$150 per fortnight or A$3,960 per annum. The former official scales were much higher, but in practice the Government had been paying all workers irrespective of position a flat A$140 per fortnight for most of the 3 years to 1 July 2006.[9] The new salary scales reduce the minimum wage to levels that are more likely to be compatible with the productivity levels of unskilled workers, and also provide incentives for education and training by rewarding more highly skilled workers with relatively higher pay rates.

D. Money, Banking, and Prices

29. Nauru uses the Australian dollar as the means of exchange and does not issue its own currency. There are no active financial institutions or services on the island. Reserves at the Bank of Nauru (BON) were drawn down to the point where it could no longer meet its obligations to depositors, and it effectively ceased operating in 1998. Similarly, the Republic of Nauru Finance Corporation and the Nauru Insurance Corporation have also ceased operation and are effectively bankrupt, although none of the institutions has yet been formally wound up.

30. According to the BON chairman, the bank has about A$100 million dollars in deposits and A$400 million in outstanding loans. Some of the loans are to the Republic of Nauru Finance Corporation (which lent the money to the Government), and others are to local citizens, although few of the latter appear to have been collateralized. The Government has been running down accounts at the bank by accepting checks in payment for a small number of government services. For example, households are currently required to pay only $5 dollars of their monthly electricity bill in cash; the rest can be paid using checks drawn on their BON accounts. The Government is also considering paying its outstanding pending salary obligations into BON accounts, thereby consolidating its debt obligations to the local community at one point. Until recently, BON checks were accepted as exchange at local shops at around 10% of their face value. Reportedly, they are no longer being accepted.

31. The BON facilities are now used by the Government only for storing cash to pay salaries, which are paid over the counter on presentation of a paycheck. Proposals have been mooted since 1999 for the Government to arrange for foreign institutions to establish banking and insurance services on the island. Until 2005, the blacklisting by the Financial Action Task Force on Money Laundering and the associated international financial counter-measures that applied to Nauru would have prevented the establishment of a branch of a foreign bank in Nauru. The counter measures were lifted on 13 October 2005 when the Financial Action Task Force on Money Laundering removed Nauru from the list. Although there are positive prospects for the establishment of a money transfer agency, recent discussions with foreign banks operating in the region have as of yet been unable to secure a commitment to establish in Nauru.

32. The small size of the economy and the relatively high cost of establishing banking and insurance operations where none exist will impede efforts to re-establish a finance sector. The

[9] In some periods, the payments were lower.

unresolved position of the BON and the situation of its borrowers and depositors—who constitute the main customers for a new bank—may also impede the sector.

33. Following advice from the Pacific Finance Technical Assistance Centre (PFTAC) in 2006, a new banking act has been drafted and reviewed by the International Monetary Fund and the PFTAC. It is scheduled to be introduced into Parliament following the 2007 election. New insurance legislation has also been drafted and is soon to be reviewed by the PFTAC. These initiatives are important to facilitating the re-establishment of the finance sector.

34. Nauru uses the Australian dollar as its means of exchange, giving it no control over monetary policy or interest rates, and rendering it unable to issue currency to fund deficit spending. This lessens the chance of inflation being driven upwards by uncontrolled government expenditures. Prices are largely anchored to those in Australia.[10] The inability to issue currency also has important implications for government financing, as the Government is dependent on fluctuating revenues from fishing licenses and phosphate exports. For countries that have an independent currency, much of the adjustment to fluctuations in export revenue comes from the exchange rate. If export prices fall, the exchange rate depreciates, reducing real incomes while stimulating activity. Monetary policy is independent and can also be used to smooth out incomes over time, leaving a much smaller role for fiscal policy.

35. These mechanisms are not available in Nauru's case. In Nauru, fluctuations in export income need to be addressed by fiscal or wage policy. Given its inability to borrow, the Government needs to maintain a buffer stock of financial capital to enable it to smooth expenditures over time. It also needs to have a source of finance to tide it over lean revenue years. In the past, the lack of a buffer fund specifically designed to be used in response to revenue shortfalls meant that, in years when phosphate prices fell, the Government drew on long-term trust funds.[11] It did so by borrowing against the assets held by the trust. No adequate institutional arrangements were in place to guard the trust funds from being used in this way. The result was that when phosphate exports fell permanently in 1990, the funds were quickly drained away via a variety of financial innovations that became more elaborate over time. This in turn meant effective control of the funds moved to a variety of poorly governed agencies, leading to the wasteful investment record of the 1990s.

36. These problems were not due to the fixed exchange rate itself but to a much wider range of institutional problems. There are in fact a number of arguments in favor of Nauru retaining its current currency arrangements. One of the advantages of using the Australian currency as the means of exchange is that it eliminates exchange rate risk for trade with Australia. As a result, there is no reason why a private company with a reputation for financial and commercial probity, and operating in a credible legal environment, should not be able to borrow from Australia at reasonable rates, even if the Government is no longer able to. The main problem with this as a route to economic recovery is that the private sector is relatively undeveloped, and those firms that do exist have to overcome the country's reputation for corruption and financial

[10] The Bureau of Statistics ceased collecting consumer price index data in 2000. In its absence, the Australian consumer price index provides a guide. Over long periods of time, movements in Nauru import prices should broadly match prices of similar goods in Australia. The relative level of traded to non-traded prices (and wages) depends on relative movements in productivity between the two countries. As Australian productivity growth has been higher than that in Nauru over the last 20 years (particularly with the decline in phosphate production), wages and hence non-traded goods prices should have declined relative to those in Australia. In other words, the real exchange rate needs to decline with changing relative productivity levels, the result following from the Balassa-Samuelson effect. With a fixed nominal exchange rate, this is achieved via relative wages and hence relative non-traded good prices.

[11] Such as an account with an Australian bank with an overdraft facility.

malfeasance, which was built up mainly in the 1990s. The country's reputation is such that even seemingly well-run companies such as Capelle and Partners are unable to secure credit lines from their suppliers and have to deal on a cash-only basis.[12] This highlights the urgent need for the Government to take further actions to re-establish the country's reputation by improving corporate governance and enforcing legal obligations and accountability.

E. Exports, Imports, Balance of Payments, and Foreign Debt

37. The Nauru Bureau of Statistics has been unable to compile balance of payments statistics on imports or exports because of the lack of both customs and survey data. However, data on merchandise trade are available from foreign sources such as the Australian Bureau of Statistics (on exports to Nauru), the United Nations Trade Database, and the International Monetary Fund Direction of Trade Statistics. However some of the United Nations and International Monetary Fund data on Nauru appear unreliable (possibly due to misclassification), particularly on the export side (e.g., large exports of frozen trout to Japan were recorded one year). The one hard data series is phosphate export volumes (Figure 2). Phosphate exports reached a peak in the 1970s at approximately 2,300,000 tons, had fallen to approximately 500,000 tons by the early 1990s and were virtually zero by 2004.

38. Nauru relies on imports for almost all of its material needs (food, consumer goods, plant and equipment, fuel, and building materials). Most of these goods are imported from Australia. The primary means of paying for imports is via phosphate exports, fishing licenses (treated as an income transfer rather than an export) and aid transfers. With the collapse of phosphate exports, the merchandise deficit had expanded to A$31 million by FY2006 (Table 3). There was probably also a deficit on the trade in services due, for example, to imports of education services, freight services, and services provided by non-resident aid workers.

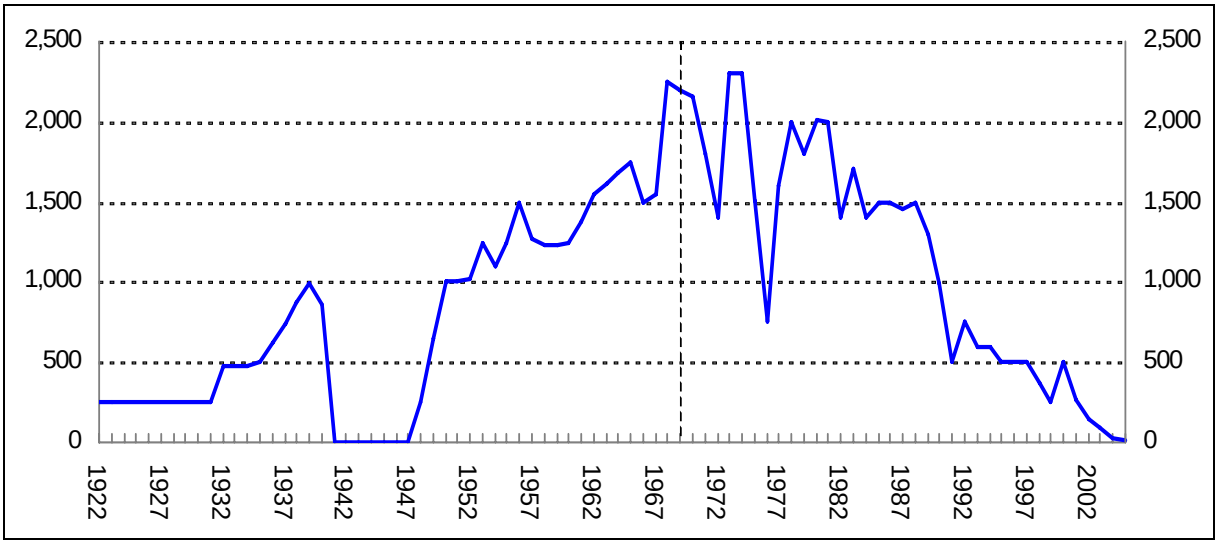
39. By implication, there is a small actual current account deficit, funded by repatriation of capital (ignoring the imputation of servicing overseas loans that are effectively in default).[13] Repatriation of capital in 2005–2006 consisted of the repayment of a loan by the Cook Islands (A$1 million in FY2006) and capital from an investment in a Philippine fertilizer company, PhilPhos (A$5 million in FY2006). There are no data on remittances from overseas workers, but based on anecdotal reports these seem likely to be negligible.

[12] Reported by the managing director in discussions with the review team.

[13] There is a contrary argument that until loans are formally in default, the imputed net factor income should be incorporated into the estimate of gross national income.

Figure 2: Phosphate Exports

('000 tons)



Source: Historical data from Nauru Bureau of Statistics, from 2001 onwards data supplied by RONPhos.

Table 3: Estimated Merchandise Trade
(A$ million, current prices)

Item	FY2004	FY2005	FY2006
Exports			
Phosphate	4.5	0.8	1.5
Other			
Total:	**4.5**	**0.8**	**1.5**
Imports			
Merchandise goods:	**30.7**	**27.3**	**32.3**
of which:			
Australia:	20.9	12.9	17.8
Other countries:	9.8	14.5	14.5
Merchandise Trade Deficit	**26.2**	**26.5**	**30.8**

FY = fiscal year.
Source: Asian Development Bank estimates from various sources. Value of imports from other countries is assumed not to change in FY2006 and FY2007.

40. The level and composition of Nauru's foreign debt has only been reported occasionally and then only as broad estimates. Finance officials had estimated that overseas public debt stood at A$600 million in 2001. A$133 million of this was formally defaulted following a court case involving a $100 million loan from General Electric. The most significant remaining component of debt was identified as an outstanding liability of ¥5 billion yen (approximately A$62 million) in bonds issued on behalf of the Republic of Nauru Finance Corporation. These had been bought by a fund that is currently attempting to recover the money.

41. The FY2008 Budget presented updated estimates of the external and domestic debt. The estimated external public debt stood at A$370 million, the equivalent of 1,015% of GDP. Domestic debt was estimated as another A$635 million or 1,745% of GDP (Table 4).

42. There is still some capital to be repaid from PhilPhos (around A$13 million),[14] and the Republic of Nauru Landowners Royalty Trust Fund, the landowner's trust fund, is estimated to have unencumbered assets of about A$70 million. There are also likely to be reasonably substantial overseas assets (in property and bank accounts) held by private citizens (perhaps on the order of A$50 million). Taken together, these debts and assets leave a net foreign liabilities position of about A$235 million, the equivalent of 645% of GDP.

43. Imputing interest/dividend payments at 6% per annum would imply a net outflow of factor income of approximately A$14 million, a flow around half the size of Nauru's GDP. Were the debt being serviced, Nauru's gross national income would be no more than A$20 million, or no more than A$2,000 (approximately $1,700) per head. However, there is almost no external debt servicing, and gross national income can be assumed to equal GDP.

Table 4: Nauru's Debt Position as of FY07

Category	A$ Million	Ratio to GDP, % [a]
Debt owed to individuals and entities outside Nauru (including Japanese Yen bonds, health-related debts, Taipei,China debt, etc.)	370	1,016
Debt owed to individuals outside the public sector and within Nauru (including the Bank of Nauru deposit holders and pending salaries)	265	728
Debt owned between and among state-owned enterprises and the Government of Nauru, and within the Nauru public sector	370	1,016
Total	**1,005**	**2,760**

GDP = gross domestic product.
[a] As a ratio of average GDP from FY2004 to FY2006.
Sources: Budget papers for FY2005, FY2006, FY2007, and FY2008; National Statistics Office, Department of Finance; other government departments and state-owned business enterprises.

III. THE GOVERNMENT AND ITS FINANCES

A. Overall Fiscal Situation

44. Historically, Nauru had no taxes and instead relied heavily on revenue from the NPC (now RONPhos) to fund recurrent expenditure. Despite some increases in charges and the introduction of customs duties in the last 3 years, the Government still lacks significant tax revenue, largely as a result of the narrow tax base. Consequently, expenditure has for some time been heavily dependent on fishing licenses, capital draw-downs and donor funding. The Government now projects that revenue from phosphate mining will increase in coming years. Attaining a sustainable financial situation will require that Nauru also (i) has well-run SOEs, and (ii) fosters sufficient private enterprise to provide a reasonable tax base for the future provision of government services.

[14] Recent efforts to fully recover this capital were unsuccessful.

45. On a Government Finance Statistics (GFS) basis, the budgeted deficit was 28.1% of GDP in FY2005, 36.3% in FY2006 and 18.0% in FY2007. Drawdowns from an investment in a Philippine fertilizer company, PhilPhos, of approximately A$5 million per year were to help fund the FY2006 deficit and were to fund the entire deficit in FY2007. The drawdown for FY2007 did not eventuate, however, with the shortfall funded by grants from Taipei, China (thereby increasing revenue and reducing the size of the actual deficit). Payments from PhilPhos had been anticipated for an additional 2 to 3 years, but these payments are no longer expected. Reflecting a shortage of options for funding budget deficits, a small budget surplus is budgeted for FY2008 and forward estimates project a continuation of near-balanced budgets to FY2010.

B. Revenue

46. The budget documents[15] show budget revenue of A$22.3 million for FY2007 and A$24.7 million for FY2008. However the revenue figures for FY2007 include capital transactions, such as borrowing and drawdowns of government capital (e.g., the A$4.4 million to be drawn down from PhilPhos), which should not be treated as revenue (they are instead financing items). On a government finance statistics (GFS) basis, revenue is estimated at A$17.8 million for FY2007 and A$24.7 million for FY2008.

47. The FY2006, FY2007, and FY2008 budgets introduced custom duties, import duties and a range of other charges (bed taxes and departure taxes), which together are expected to raise approximately A$2 million per year. The other main sources of revenue are fishing licenses, which net between A$5 million and A$7 million dollars per year, depending on seasonal conditions, and dividends from RONPhos, which are expected to provide approximately A$0.8 million in a typical year.

48. The budget is heavily dependent on grant aid. The revenue estimates included A$6.8 million in donor funding in FY2007 and A$11.0 million for FY2008. A substantial amount of aid is also provided off-budget, much of which is in-kind. It is estimated that in total Nauru received approximately A$33 million of aid in FY2006, leading to a very high ratio of aid to GDP for the year of 89.4%. The bulk of this, A$20 million, came from Australia, under a memorandum of understanding (MOU) with the Australian Government. Aid flows have been of a similar level over the last 5 years. Australian aid is budgeted as A$18.9 million in FY2007 and A$18.3 million for FY2008. Taipei,China was estimated to have contributed a total of A$5.5 million in FY2007 and is budgeted to contribute A$4.6 million in FY2008, also under an MOU.

C. Expenditures

49. Government expenditure was budgeted at A$23.0 million in FY2007 and A$25.0 million in FY2008, making it almost as large as GDP,[16] which is obviously not a sustainable position. The sustainability issue is alarming when the substantial off-budget public expenditures funded by aid donors are also taken into account. For example, donors spent A$11.9 million on electricity and water in FY2004 and A$9.4 million in FY2006. While some of the aid money is directed toward recurrent expenditure (such as the provision of electricity and water), much of it is earmarked for investment and capital works of various kinds. For example, expenditure in FY2007 was boosted by (i) the refurbishment of the port (anchor buoys) costing A$3.6 million (funded by Taipei,China); and (ii) large subsidies provided to some SOEs to keep them operating, the largest of which was a A$2.7 million payment to Air Nauru (now Our Airline) to

[15] Republic of Nauru. 2006. *2006-07 Budget*.
[16] The comparison is with GDP excluding pending salaries.

help it pay for a charter service following repossession of its last plane. Total aid-funded expenditure for FY2007, both on and off-budget, was projected to be A$35 million, pending acquisition of a new aircraft (which was also funded by Taipei,China).

50. Total public expenditure in FY2006, as recorded in the National Sustainable Development Strategy, was A$49 million, a ratio to GDP of approximately 130%; total public expenditure in FY2007 and FY2008 is likely to be close to this figure.

51. Current expenditure is far in excess of the Government's current sustainable revenue base of around A$8.7 million. The revenue base is, for example, smaller than donor expenditure on the provision of electricity and water in FY2006. This in turn indicates that significant structural adjustment is still to come. To have any chance of putting government expenditure on a sustainable basis, the Government will need to:

(i) ensure that SOEs, including Our Airline, operate on a commercial basis;
(ii) foster development of a private sector on the island, while at the same time finding ways of raising revenue from it; and
(iii) re-examine government expenditures and government priorities.

52. A considerable part of the government expenditure in recent years has been in the form of subsidies to SOEs such as Air Nauru. Our Airline will need to be run so that it makes a significant return to the Government, as will other operations such as Eigugu Holdings and the Menen Hotel. It will be particularly important to run the water and electricity utilities on a commercial basis with full cost recovery from consumers. Higher charges will in turn ensure that households use these scarce resources efficiently. The comprehensive ADB report[17] on reforming the NPC indicates that there are gross inefficiencies in the way electricity is generated and used. For example, the cost of generating electricity using diesel generators is so high that it would be 50% cheaper for households to use propane gas for cooking. However, as long as electricity is charged at just A$5 per month, there is little incentive for Nauruan households to consider energy conservation, or to change their behavior and reduce the use of electricity.

D. Aid and Financial Assistance

53. Aid has been used effectively to refurbish utility infrastructure, the port, and health and education facilities, as well as to increase the provision of health, education and security services, and government administration. Expenditure on Australian "in-line" officials has been particularly effective.[18] The increased capacity of the economy in recent years provides some grounds for optimism for the future.

[17] ADB. 2006. *Reform of the Nauru Phosphate Corporation: Draft Final Report.* Manila. The report was prepared as part of ADB technical assistance (ADB. 2005. *Technical Assistance to Nauru for Reform of the Nauru Phosphate Corporation*. Manila). The report advocates a scaled tariff with the full cost per unit only imposed on the final margin. The rationale for this is that households could not afford full cost recovery. The Government could choose to implement the reform in a revenue-neutral way, however, making a fixed transfer to households to help them to pay their bills. Until households are faced with the full cost of their consumption they will not have a full incentive to invest in electricity-saving devices, for example moving to propane for cooking, or installing solar water heating. The uncertain ownership of the housing stock is a related problem.

[18] Based on the review team's observations and discussions, including with the Minister for Finance. The in-line officials fill a critical gap in administrative personnel and bring with them in-depth knowledge of how equivalent departments and authorities in Australia operate. However, funding in-line officials is high cost, and the officials themselves need to prepare Nauruans to take their places, for example by mentoring local staff.

54. Australian aid is unlikely to remain at current levels (approximately A$20 million per annum), however. Aid is provided under an MOU negotiated between the two countries in relation to the establishment of the Refugee Processing Center.[19] Australia's Department for Immigration and Multicultural Affairs provides the funding for the International Organization for Migration (IOM) to develop and run the facility. It also provides funding for a number of refugee-related government services (e.g., a ward at the hospital reserved for use by the refugees).

55. Operation of the Refugee Processing Center is very expensive, given the number of refugees being accommodated—only two in 2005–2006. Combined with the aid package, the total cost of providing the facilities was close to A$30 million. IOM has a facility on Manus Island in Papua New Guinea that is potentially less expensive to run, but the use of which is limited to refugees from areas other than West Papua (the Papua New Guinea government will not accept refugees from West Papua who are picked up in Australian waters). In the absence of significant numbers of West Papuan refugees, the Nauru camp is likely to be mothballed at some point by IOM. The Australian Labour Party has previously pledged to close the refugee facility down if it is successful in the 2007 national election (the Party's policy has been for refugees to be landed and processed on Australian soil). If the camp was closed, Australian aid could drop to as little as A$2 million per annum.[20]

56. There are a number of reasons for the dependence on aid, a chief contributor being the state of financial collapse. Combined with the other institutional features—such as the lack of skills, constraints on non-Nauruans setting up local business, and the dominance of the public sector in economic activity—the increased aid expenditure has offered little in the way of an increase in the local production of goods and services. Instead, most money has flowed out of the country for imported goods and services, including labor.[21]

57. Issues related to governance, management, and agency capacity are of considerable concern. Aid organizations need to be aware of the constraints and problems when they plan their programs. The Government can no longer borrow overseas and hence is in no position to stimulate demand. Nor can it, given its tangle of unresolved existing financial obligations, set up a financing facility for local contractors and other business to substitute for absent banking services. Aid programs need to be adjusted to account for the unusual circumstances that Nauru is facing. An example of the innovative approach required is provided by a recent initiative to develop a small business incubator and start-up fund as a partial substitute for the missing finance sector. This is to commence in FY2008 with the support of funding from the Australian Agency for International Development and United Nations Development Programme.

[19] The aid program under the MOU is renegotiated every 18 months or so. The latest program will be finalized September 2006.

[20] Based on discussion with Australian officials and by comparison with Australian aid to other Pacific island countries.

[21] In part, the aid has simply replaced phosphate revenue for the Government. As the aid agencies have moved in, the Government has withdrawn. For example, the provision of fuel and equipment for the power station, which the Government would otherwise have been forced to fund, frees up government revenue for other priorities.

IV. SECTORAL ISSUES

A. Phosphate Mining

58. Phosphate mining has been the backbone of the Nauruan economy since phosphate was discovered at the turn of the 20th century. There are two levels of phosphate deposits—the primary surface resource, which is extracted from between the coral pinnacles, and the secondary resource, which lies underneath. The surface resource originally consisted of around 80 million tons, with about 1.5 million tons in accessible deposits remaining. This is sufficient for 4 to 5 years of further production at present rates of extraction (300,000–500,000 tons per annum).[22] The secondary resource is estimated at around 20 million tons.[23] The processing facilities were recently refurbished by the Australian fertilizer company, Incitec Pivot, in exchange for three 30,000 ton shipments of phosphate and the right to purchase seven more. The processing facilities, mainly consisting of crushers and drying kilns, were originally designed to produce 1.5 to 2.0 million tons a year. The refurbishments brought capacity back to 300,000–500,000 tons per year (depending on how intensively the facility is used and how much electricity and fuel is supplied). Further refurbishment work could increase capacity to 1 million tons a year.

1. Phosphate Market and Prospects

59. There is no shortage of phosphate in the world. Current world mining reserves stand at 18 billion tons, mainly located in the People's Republic of China, North Africa (Morocco and Western Sahara), South Africa, and the United States. Most phosphate is obtained via strip mining. Global production stood at 148 million tons in 2005, with the United States the largest producer at 38.3 million tons, and also the largest consumer at 40.0 million tons. US import prices have been relatively stable over the last 5 years rising from US$26.9 per ton in 2001 to US$27.9 per ton in 2005.

60. The prospects for phosphate prices appear good. Production at the major US mines in Florida is decreasing as reserves are depleted. Approval of new mines is being delayed because of environmental concerns. However, production is likely to rise in other parts of the world to meet demand. Australia, for example, has a large phosphate deposit at Phosphate Hill near Mt. Isa. The current mining reserve is around 150 million tons and the deposit itself could be up to 1.5 billion tons. Incitec Pivot recently purchased this deposit as part of its purchase of Southern Cross Fertilizers from BHP Billiton. The company has plans to build a new super phosphate processing facility near the site using sulfuric acid from Mt. Isa (super phosphate production is often co-located with copper smelting).

61. High oil prices also lend some support to phosphate prices. High oil prices increase the price of natural gas, which in turn pushes up the price of nitrogenous fertilizers. There is some degree of substitutability between these and phosphate-based fertilizers, and hence some impact on the demand for phosphate.

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[22] Reported by the acting manager of RONPhos. Other surface deposits exist around Buada lagoon and under access roads but will not be mined.

[23] This is the mining reserve, i.e., defined as economical to mine at current prices. The phosphate deposit itself is much larger and probably measures in the hundreds of million tons. Geologically, Nauru consists of a 500 meter column of porous dolomitic limestone on top of an ancient sea mount. The limestone built up over many millions of years of changing sea levels. Cavities in the limestone are generally filled with marine phosphate.

62. Nauru's phosphate rock is premium grade, and of such high concentration that it requires no beneficiation (processing to remove impurities and increase the concentration of phosphate) before being converted into super-phosphate. It is also a "low-odor" rock. Some grades can be applied directly to the soil without further processing. This type of phosphate rock is in short supply; the only other sources for this type of high-grade rock were Banaba (Ocean) Island and Christmas Island, both of which were formerly mined by the British Phosphate Commission and both of which have been depleted. The only problem with Nauru phosphate is its high cadmium content. However, it can be mixed with phosphate from other sources to lower the concentration to acceptable levels. The phosphate rock from the sub-surface deposits will probably contain much less cadmium than the surface rock.

63. As a result of its high quality, phosphate rock from Nauru commands a premium on the world market. As the process of beneficiation is usually energy-intensive (and in Florida, environmentally costly), that premium is likely to rise over time. Consequently, the price outlook for Nauru phosphate exports in US dollars appears good.

2. The Exchange Rate: Importing Australia's Dutch Disease?[24]

64. Any rise in the US dollar price of Nauru phosphate could easily be swamped by movements in the Australian dollar against the US dollar, raising the question of whether the Australian dollar should continue to be used as the local currency. The Australian dollar is linked to the price of Australian mineral exports, which are sold on volatile world markets. Exchange rate fluctuations help to stabilize the Australian economy in the face of this volatility. However, phosphate prices are largely determined by the large US market and appear relatively stable in US dollars. Consequently, by being tied to the Australian dollar, Nauru may be introducing volatility into its income stream. For example, since 2001 the Australian dollar has appreciated by 40% against the US dollar. This has reduced the revenue from any given level of phosphate exports by roughly 30%.

65. However, as Nauru imports most of its goods from Australia, converting to the US dollar would probably only partially stabilize income in real terms. When the Australian dollar appreciates, US dollars would simply buy fewer Australian goods. Nauru therefore seems locked into the vagaries of the Australian exchange rate. In many currency areas, this problem is reduced by the free flow of labor between countries. However, Nauru has no reciprocal visa arrangements with Australia. Given the small size of Nauru, even small labor flows could make a big difference to adjustment costs as the country's real income fluctuates with the currency.[25]

3. Achieving Phosphate's Potential

66. The existence of a 20 million ton subsoil reserve presents a significant second chance for Nauru. The key to exploiting the reserve and the remaining 1.5 million ton surface deposits will be in securing the right personnel to run the mine (i.e., a management team, engineers, and

[24] The term Australia's Dutch disease (also sometimes referred to as the Gregory effect in Australia) refers to the effect of higher commodity export prices on the A$ exchange rate. As commodity prices rise the exchange rate rises, making other export- and import-competing industries less competitive. As Nauru uses the A$, its export industries are similarly affected.

[25] Another possible way of stabilizing income would be for RONPhos to negotiate long-term contracts in Australian dollars rather than US dollars. Australian dollar contracts would probably be slightly less favorable than US dollar contracts, but would probably be a cheap way for the country to hedge against the exchange rate risk. The buyers (usually large fertilizer companies) would probably be in a far better position to spread the risk, e.g., by operational hedging, than is Nauru.

skilled operators for the equipment) and in securing a reputation for reliability in supply. The Australian fertilizer company, Incitec Pivot, appears keen to continue its association with RONPhos and is helping to organize a replacement management team for Astro Pacific Group, whose contract ended in May 2006. Currently the mine is (i) operating on a very thin line of credit from its overseas suppliers (for materials and equipment to operate the mine); (ii) having difficulty securing sufficient power and fuel to run its operations; and (iii) dealing with the loss of skilled equipment operators who have been repatriated. According to Incitec Pivot, if RONPhos can re-establish a reputation for reliability in supply and for financial probity it should be able to secure long-term contracts at above-current market price. This would provide the necessary capital to staff the mine properly and to run the operations. Lack of finance is a key constraint and something of a catch 22—operating capital is needed to establish credibility in supply, but credibility in supply is needed to obtain the operating capital.

67. Ideally, the mine should be run on a fully commercial basis to maximize its value over time. The consultant's report[26] on the feasibility of secondary phosphate mining for the Nauru Rehabilitation Corporation (NRC) and the Australian Government (via the Australian Agency for International Development) indicates that the NRC could economically supply phosphate rock to RONPhos at A$9 per ton. The A$9 a ton would provide a sufficient return to pay for and maintain the needed mining equipment and to rehabilitate the land. With a current market price of A$54 a ton, this would appear to be more than sufficient for RONPhos to generate a healthy operating surplus, and to contribute to the development and future needs of the island.

68. The Government needs to address the future respective roles of the NRC and RONPhos when the primary reserve is exhausted. The current report on the future of the NRC proposes that the secondary mining be carried out exclusively by NRC, which would sell the phosphate ore to RONPhos for processing, and use the proceeds to fund rehabilitation. This approach is problematic, however. Experience in other countries indicates that vertically integrated mining operations are more efficient than operations where many players are involved. Mining is capital-intensive and vertical integration reduces the risk to capital, particularly when expansion is being planned (introducing uncertainty into operations can be very costly). In addition, it is doubtful whether Nauru has enough professionals and skilled workers to properly staff two organizations. NRC is not an economic entity but a semi-autonomous statutory agency vested with an environmental and social function—namely, land rehabilitation. The organization has not been well-run in the past, appears overstaffed relative to its current output, and is hamstrung by the continual need to reach agreement on its operations with the Australian and Nauru governments. In these circumstances, it would appear preferable to vest the commercial organization, RONPhos, with both the responsibility for, and the management team and staff needed, to carry out both the mining and the processing. The NRC would be left with the residual role of setting out the rehabilitation requirements and contracting RONPhos to do the main part of the rehabilitation work as part of the secondary mining process.

69. The Government should consider privatizing RONPhos, as there is no reason for it to be involved in a mining operation. No externality or welfare issue is being addressed by public ownership. Rather, public ownership creates a difficult organizational problem for the Government, diverting the attention of key staff. In the past, public ownership has been associated with poor governance, poor performance, and poor maintenance of the mining operation, making it a source of rather than a solution to problems. The Government need not own the operation to raise revenue from it. It can raise money from mining by imposing a levy

[26] URS. 2006. *Nauru Rehabilitation Corporation Draft Work Program and Secondary Phosphate Mining Feasibility Study.* Canberra.

on phosphate exports.[27] Moreover, privatizing the operation would release it from the Government's current financial bind, while at the same time providing the Government with much needed funds. Obviously, this cannot happen immediately, but, given the importance of phosphate mining to Nauru's economic future, the Government should carefully consider the options for the ownership and organization of the operation. There are a number of prior actions that would need to be taken to secure the operating and business environment, so as to achieve a good return on the sale, if the Government decides to exercise that option.[28]

B. Fisheries and Agriculture

70. There is currently no formal commercial agriculture in Nauru. The agricultural output in Table 1 is based on estimates of home production of fruit, vegetables and livestock (i.e., pigs, chickens and ducks, which are fairly common around the island).[29] Constraints on the past development of commercial market gardens include the complex system of land tenure, high wages, and lack of finance. However, given the lower wages, the potential for the development of commercial agriculture does appear to exist, if the other constraints can be overcome. The natural constraining factors—the limited availability of arable land (there is only about 4 km^2 of fertile land, much of which is taken up by residential housing), and climatic vagaries—suggest that the development of local agriculture will be fairly limited.[30]

71. The potential for growth in the local fishing industry appears more promising. Nauru currently collects between A$5 million and A$7 million per year in fishing licenses. The licenses represent about 8% of the value of the catch taken from Nauruan waters, which is on the order of A$50 million to A$80 million dollars per year. One way for Nauru to increase its GDP would be to increase the value added that it generates from this resource.

72. One way of doing this would be to recommence longline fishing of yellowfin and bigeye tuna.[31] With Our Airline commencing twice-weekly flights from Brisbane to Nauru, there will be ample freight space to transport fresh tuna to Brisbane and from there to the Tokyo market. Given a small capital investment, the two existing boats could generate revenue of up to A$30,000 a week.[32] Back-loading freight would also improve the economics of the Brisbane–Nauru route, which will otherwise have to be cross-subsidized by other routes or receive a subsidy from the budget.

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[27] This could include a levy hypothecated to rehabilitation, if the NRC requires more funds than it already has to carry out rehabilitation.

[28] This includes re-establishing Nauru's reputation for financial and commercial probity, which further underlines the need to take action to clean up the country's failed financial institutions and to enforce accountability.

[29] The estimates are in turn based on census data on the number of households engaged in these activities.

[30] However, the ultimate limitation is the small size of the local fresh food market for the crops that can be grown on Nauru. Given the locational and other disadvantages of Nauru, it seems unlikely that it could ever develop a viable export industry in any agricultural product (unless wages were very low). This in turn has implications for the economics of the rehabilitation of the mined-out lands: (i) what can the land be used for; (ii) how much effort should be devoted to rehabilitation relative to other activities; and (iii) should the entire area be rehabilitated?

[31] Longline fishing is far less capital-intensive than purse-seine fishing. The capital required consists of relatively small boats with location equipment, while operational costs consist mainly of fuel and bait. Fish are packed in ice and flown to foreign markets. The fishery is possibly more secure than others around the Pacific. Isolated sea mounts such as Nauru are surrounded by higher-than-average concentrations of plankton and micronekton, which attract migrating pelagic fish. The surrounding waters have been described as a "filling station" for migrating tuna.

[32] This figure is based on discussions with the Nauru Fisheries Corporation. Fresh tuna sells at around A$15–$20 per kilogram in the Tokyo market. Given that Our Airline has the capacity to transport around 8 to 10 tons per week, the prospect of generating revenue from longline and handline fishing appears reasonable. For example, assuming that tuna constitutes 60% of the weight, if the capacity is fully utilized it would appear to have a market value of A$80,000–$90,000 per week (from 200–300 fish). Reportedly, the two existing longline fishing boats were generating up to A$30,000 per week when fully operational several years ago.

73. If such an operation is viable, it is preferable that it be privately owned and operated. Past evidence in the Pacific is consistent with the prediction from economic principles that government-led commercial fishing will fail to achieve commercial viability and will carry significant fiscal risk. The key to achieving economic and commercial viability would be the establishment by the Government of an enabling environment for commercial fishing firms. As Nauru has no income taxes or company taxes, it would need to generate revenue from the venture through various charges or via an export levy.[33] For any fishing operation to be in the community's interest, such charges or levy should be set at a level similar to what would be paid by alternative, offshore fishing operations. Otherwise the community is likely to be better off with fishing undertaken by the offshore fishing operations.

C. Transport

74. The government-owned airline, Our Airline (formerly Air Nauru), makes the most significant contribution to the transport sector. It also needs careful monitoring and management. Poor management of Air Nauru was a major financial drain on the Government. The accumulated losses over time are arguably one of the key factors behind the financial and development crisis the country faces today.

75. Our Airline began operations in October 2006 using a Boeing 737-300 airplane purchased with funds supplied by Taipei,China. The airline will initially fly twice weekly to Brisbane, Australia; Tarawa, Kiribati; and Majuro, Marshall Islands and return. It has lost two of its profitable routes (to Norfolk Island and Fiji Islands) as a result of its recent troubles. These routes were formerly used to cross-subsidize the Brisbane-Nauru route. Our Airline will be attempting to build its operations and find other profitable routes, but until then it appears to be planning to run at a loss on the Brisbane–Nauru route.

76. The establishment of longline fishing on the island has the potential to enable Our Airline to operate the Brisbane-Nauru route profitably. Its airplane has the capacity to carry 4–5 tons of freight, but little is carried on the Nauru–Brisbane leg. Full utilization of the freight space on that leg to carry tuna would generate significant income from tuna exports, and eliminate the need for the Government to cross-subsidize the airline.

D. Health

77. Rather than spending money on health and education during the 1970s, 1980s, and 1990s, the Government's largest expenditure item was Air Nauru, which ran at a loss of about A$20 million a year throughout the 1980s, peaking at A$46 million in 1983–1984.[34] In comparison, roughly A$1 million per year was spent on education, and A$2 million per year on health.

78. As a result of high levels of income and government-guaranteed jobs during the prosperous years of the phosphate boom, indigenous Nauruans ceased to fish or to practice local agriculture. Their diet became Westernized, with high levels of rice and fatty foods. As a consequence of this and their relative inactivity (and possibly a genetic disposition to store fat),

[33] This would constitute a resource rent charge and be in addition to charges for any goods and services supplied by the Government.

[34] Centre for International Economics. 1990. *An Examination of Nauru's Rock Phosphate Income, Report.* Canberra, Australia: Department of Foreign Affairs and Trade.

Nauruans have the highest levels of obesity in the Pacific.[35] This in turn has led to a high mortality rate through obesity-related disease—in particular diabetes and cardiovascular disease. About 30% of the population has type 2 diabetes, and 50% are likely to develop it as they age, which is the highest incidence in the world. The disease can be managed with drugs in its early stages, but compliance with drug treatments is poor. Treatment of patients with serious conditions is expensive, and sometimes requires transport to Fiji Islands or Australia. The poor quality of water means that self dialysis is impossible.

79. There are also problems with alcohol consumption. Health department surveys show that 50% of adult Nauruans engage in binge drinking. The incidence appears to have increased in recent years in association with high levels of unemployment. Binge drinking is associated with violence. It is also means workers spend a high proportion of their budget on alcohol, with little left for other household items. Despite being banned, consumption of home distilled alcohol has increased, leading to a number of deaths from alcohol poisoning.

80. These problems combine to give Nauruans a very high mortality rate. Life expectancy for males is just 52 years, and for females 58.[36] There are some signs of improvement, however, with active health education campaigns as part of the school curriculum, rising education levels, and greater recourse to home production of fruit and vegetables as incomes fall. On the down side, the current age profile of the population suggests that pressures on the health budget may increase rapidly over coming decades, even if fertility rates drop.

E. Education

81. The lack of a skilled workforce on the island constrains development. Skill levels are relatively low as a result of low education expenditures during the years of prosperity, and the previous widespread availability of highly paid government jobs, which removed incentives to partake in education and training. The situation is changing rapidly, however, and education features prominently in the National Sustainable Development Strategy (NSDS). Aid agencies are providing funding to repair roofs on schools, develop the curriculum, and offer scholarships for students to study in Australia and Fiji Islands. The Australian Agency for International Development is providing a Director of Education under its funding package. Primary and secondary school attendance ratios are rising from the very low levels (60%) shown in the 2002 census and are currently reportedly at about 70%. In addition, more students are now staying on to matriculation, and schools are now offering courses in science and technology and aiming to meet international standards for literacy and numeracy, so that Nauruan students have the skills needed to undertake overseas study successfully.

82. Given the youthful age profile of the Nauruan population, the occupational structure of the workforce can change rapidly. Although there were only 27 indigenous Nauruans with university degrees at the time of the 2002 census, the supply of professionals could improve quickly if the number of Nauruans studying overseas increases.

[35] Secretariat of the Pacific Community. 2000. *Obesity in the Pacific: Too Big to Ignore, Report of the Workshop on Obesity Prevention and Control Strategies in the Pacific*. Noumea, New Caledonia.

[36] Secretariat of the Pacific Community and Republic of Nauru Bureau of Statistics. 2006. *Demographic Profile of the Republic of Nauru: 1992–2002.* Nauru.

V. DEVELOPMENT ISSUES AND PROSPECTS

A. The National Sustainable Development Strategy

83. The NSDS was developed by the Government through wide community involvement and in consultation with the Australian Agency for International Development and ADB. The key goals set out in the strategy are:

(i) establishment of stable, trustworthy, fiscally responsible government;
(ii) provision of enhanced social, infrastructure, and utilities services;
(iii) development of an economy based on multiple sources of revenue;
(iv) rehabilitation of mined-out lands for livelihood sustainability; and
(v) development of domestic food production.

84. A national development committee has been set up by the Government to consider all budget proposals in the light of the NSDS goals. The NSDS is the result of an extensive process of consultation and discussion, and is a flexible "living" document. It contains concrete actions and time lines to meet the various objectives. The Government's commitment to the NSDS and the time invested in its development are further signs of the momentum for reform. The appendix to the NSDS identifies many of the problems discussed above (e.g., the need for better accountability and management of SOEs, the difficulties involved in setting up businesses, the problems with skill shortages and the need for more education and training). It also sets out a large number of specific actions, some seemingly simple, which could address some of these problems.

85. However, there appears to have been insufficient analysis undertaken prior to deciding on the actions to be taken across sectors to meet the specific goals. In many cases, the actions consist of asking aid donors for more money to support additional government activities, or to add to the existing government bureaucracy.

86. It is unclear why the proposals and schemes put forth now will work, when similar proposals have failed in the past. The previous attempt to establish longline fishing failed, possibly because the boats and equipment were supplied by the government and were publicly-owned. There was consequently no strong incentive to maintain them to preserve their resale value, and thus when the boats and equipment broke down the operation ceased. Similarly, previous attempts to establish local agriculture have not worked, nor have efforts to obtain foreign banking and insurance (first mooted 8 years ago).

87. The Government's involvement in so many activities needs to be questioned if the underlying problems are to be solved. The standard economic questions need to be asked: what welfare goal, externality or other market failure is being addressed? Is there a possibility of market failure, is it greater than the risk of government failure? If regulation is necessary, are there the resources to do so? If government expenditure is already larger than GDP, can increasing government expenditure be part of the solution to the country's problems? Given the failure of public ventures in the past, are there ways of setting up these schemes so that the responsibility for making investment decisions and maintaining capital is taken by the private sector? Given the problems that have been encountered in the past, and the lack of enough qualified people to properly constitute all the boards that are required, is it possible to scale down the Government's involvement in SOEs in favor of licensing, outsourcing or selling off some of their functions? What prior actions, such as making it easier for non-Nauruans to own a business on the island, are required for that to take place? Answering some of these questions

would help to focus the strategy and identify where the Government can make the greatest contribution to sustainable development, reduce its reliance on foreign aid, and put the country on its own feet.[37]

B. Prospects for Economic Growth

88. Despite the difficulties it faces, Nauru does have some economic growth prospects, but achieving growth will require a sustained, broad-based reform effort. Table 5 provides a scenario that shows what might be achieved if the reform momentum is maintained and new growth initiatives are adopted. For the purpose of comparison, historical figures are also shown excluding pending salaries.

89. In brief, with continued reform, GDP could quickly rebuild. Much of this growth is projected to arise from the successful restoration of phosphate mining and processing. Significant contributions are also projected as a result of assumed performance improvements in the electricity and water utilities and the government airline (adding A$6 million to GDP and lifting a considerable weight from the Government budget).[38] Development of fishing and local agriculture is also assumed. The scenario presented in Table 5 assumes that home production by indigenous Nauruans will continue to increase, and that some profitable commercial market gardens will be established over the next 3–4 years.[39] However, even under these assumptions, the contribution of agriculture to GDP will be relatively modest. It is estimated that, in total, agriculture and fishing could to add another A$4.5 million to GDP.

90. To produce these outcomes will require a significant reform effort, in particular (i) ensuring that an experienced management team is appointed to run RONPhos; (ii) following through with market reforms of electricity and water provision; and (iii) ensuring that a climate is created for the development of private sector activity. Critical to that and to sustained development on the island, particularly if present high levels of aid are withdrawn, will be the re-establishment of a domestic financial system and of credibility in international markets. Poor standards of management and accountability of SOEs will need to be improved. In this context, it is important not only to legislate but also to enforce accountability. Without these reforms and without the re-establishment of a reputation for financial probity in international markets, the alternative scenario could well be one of economic collapse once aid flows return to more normal levels.

[37] A similar approach to analyzing the role of government in individual activities is set out in a report from the ADB Economic Research Department (ADB. 2004. *Economic Analysis Retrospective–2003 Update.* Manila, Chapter 3).

[38] The projections for electricity and water in the scenario assume that the government implements the recommendations contained in the consultant's report. Ideally, it should move to full cost recovery.

[39] The A$1 million increase in agriculture assumes the development of domestic and market gardens that replace a small proportion of Nauru's food imports. The $3 million increase in fisheries assumes increased production for the local market and the resumption of fresh fish exports, taking advantage of the cargo space available on Our Airline.

Table 5: Prospects for GDP if Economic Reform Continues
(A$ million, current prices)

Item	Actual			Scenario			
	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
Agriculture, Fishing, Other	3.7	4.0	3.9	3.7	4.7	6.8	8.3
Agriculture	0.7	0.7	0.7	0.7	0.9	1.5	2.0
Fishing	2.7	3.0	2.9	2.7	3.5	5.0	6.0
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Mining	2.6	0.5	0.6	4.6	4.6	4.6	4.6
Manufacturing	0.1	0.1	1.9	0.6	0.7	1.0	1.2
Electricity, Water	(5.7)	(5.4)	(2.8)	(3.5)	(1.5)	0.5	1.0
Construction	0.7	0.6	2.0	0.6	0.8	0.9	1.0
Commerce, etc.	8.0	7.0	7.6	8.0	8.1	8.3	8.4
Wholesale and Retail	4.3	3.6	4.3	4.9	5.0	5.1	5.2
Vehicles	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Accommodation	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Restaurants	1.0	0.7	0.6	0.5	0.5	0.6	0.6
Transport, Communication	10.5	7.6	3.4	0.3	0.9	1.9	1.9
Finance and Business Services	1.1	1.1	1.1	0.7	1.1	2.0	3.0
Public Administration and Services	4.9	5.0	7.1	8.1	7.3	7.3	7.3
Personal, Other Services	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Ownership of Dwellings	3.2	3.2	3.2	3.2	3.3	3.4	3.5
Government Consumption of Fixed Capital	0.3	0.3	0.3	0.3	0.3	0.3	0.3
GDP at Market Prices excluding pending salaries (A$ million)	29.7	24.5	28.5	26.9	30.5	37.2	40.7

() = negative, FY = fiscal year, GDP = gross domestic product.
Source: Asian Development Bank estimates from various sources.

C. Debt Management

91. The decline in Nauru's financial position has been dramatic. Assets in the main investment funds, the Nauru Phosphate Royalty Trust, were reported as A$1,000 ($856 million) in 1998. Assets in the trust peaked at A$1,241 ($959 million) in 1990, had declined to A$1,044 million ($707 million) by 1993 and once provision was made for doubtful assets, could have been as low as A$800 million (approximately $621 million) in 1994. At the same time as the value of the trusts was in decline, public debt was rising. Public debt was reported as A$97 million ($77 million) in FY1988, but had reached A$317 million ($213 million) by FY1993.[40] As noted above, holdings in the Nauru Phosphate Royalty Trust are estimated to now be worth less than A$100 million ($85 million) and total government and private debt (external and domestic) as of mid-2007 is estimated as approximately A$1,005 million ($854 million).

92. Economic and fiscal management is shaped by the need to address this extremely high level of foreign and domestic debt. The FY2008 budget papers concluded that even with optimistic assumptions regarding the growth of revenue, Nauru would only be able to service 5% of its debt. Attempts to repay too much external debt could place severe pressure on the

[40] Assets in the Nauru Phosphate Royalty Trust were used as collateral for Government loans. Once provision was made for bad debts and assets collateralized by Government borrowing, the net value of the Trust may have been as low as A$547 million in 1993 (Economic Insights. 1994. The Nauru Economy: Problems, Prospects and Policies. Report for the Australian International Development Assistance Bureau. December. pp.12-14, 33)

budget, potentially absorbing any fiscal surplus offered by the renewal of phosphate mining and compressing public expenditure on essential services. Furthermore, uncertainty over whether unpaid public salaries or deposits in the national bank will be honored has the potential to fuel political instability and deter reform efforts.

93. Nauru needs to explore the potential for a restructuring of its debt, including the forgiveness of some external and domestic debt. Any such debt restructuring is likely to be most effective if complemented by performance requirements, such as the Cook Islands entered into as part of its debt restructuring of the late 1990s.

VI. CONCLUSIONS

94. Nauru is going through a tumultuous period of economic change. It is difficult to imagine a worse economic situation than that reached at the turn of this century, following years of government profligacy and public sector mismanagement. The development opportunities provided by phosphate mining were squandered on extravagant expenditures such as the airline, poor investments, and misdirected government policy. Nauru is a case study of the problems that can be engendered by a resource boom, and how not to respond to them.

95. Things are changing, however. The present Government is addressing some of the structural problems the economy faces and is making changes to establish a base for future economic growth. Prospects for phosphate mining and exports appear good. Revenue from fishing licenses continues to support the budget. A small revenue base has been established and the SOEs and utility services are being reformed. Nauru has also been removed from the Financial Action Task Force on Money Laundering blacklist, an essential requirement for the reestablishment of a finance industry. Government wages have been cut to affordable levels that are more in line with productivity. The level of overstaffing of government departments and the SOEs has been reduced.

96. Much more needs to be done, particularly in terms of correcting the deep institutional problems that led to Nauru's severe economic deterioration. Deep-seated reforms to governance arrangements are essential requirements for Nauru's development. The absence of accountability and transparency, particularly of public corporations, was central to Nauru's severe economic deterioration and concerted, corrective action is required to achieve a sustainable improvement. Many of the necessary changes have commenced and the NSDS has been prepared as a guide to continuing efforts.

97. There are some grounds for optimism regarding the prospects for medium-term growth, as long as the current reform momentum is sustained. In addition to the resource-based revenue from phosphate mining, fishing licenses, and land rents on the Refugee Processing Center, the potential exists for some modest activities, such as longline fishing, local agriculture and services (such as construction, professional services, finance and insurance), and tourism. Together with a turnaround in the performance of the public utilities and airlines, these potentially add up to sufficient activity to sustain a reasonable living standard. In short, confirmation of reform is an essential first step if Nauru is to achieve a sustainable economic future.

STATISTICAL APPENDIX

1. This appendix describes the estimation of gross domestic product (GDP), gross national income, government finance statistics (GFS) tables, income and capital accounts for the general government sector, and an external account for Nauru.

A. Estimates of GDP for Nauru

2. Estimates of gross domestic product (GDP) have been prepared for the fiscal year (FY) 2004 to FY2006. Compiling GDP estimates for Nauru is complicated by a number of special factors. These include pending salaries, Bank of Nauru (BON) checks, the treatment of the Refugee Processing Center, large subsidies to government-owned business enterprises, large numbers of redundancies in the public sector (both the public service and government-owned business enterprises) and gaps in the statistical collection. In fact, apart from the budget documents for recent years, there are no economic statistics for Nauru. Production of the consumer price index ceased in about 1999. In addition, most government-owned business enterprises have not been producing adequate profit and loss accounts and balance sheets. There are no income or value-added taxes in Nauru, so taxation data are not available for use in compiling national accounts statistics.

B. Basic Compilation Methods

3. GDP estimates have been compiled by industry using a mixture of the income and production approaches. Using the income approach, GDP is equal to compensation of employees plus gross operating surplus plus taxes on production and imports less subsidies. Using the production approach, GDP is equal to output less intermediate consumption. The contribution of the general government sector to GDP is equal to compensation of employees plus consumption of fixed capital for general government. Most of the general government sector has been left in the public administration industry, rather than separately estimating for various sectors such as education and health. The method used for particular industries depends on the information available. Details of the information available and the assumptions used are provided as notes in a spreadsheet.[1]

C. Pending Salaries

4. Production of phosphate, the country's main source of income for decades, was extremely low for the period FY2004 to FY2006. As a result of the economic difficulties in Nauru in recent years, the BON was unable to continue functioning and the Government was unable to obtain further loans from overseas sources. As a consequence, the Government and the Nauru Phosphate Corporation (NPC) were unable to continue to pay workers' wages and salaries. A portion of the wages was paid in cash, while the unpaid wages were accrued as a liability and are referred to as "pending salaries".

[1] The original version of the spreadsheet was prepared by the former Secretariat of the Pacific Community Statistician in 2004 and further modified by the Pacific Financial Technical Assistance Centre Statistical Advisor in August 2005. The spreadsheet has been altered to provide estimates for FY2004 to FY2006 and a forecast for FY2007. Some of the original assumptions have been modified and additional source data used to compile the current version. The non-monetary columns in the spreadsheet are used only to record pending salaries for the general government sector for the reasons explained below.

5. The treatment of pending salaries is particularly important for the general government sector, as the measure of GDP depends directly on the value of compensation of employees for general government. In the case of private or government-owned business enterprises, the measure of GDP is not affected by the inclusion or exclusion of pending salaries from employee compensation, since offsetting adjustments would be made to employee compensation and gross operating surplus.

6. It is not clear at this time to what extent pending salaries will eventually be paid to employees. No pending salaries are outstanding for the employees of some government-owned business enterprises (e.g., Air Nauru or Nauru Rehabilitation Corporation), while the expatriate workers at the NPC (now RONPhos) who have recently been repatriated to their home countries have been paid their pending salaries in full (using aid funds from Taipei,China). Public service employees are expected to have their pending salaries added to their BON accounts, so the final outcome is likely to be linked to the process of putting the BON into receivership or winding it up completely.

7. In addition to the way of measuring GDP through the standard United Nations System of National Accounts, 1993 (SNA93), an alternative measure is provided that excludes pending salaries for the general government sector.

D. BON Checks

8. The BON has not been operating normally for many years. It is now mainly used as a storage facility for cash and to pay cash salaries to public service employees. In FY2007, some transactions are, however, still being made using BON checks. These include (i) the bulk of household electricity bills, all but A$5 per month of which are payable by check; (ii) the value of government birth and death payments (these are deducted if the recipient has sufficient funds in a BON account); (iii) the cost of overseas medical referrals; (iv) retrenchment payments; and (v) prisoners' rations (also deducted if the recipient has sufficient funds in a BON account). In some earlier periods, BON checks were used to purchase various goods and services, but their value was progressively discounted (reportedly A$5 in cash was equal to an A$50 check only a year or two ago).

9. A major issue relating to BON checks is how to calculate the income of the electricity utility. Calculation of value added is directly affected by whether revenue received as BON checks is valued at face value or discounted. The estimates presented in this report treat the checks at face value. If they were to be discounted, the estimates of GDP would be reduced.

E. Treatment of the Offshore Processing Centers

10. GDP represents the value of all goods and services produced within the domestic territory of a country. The domestic territory of a country is defined to include embassies, military bases, etc. the country occupies in overseas countries and to exclude embassies, military bases, etc. of other countries located within its own borders. Under arrangements between the Australian Government, the Government of Nauru and the International Organization for Migration, a Refugee Processing Centre has been set up on Nauru. The Australian Bureau of Statistics treats the OPC as part of Australia's domestic territory for BOP and GDP calculations. While there may be some debate about whether the OPC is part of Australia's domestic territory or whether it is the economic territory of an international organization (IOM), it is clear that the OPC is not part of Nauru's domestic territory. This is shown by the extracts below from the United Nations national accounts manual, which imply that the activity at the OPC sites is not

part of the gross domestic product of Nauru. The camps are patrolled by non-Nauruans and off limits to Nauruans.

> "The economic territory of a country includes: ... (b) territorial enclaves in the rest of the world (clearly demarcated areas of land which are located in other countries and which are used by the Government which owns or rents them for diplomatic, military, scientific or other purposes - embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, etc., - with the formal political agreement of the Government of the country in which they are physically located."[2]

> "The economic territory of an international organization consists of the territorial enclave, or enclaves, over which it has jurisdiction; these consist of clearly demarcated areas of land or structures which the international organization owns or rents and which it uses for the purposes for which the organization was created by formal agreement with the country, or countries, in which the enclave or enclaves are physically located. It follows that the economic territory of a country does not include the territorial enclaves used by foreign governments or international organizations which are physically located within the geographical boundaries of that country." (SNA93, paragraphs 14.10 and 14.11)

F. Subsidies to Government-Owned Business Enterprises

11. Some government-owned businesses are heavily subsidized. The electricity utility is the most heavily subsidized, with revenue from sales of electricity falling far short of the cost of supplying power. The subsidies are largely financed by donor aid with the Australian Agency for International Development providing much of the fuel and maintenance expenditure to ensure an ongoing supply of electricity. Large additional expenditures have been required over recent years to hire temporary portable generators and to undertake major maintenance on the generators in the power station. Lack of adequate maintenance over many years has resulted in all eight generators in the main power station currently being out of service (some of these generators have effectively reached the end of their useful lives, but some are less than 5 years old). It should also be noted that there are large unpaid accounts, as many customers (including households, businesses and government entities) have not been regularly paying for their electricity.

12. Air Nauru has been receiving an unusual type of subsidy in that the Government of Nauru has purchased aircraft and supplied these to Air Nauru effectively at no cost. There are two possible ways of viewing this situation. First, the Government can be seen to be simply making a capital transfer to Air Nauru. Alternatively, Air Nauru could be seen as making an imputed payment to the Government for an operating lease on its aircraft, which is matched by a subsidy from general Government equal to the operating lease payments. However, the measure of GDP is not affected by which of these two treatments is adopted.

G. Redundancies and Salary Reductions

13. The Government of Nauru has reacted to the difficult economic conditions over recent years by undertaking a series of major reforms of public service and government-owned

[2] United Nations. 2001. The 1993 System of National Accounts Internet Access System. Paragraph 14.9 (available at http://unstats.un.org/unsd/sna1993/toctop.asp)

business enterprises. These have included a significant number of redundancies, and from 1 July 2006, a significant reduction in the salaries payable to public servants and employees of most government-owned business enterprises. Consequently, the contribution of the general government sector to GDP in FY2007 will be significantly lower than in earlier years (assuming that pending salaries are included for the general government sector).

H. Accounts for General Government

14. GFS tables and national accounts-style income accounts and capital accounts have been prepared using information contained in budget papers for FY2005, FY2006 and FY2007. Some estimates have been made regarding the likely magnitude of the additional donor assistance when compiling the accounts for general government for FY2007.

15. In a number of areas, additional information is required from the Department of Finance in Nauru in order to make the GFS tables and the income and capital accounts more accurate. There are also a number of issues that need to be resolved to improve these tables and accounts. The major issues are discussed below.

16. Data are required concerning the actual level of donor assistance in FY2006 and a disaggregation of this expenditure (and that for FY2005 and FY2007) into final consumption expenditure and gross fixed capital formation.

17. No precise data are currently available on the amount of interest payable on Nauruan Government debt. For the purpose of estimating gross national income, an approximate level of debt and an assumed interest rate have been used to obtain an estimate of the accruing interest on Nauruan Government debt. However, these estimates have not been included in the general government accounts.

18. There is an issue with how the purchase of an aircraft for Air Nauru should be recorded in the general government accounts. Currently, an amount of A$2,666,667 is included in capital transfers received but no transfer to Air Nauru is shown. This amount is also included in gross fixed capital formation for general government. Taipei,China has met the purchase cost for the aircraft through a number of annual installments. For capital expenditure purposes, the full value of the aircraft should be recorded when change of ownership occurred. The legal owner appears to be a shelf company set up especially to own the aircraft. It would be necessary to clarify the legal arrangements in order to properly record transactions relating to the purchase of the aircraft for use by Air Nauru in the general government accounts.

19. The budget documents for FY2005 may not be fully consistent with those for the following 2 years in respect of the treatment of subsidies. Virtually nothing is recorded for subsidies in FY2005 in the budget papers; however, some significant transfers to government business enterprises may have taken place.

20. There appear to be small differences between the sums of the detailed components of revenue and expenditure in FY2006 and the corresponding published totals.

I. Trade Data

21. Recent data for exports and imports of goods and services for Nauru are not available from the Statistics Office in Nauru. Data for exports and imports have therefore been examined from three sources—counterpart data from Australia for exports to and imports from Nauru;

trade data on the ADB database; and trade data on the United Nations database. The data from these three sources do not match. The information in the United Nations database for imports from Nauru seems quite implausible in many cases. For example, it is unlikely that in 2003 Nigeria had imports from Nauru of A$11.2 million across a wide range of commodities including A$2 million for dairy products and A$6 million for fish; or that Japan had imports from Nauru of A$11.2 million for refrigeration equipment; or that in 2004 South Africa had imports from Nauru of A$7.3 million for petroleum and petroleum products. In fact the majority of the implied exports from Nauru do not look correct, especially in view of the commodities recorded as being exported from Nauru. It would appear that there are many serious misclassifications in the trade data for many countries. The data for imports to Nauru look more reasonable but may also suffer from misclassifications. For example, the following import items in 2003 look highly implausible: A$1.2 million special industrial machinery from Togo and A$1.7 million in coal, coke, etc. from Indonesia.

J. Balance of Payments

24. Although there are major gaps in the data available, a very rough approximation was made in order to compile a set of balance of payments tables for Nauru. The estimated external account excludes interest on debts that has not been serviced.

ECONOMIC INDICATORS

Table A2.1: Gross Domestic Product
(current prices)

Item	Including Pending Salaries for General Government			Excluding Pending Salaries for General Government		
	FY2004	FY2005	FY2006	FY2004	FY2005	FY2006
GDP at market prices (A$ million)	38.36	34.01	36.88	29.70	24.48	28.51
GDP per capita at market prices (A$)	3,805	3,373	3,695	2,946	2,428	2,857
$/A$ rate	0.71	0.75	0.74	0.71	0.75	0.74
GDP at market prices ($ million)	27.37	24.27	26.32	21.19	17.47	20.34
GDP per capita at market prices ($)	2,715	2,407	2,637	2,102	1,733	2,038

FY = fiscal year, GDP = gross domestic product.
Sources: Budget papers for fiscal year 2005, 2006 and 2007; National Statistics Office, Department of Finance, other Government departments and state-owned business enterprises.

Table A2.2: Gross Domestic Product by Industry
(A$ million, current prices)

Item	FY2004	FY2005	FY2006
Agriculture, fishing, hunting	3.7	4.0	3.9
Mining	2.7	0.6	0.7
Manufacturing	0.1	0.1	1.9
Electricity, water	(5.7)	(5.4)	(2.8)
Construction	1.2	1.1	2.5
Commerce, etc.	8.0	7.0	7.6
Transport and communication	10.5	7.6	3.4
Finance and business services	1.1	1.1	1.1
Public administration	13.0	13.9	14.9
Personal and other services	0.3	0.3	0.3
Ownership of owner-occupied dwellings	3.2	3.2	3.2
Consumption of fixed capital for by General Government	0.3	0.3	0.3
GDP at market prices (A$ million)	38.4	34.0	36.9

( ) = negative, FY = fiscal year, GDP = gross domestic product.
Sources: Budget papers for FY2005, FY2006 and FY2007; National Statistics Office, Department of Finance; other government departments and state-owned business enterprises.

Table A2.3: The Main Sources of Imports

Origin	**A$ million** (current prices)			**Share of Imports** (%)		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Australia	17.80	12.23	9.15	67.4	69.0	36.5
Indonesia	2.75	1.01	0.02	10.4	5.7	0.1
United States	1.87	0.73	1.63	7.1	4.1	6.5
Togo	1.19	0.00	0.00	4.5	0.0	0.0
United Kingdom	0.66	0.82	0.21	2.5	4.6	0.8
Germany	0.43	0.98	1.15	1.6	5.5	4.6
Poland	0.35	0.00	0.00	1.3	0.0	0.0
Hong Kong, China	0.15	0.39	0.34	0.6	2.2	1.4
Viet Nam	0.13	0.00	0.00	0.5	0.0	0.0
Republic of Korea	0.06	0.08	11.81	0.2	0.5	47.1
Total Imports	26.41	17.73	25.09	100.0	100.0	100.0

Note: Some data contained in this table may be unreliable.
Source: United Nations trade database.

Table A2.4: The Main Export Destinations

Destination	**A$ million** (current prices)			**Share of Exports** (%)		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Japan	11.46	1.37	0.23	37.3	9.6	6.1
Nigeria	11.23	0.00	0.00	36.6	0.0	0.0
India	3.61	1.67	0.00	11.8	11.7	0.0
Republic of Korea	1.74	0.48	1.09	5.7	3.4	29.6
Pakistan	0.45	0.43	0.08	1.5	3.0	2.1
United States	0.31	0.13	0.16	1.0	0.9	4.3
United Kingdom	0.25	0.14	0.25	0.8	1.0	6.8
Belgium	0.23	0.00	0.00	0.8	0.0	0.0
Canada	0.21	0.02	0.88	0.7	0.2	23.8
South Africa	0.04	7.34	0.04	0.1	51.1	1.0
Total Exports	30.69	14.35	3.69	100.0	100.0	100.0

Note: The data contained in this table is highly unreliable.
Source: United Nations trade database.

Table A2.5: Fiscal Revenue and Expenditure
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget	FY2008 Budget[a]
A. Total revenues included in Budget	11.357	26.975	22.288	24.695
Deduct				
Repayment of capital from PhilPhos	0.000	5.000	4.400	0.000
Repayment of Cook Islands loan	1.716	1.070	0.000	0.000
Fisheries loan repayment			0.137	0.000
B. Actual Revenue	9.641	20.905	17.751	24.695
of which				
Tax	0.967	1.204	2.383	1.932
Property income	4.905	7.666	6.262	6.934
Grants from Aid Donors	2.041	9.708	6.773	11.022
Other current transfers	0.006	0.000	0.015	0.000
Sales of goods and services	1.722	2.170	2.318	4.809
Unexplained discrepancy		0.157		0.000
C. Total expenditures included in Budget	9.776	26.404	22.226	24.657
Deduct				
Loan to Fisheries			0.137	0.000
Public debt repayments	0.000	0.419	0.270	0.270
Contingency fund	0.118	0.050	0.050	0.050
D. Actual Expenditure	9.658	25.935	21.769	24.337
of which				
Employee expenses	4.471	5.949	5.890	7.406
Operating expenses	4.565	7.194	8.543	13.611
Property expenses	0.345	0.414	0.505	0.505
Current transfers	0.079	6.140	2.150	2.177
Gross fixed capital formation	0.199	6.139	4.682	0.639
Unexplained discrepancy		0.099		
(B)-(D)=Net Lending(+)/Borrowing(-)	(0.018)	(5.030)	0.062	0.038

( ) = negative, FY = fiscal year.
[a] There are some differences in classification between FY2007 and FY2008.
Source: Budget papers for FY2005, FY2006, FY2007, and FY2008.

Table A2.6: Fiscal Revenue and Expenditure including Pending Salaries
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget	FY2008 Budget[a]
Total Revenues included in Budget	11.357	26.975	22.288	24.695
Deduct				
Repayment of capital from PhilPhos	0.000	5.000	4.400	0.000
Repayment of Cook Islands loan	1.716	1.070	0.000	0.000
Fisheries loan repayment			0.137	0.000
GFS Revenue	9.641	20.905	17.751	24.695
of which				
Tax	0.967	1.204	2.383	1.932
Property income	4.905	7.666	6.262	6.934
Grants from Aid Donors	2.041	9.708	6.773	11.022
Other current transfers	0.006	0.000	0.015	0.000
Sales of goods and services	1.722	2.170	2.318	4.809
Unexplained discrepancy		0.157		0.000
Total Expenditures included in Budget plus Pending Salaries	19.305	34.775	23.037	24.977
Deduct				
Loan to Fisheries			0.137	0.320
Public debt repayments	0.000	0.419	0.270	0.270
Contingency fund	0.118	0.050	0.050	0.050
GFS Expenditure	19.187	34.307	22.580	24.337
of which				
Employee expenses (including pending salaries)	14.000	14.321	6.701	7.406
Operating expenses	4.565	7.194	8.543	13.611
Property expenses	0.345	0.414	0.505	0.505
Current transfers	0.079	6.140	2.150	2.177
Gross fixed capital formation	0.199	6.139	4.682	0.639
Unexplained discrepancy		0.099		
GFS Net Lending(+)/Borrowing(-)	(9.547)	(13.402)	(4.829)	0.358

( ) = negative, FY = fiscal year, GFS = government finance statistics.
[a] There are some differences in classification between FY2007 and FY2008.
Sources: Budget papers for FY2005, FY2006, and FY2007; Department of Finance.

Table A2.7: Fiscal Revenue and Expenditure including Pending Salaries and All Other Donor Aid
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget
Total Revenues included in Budget plus All Other Donor Aid Transfers	29.482	47.858	39.365
Deduct			
Repayment of capital from PhilPhos	0.000	5.000	4.400
Repayment of Cook Islands loan	1.716	1.070	0.000
Fisheries loan repayment			0.137
GFS Revenue	27.766	41.788	34.828
of which			
Tax	0.967	1.204	2.383
Property income	4.905	7.666	6.262
Grants from Aid Donors	20.166	30.591	23.850
Other current transfers	0.006	0.000	0.015
Sales of goods and services	1.722	2.170	2.318
Unexplained discrepancy		0.157	
Total Expenditures included in Budget plus Pending Salaries and All Other Donor Aid	37.430	55.658	40.114
Deduct			
Loan to Fisheries			0.137
Public debt repayments	0.000	0.419	0.270
Contingency fund	0.118	0.050	0.050
GFS Expenditure	37.312	55.190	39.657
of which			
Employee expenses (including pending salaries)	14.910	15.861	8.241
Operating expenses	7.668	16.177	14.460
Property expenses	0.345	0.414	0.505
Current transfers	10.191	13.500	9.770
Capital transfers to state-owned enterprises	3.000	2.000	1.000
Gross fixed capital formation	1.199	7.139	5.682
Unexplained discrepancy		0.099	
GFS Net Lending(+)/Borrowing(-)	(9.547)	(13.402)	(4.829)

( ) = negative, FY = fiscal year, GFS = government finance statistics.
Sources: Budget papers for FY2005, FY2006, and FY2007; Department of Finance; National Sustainable Development Strategy document.

Table A2.8: General Government Income Account, Before Addition of Donor Aid not Included in the Budget
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget
Income			
Primary income receivable			
Gross operating surplus	250,000	250,000	250,000
Taxes on production and imports	961,654	1,145,362	2,148,540
Property income receivable			
Interest			
Dividends	0	0	819,690
Rent on natural assets	4,904,963	7,666,390	5,442,700
Total property income receivable	4,904,963	7,666,390	6,262,390
Total primary income receivable	**6,116,617**	**9,061,752**	**8,660,930**
Secondary income receivable			
Current taxes on income and wealth			
Income tax			
Other current taxes	5,550	58,620	234,810
Other current transfers	2,046,680	6,866,139	4,076,089
Total secondary income	**2,052,230**	**6,924,759**	**4,310,899**
Total Gross Income	**8,168,847**	**15,986,511**	**12,971,829**
Use of Income			
Primary income receivable			
Property income payable			
Interest			
Rent on natural assets	344,595	413,514	504,504
Total property income payable	344,595	413,514	504,504
Subsidies	1,600	5,198,866	1,142,900
Total primary income payable	**346,195**	**5,612,380**	**1,647,404**
Secondary income payable			
Social assistance benefits to residents	77,463	941,033	1,006,601
Other current transfers			
Total secondary income payable	**77,463**	**941,033**	**1,006,601**
Total Income Payable	**423,658**	**6,553,413**	**2,654,005**
Gross Disposable Income	**7,745,189**	**9,433,098**	**10,317,824**
Final consumption expenditure	16,843,508	19,345,089	12,925,946
Net saving	(9,348,319)	(10,161,991)	(2,858,122)
Consumption of fixed capital	250,000	250,000	250,000
Total Use of Gross Income	**8,168,847**	**15,986,511**	**12,971,829**

( ) = negative, FY = fiscal year.
Sources: Budget papers for FY2005, FY2006, and FY2007; Department of Finance.

Table A2.9: General Government Income Account, After Addition of Donor Aid not Included in the Budget
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget
Income			
Primary income receivable			
Gross operating surplus	250,000	250,000	250,000
Taxes on production and imports	961,654	1,145,362	2,148,540
Property income receivable			
Interest			
Dividends	0	0	819,690
Rent on natural assets	4,904,963	7,666,390	5,442,700
Total property income receivable	4,904,963	7,666,390	6,262,390
Total Primary Income Receivable	**6,116,617**	**9,061,752**	**8,660,930**
Secondary income receivable			
Current taxes on income and wealth			
Income tax			
Other current taxes	5,550	58,620	234,810
Other current transfers	16,171,680	24,749,139	19,153,089
Total Secondary Income	**16,177,230**	**24,807,759**	**19,387,899**
Total Gross Income	**22,293,847**	**33,869,511**	**28,048,829**
Use of Income			
Primary income receivable			
Property income payable			
Interest			
Rent on natural assets	344,595	413,514	504,504
Total property income payable	344,595	413,514	504,504
Subsidies	10,113,600	12,558,866	8,762,900
Total Primary Income Payable	**10,458,195**	**12,972,380**	**9,267,404**
Secondary income payable			
Social assistance benefits to residents	77,463	941,033	1,006,601
Other current transfers			
Total Secondary Income Payable	**77,463**	**941,033**	**1,006,601**
Total Income Payable	**10,535,658**	**13,913,413**	**10,274,005**
Gross Disposable Income	**11,758,189**	**19,956,098**	**17,774,824**
Final consumption expenditure	20,856,508	29,868,089	20,382,946
Net saving	(9,348,319)	(10,161,991)	(2,858,122)
Consumption of fixed capital	250,000	250,000	250,000
Total Use of Gross Income	**22,293,847**	**33,869,511**	**28,048,829**

( ) = negative, FY = fiscal year.
Sources: Budget Papers for FY2005, FY2006, and FY2007; Department of Finance; National Sustainable Development Strategy document.

Table A2.10: General Government Capital Account, Before Addition of Donor Aid not Included in the Budget
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget
Net saving	(9,348,319)	(10,161,991)	(2,858,122)
Consumption of fixed capital	250,000	250,000	250,000
Capital transfers receivable	0	2,842,000	2,711,667
less Capital transfers payable			
Gross Saving and Capital Transfers	**(9,098,319)**	**(7,069,991)**	**(103,545)**
Gross fixed capital formation	198,571	6,139,232	4,682,339
Changes in inventories			
Acquisitions less disposals of non-produced non-financial assets			
Net lending (+) / Net borrowing (-)	(9,296,890)	(13,209,223)	(4,578,794)
Total Capital Formation and Net Lending (+)/Net Borrowing (-)	**(9,098,319)**	**(7,069,991)**	**(103,545)**

( ) = negative, FY = fiscal year.
Sources: Budget papers for FY2005, FY2006, and FY2007; Department of Finance.

Table A2.11: General Government Capital Account, After Addition of Off-Budget Donor Aid
(A$ million, current prices)

Item	FY2005 Actual	FY2006 Budget	FY2007 Budget
Net saving	(9,348,319)	(10,161,991)	(2,858,122)
Consumption of fixed capital	250,000	250,000	250,000
Capital transfers receivable	4,000,000	5,842,000	4,711,667
less Capital transfers payable	3,000,000	2,000,000	1,000,000
Gross Saving and Capital Transfers	**(8,098,319)**	**(6,069,991)**	**1,103,545**
Gross fixed capital formation	1,198,571	7,139,232	5,682,339
Changes in inventories			
Acquisitions less disposals of non-produced non-financial assets			
Net lending (+) / net borrowing (-)	(9,296,890)	(13,209,223)	(4,578,794)
Total Capital Formation and Net Lending (+)/Net Borrowing (-)	**(8,098,319)**	**(6,069,991)**	**1,103,545**

( ) = negative, FY = fiscal year.
Sources: Budget papers for FY2005, FY2006, and FY2007; Department of Finance; National Sustainable Development Strategy document.

Table A2.12: External Account
(A$ million, current prices

Item	FY2004	FY2005	FY2006
Imports of goods and services			
Goods	30.7	27.3	32.3
Services (Air Nauru)	18.0	19.1	22.7
Primary income payable to non-residents			
Compensation of employees	4.1	3.9	3.1
Property income payable			
Interest[a]			
Net lending	1.5	(0.3)	5.8
Resources Provided by Nonresidents	**54.3**	**50.1**	**63.9**
Exports of goods and services			
Goods	4.5	0.8	1.5
Services (Air Nauru)	23.5	22.0	22.4
Primary income receivable			
Compensation of employees	0.5	0.4	0.8
Property income receivable			
Interest			
Dividends			
Rent on natural assets	5.2	5.1	7.3
Secondary income receivable			
Current taxes on income and wealth			0.0
Current donor aid transfers	16.0	16.2	24.7
Other current transfers (Funds for Nauru Rehabilitation Corporation)	1.6	1.6	1.3
Capital transfers from non-residents	3.0	4.0	5.8
Resources Provided to Nonresidents	**54.3**	**50.1**	**63.9**

( ) = negative, FY = fiscal year.
[a] Excluding interest flows on debt that has not being serviced
Sources: Budget papers for FY2005, FY2006, and FY2007; National Sustainable Development Strategy document.