

**Validation Report**  
October 2018

# Nauru: Fiscal Sustainability Reform Program

Reference Number: PVR-569  
Project Number: 48478-01  
Grant Numbers: 0473 and 0474

Independent  
**Evaluation**  **ADB**

*Raising development impact through evaluation*

## ABBREVIATIONS

ADB	–	Asian Development Bank
FMIS	–	Financial Management Information System
MOF	–	Ministry of Finance
MOU	–	memorandum of understanding
NUC	–	Nauru Utilities Corporation
NTF	–	Nauru Intergenerational Trust Fund
NSDS	–	Nauru National Sustainable Development Strategy
PCR	–	program completion report
PFM	–	public finance management
RPC	–	Regional Processing Centre
RRP	–	report and recommendation to the President
SOE	–	state-owned enterprise
TA	–	technical assistance

## NOTE

In this report, “\$” refers to United States dollars and A\$ refers to Australian dollars.

<b>Director General</b>	Marvin Taylor-Dormond, Independent Evaluation Department (IED)
<b>Deputy Director General</b>	Véronique Salze-Lozac’h, IED
<b>Director</b>	Walter Kolkma, Thematic and Country Division, IED
<b>Team Leader</b>	Joanne Asquith, Principal Evaluation Specialist, IED

The guidelines formally adopted by the Independent Evaluation Department (IED) on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. To the knowledge of IED management, there were no conflicts of interest of the persons preparing, reviewing, or approving this report. The final ratings are the ratings of IED and may or may not coincide with those originally proposed by the consultants engaged for this report.

In preparing any evaluation report, or by making any designation of or reference to a particular territory or geographic area in this document, IED does not intend to make any judgments as to the legal or other status of any territory or area.

## PROGRAM BASIC DATA

<b>Project Number</b>	48478-001	<b>PCR Circulation Date</b>	26 July 2017	
<b>Grant Numbers</b>	0473 and 0474	<b>PCR Validation Date</b>	Oct 2018	
<b>Program Name</b>	<b>Fiscal Sustainability Reform Program</b>			
<b>Sector and subsector</b>	Public sector management	Public administration		
<b>Strategic agenda</b>	Inclusive economic growth			
<b>Safeguard categories</b>	Environment		C	
	Involuntary resettlement		C	
	Indigenous peoples		C	
<b>Country</b>	Nauru		<b>Approved</b> (\$ million)	<b>Actual</b> (\$ million)
<b>ADB Financing</b> (\$ million)	<b>ADF: 2.00</b>	<b>Total Program Costs</b>	3.80	3.80
	<b>OCR: 0.00</b>	<b>Grant</b>		
		0473	2.00	2.00
		<b>Borrower</b>	0.00	0.00
		<b>Beneficiaries</b>	0.00	0.00
		<b>Others</b>	0.00	0.00
<b>Cofinancier</b>	Government of Australia	<b>Total Cofinancing</b>		
		0474	1.80	1.80
<b>Approval Date</b>		<b>Effectiveness Date</b>		
0473	21 Mar 2016	0473/0474	30 Jul 2016	8 Jun 2016
0474	28 Apr 2016			
<b>Signing Date</b>	1 May 2016	<b>Closing Date</b>	30 Jun 2016	30 Dec 2016
<b>Project Officer</b>	R. Rajah	<b>Location</b>	<b>From</b>	<b>To</b>
		Pacific Liaison and Coordination Office in Sydney, Australia	23 Mar 2016	16 Jul 2017
<b>IED Review Director</b>	W. Kolkma, IETC			
<b>Team Leader</b>	J. Asquith, Principal Evaluation Specialist, IETC*			

ADB = Asian Development Bank, ADF = Asian Development Fund, IED = Independent Evaluation Department, IETC = Thematic and Country Division, OCR = ordinary capital resources, PCR = program completion report.

\*Team members: S. Palle Venkata (Quality Reviewer); M.J. Dimayuga and A. Morales (Senior Evaluation Officers); and J. Hawley and J. Eerikainen (Consultants).

## I. PROGRAM DESCRIPTION

### A. Rationale

1. Nauru, the smallest member country of the Asian Development Bank (ADB), faces development challenges stemming from its small size, small population, and remoteness. Limited resources constrain the scope by which the private sector could develop and the public sector dominates the economy and employment. Nauruan institutions are thinly resourced, relatively weak, and highly dependent on foreign investors.<sup>1</sup>

<sup>1</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Nauru for the Fiscal Sustainability Reform Program*. Manila.

2. The country's main sources of revenue come from (i) fishing license fees, (ii) payments to landowners from the liquidation of the Nauru Phosphate Royalties Trust,<sup>2</sup> (iii) the Regional Processing Centre (RPC) for asylum seekers<sup>3</sup> and its associated duties and taxes, and (iv) the export of phosphates. Fishery license fees are volatile, the RPC payments were at risk of termination, and phosphate reserves are expected to be exhausted in the next 20 years (footnote 1). The country's dependence on a narrow set of uncertain revenue streams, which are finite and volatile, gave rise to concerns about the quality of public expenditure and long-term economic sustainability.<sup>4</sup>

3. Poor asset management and limited internal capacity affected water production, quality, and delivery. These also affected the reliable supply of electricity, which in turn affected productivity, and access to education, health, and public safety. The provision of subsidized power was a fiscal burden, hence, there was a need to reduce fiscal costs, strengthen the environment for private sector development, and improve the delivery of basic services to households.

4. To address these concerns, the government sought to achieve fiscal sustainability by (i) strengthening public finance management (PFM), (ii) realizing fiscal savings through power sector efficiency, and (iii) putting in place a mechanism to save windfall revenues for future generations. Thus, ADB approved the Nauru Fiscal Sustainability Reform Program (footnote 1). This program was built on earlier reforms supported by ADB (and other development partners) to (i) improve PFM and the performance of state-owned enterprises (SOEs), and (ii) establish the Nauru Intergenerational Trust Fund (NTF) that would save unexpected gains or windfalls in public revenue (footnote 4).

5. Due to its recent history of debt distress, Nauru is eligible for Asian Development Fund grants.<sup>5</sup> The program—which was built on and informed by earlier reforms and technical assistance (TA) provided by ADB and other development partners—was designed to support the government's long-term development goal of improving fiscal sustainability. The grant's format was based on the government's development policy letter and supporting policy matrix.

## **B. Expected Impacts, Outcomes, and Outputs**

6. The program's expected impact was aligned with the goals and objectives of the Nauru National Sustainable Development Strategy 2005–2025 (NSDS).<sup>6</sup> The strategy aimed to improve the quality of life for all Nauruans on a sustainable basis through (i) a stable, trustworthy, and fiscally responsible government; (ii) provision of enhanced social infrastructure and utility services; and (iii) the development of an economy based on multiple sources of revenue.

---

<sup>2</sup> R. Rajah. 2017. Securing Sustainability: Nauru's New Intergenerational Trust Fund and Beyond. *Issues in Pacific Development*. No. 1. Manila. ADB. Little is known about the trust, reflecting its nontransparent governance and weak managerial arrangements. From an estimated value of A\$1 billion in 1990, its value was estimated at A\$100.0 million upon entering receivership in 2004.

<sup>3</sup> The Regional Processing Centre is operated under a bilateral agreement with the Government of Australia, underpinned by a 5-year agreement that will expire in 2019, although there is potential to extend the agreement. See reference in footnote 2.

<sup>4</sup> ADB. 2017. *Completion Report: Fiscal Sustainability Reform Program in Nauru*. Manila.

<sup>5</sup> ADB. 2014. *Country Operations Business Plan: Nauru, 2015–2017*. Manila.

<sup>6</sup> Government of Nauru, Ministry of Finance and Economic Planning. 2009. *National Sustainable Development Strategy, 2005–2025: Partnership for Quality of Life*. [http://www.nationalplanningcycles.org/sites/default/files/planning\\_cycle\\_repository/nauru/nauru\\_development\\_strategy\\_2025\\_en\\_2005.pdf](http://www.nationalplanningcycles.org/sites/default/files/planning_cycle_repository/nauru/nauru_development_strategy_2025_en_2005.pdf).

7. The intended outcome was improved fiscal sustainability. The program's three expected outputs were (i) improved PFM (operationalize the Financial Management Information System (FMIS), develop aggregate revenue and expenditure projections, and implement the Employment and Services Tax Bill); (ii) efficient service delivery by the Nauru Utilities Corporation (NUC) (develop a strategic plan and a maintenance plan); and (iii) improved funding mechanism for future service delivery (establish the NTF and for the government to ensure its initial capitalization). Establishing the NTF was the main feature of this program. This was to be done with the government investing a portion of its windfall revenues to build a pool of financial assets that can be drawn upon in the future to provide a stable source of budget financing.

### C. Provision of Inputs

8. The program was funded by a \$3.8 million single-tranche policy-based grant comprising a \$2.0 million ADB grant (approved on 21 March 2016) and \$1.8 million equivalent cofinancing from the Government of Australia (approved on 28 April 2016) administered by ADB. The full amount provided seed funding for the NTF. The grant became effective on 8 June 2016 upon completion by the government of the required policy actions. The ADB grant was disbursed on 31 August 2016. The Government of Australia grant was disbursed on 14 September 2016, some 3 months after the planned date to accommodate the government's delay in finalizing the conditions of funds withdrawal.

9. Grant effectiveness was dependent on the completion of the nine policy actions and these were completed on 8 June 2016, which was 22 days earlier than planned.

10. Program activities were confined to poverty alleviation by supporting sustainable, equitable, and inclusive long-term economic growth built on improved PFM, better service delivery by (and reduced subsidies to) the NUC, and saving windfall revenues to fund future service delivery. There were no immediate gender implications in the program. It was classified as category C for environment, involuntary resettlement, and indigenous peoples.<sup>7</sup> No consultants were engaged and there was no attached TA.

### D. Implementation Arrangements

11. The Ministry of Finance (MOF), as the executing agency, was responsible for overseeing the implementation of the agreed policy actions by the implementing agencies; and for program administration, disbursements, and record maintenance. The MOF implemented output 1 through the Department of Treasury and Revenue, and output 2 through the Department of Planning and Aid. The NUC was the implementing agency for output 3. The table below summarizes the policy actions for each output indicator.

**Table 1: Policy Actions for Each Output Indicator**

Output	Policy Actions
Output 1: Improved public financial management	<ol style="list-style-type: none"> <li>1. FMIS accounts payable and bank reconciliation function made fully functional.</li> <li>2. Quarterly financial progress reports produced and regularly submitted to the Minister of Finance.</li> <li>3. Weekly in-year budget reports will be produced and made regularly available to all ministries.</li> </ol>

<sup>7</sup> ADB (Independent Evaluation Department). 2018. Safeguard Performance and ADB's Safeguard Work Quality: Fiscal Sustainability Reform Program. 11 May (internal). IED Safeguards Performance Assessment confirms that safeguards categorizations were correct as all program activities were confined to policy and institutional reforms.

Output	Policy Actions
	<p>4. Aggregate revenue and expenditure projections for FY2016–FY2018 prepared.</p> <p>5. The Employment and Services Tax approved by the Parliament and came into force.</p>
Output 2: Efficient service delivery by the NUC	<p>6. Strategic Plan for the NUC, which includes performance-based management system, financial accounting software, and short-term program for asset rehabilitation developed.</p> <p>7. Strategic maintenance plan for NUC assets developed and adopted.</p>
Output 3: Improved funding mechanism for future service delivery	<p>8. Memorandum of understanding signed between the government and the Government of Australia on the establishment of the NTF.</p> <p>9. Government to make an initial allocation of A\$20.4 million (A\$10.4 million to be paid from 2016 revenues and A\$10 million to be paid from cash set-asides from previous financial years).</p>

FMIS = Financial Management Information System, NTF = Nauru Intergenerational Trust Fund, NUC = Nauru Utilities Corporation.

Source: ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant to Nauru for the Fiscal Sustainability Reform Program*. Manila.

12. According to the program completion report (PCR), all policy actions were completed. All covenants in the two grant agreements were also complied with (footnote 4).

13. The report and recommendation of the President (RRP) showed that there were three key risks, and the risk assessment and risk management plan (attached to the RRP) cited five medium and two high risks (footnote 1). The overall program risk was assessed as medium. The two high risks were as follows:

- (i) External shocks, such as natural disasters, and high oil and food prices damage the economy and the country's financial position. These are to be mitigated by ADB support to the government's efforts to promote fiscal sustainability, and by supporting the establishment of the NTF to save current windfall public revenues for the future. The NTF framework contains provision for lower, delayed, or no government contribution in the event of unforeseen negative shocks.
- (ii) The government is unable to implement policy reform actions because it lacks the capacity. This is to be mitigated by the government and development partners by jointly developing policy reform actions, with reform areas prioritized and linked to available TA support. ADB is to provide the government TA support in assessing and formulating plans for improving PFM, and in strengthening the corporate governance of the NUC. The Government of Australia is to fund resident advisors and provide TA support in (a) developing the FMIS, (b) formulating revenue and administration policies, and (c) instituting reforms in the education and health sectors. The Pacific Financial Technical Assistance Centre supports reforms to financial instructions and statistics.<sup>8</sup> Ongoing government–development partner policy dialogue will ensure that reforms will continue to be implemented.<sup>9</sup>

<sup>8</sup> The Pacific Financial Technical Assistance Centre was established in 1993 to promote macro financial stability in the Pacific Island countries through a focused program of technical assistance and training. It was the first International Monetary Fund (IMF) regional technical assistance centers, representing a collaborative venture between the IMF, the member countries, and bilateral donor partners. The Centre's goal is to strengthen the institutional capacity of Pacific countries to design and implement sound macroeconomic and financial policies. <https://www.imfconnect.org/content/PFTAC/en1/about-pftac.html>.

<sup>9</sup> ADB (Pacific Department). 2017. Project Review and Inception Missions to Nauru: Fiscal Sustainability Reform Program, and Strengthening Financial Inclusion and Financial Sector Development. Back-to-office report.

14. The third key risk cited in the RRP was if political consensus on reform would not be maintained. Such risks were to be mitigated through close consultation with the government on program design and by requiring the government to make its full budget contribution to the NTF. The program was anchored to the NSDS, which enjoys broad political support. Support for reforms would be maintained by holding a major conference on NSDS every 3 years and smaller, sector-specific meetings annually. Regular joint missions undertaken by ADB and development partners, particularly on the Public Financial Management (PFM) Action Plan,<sup>10</sup> and wide consultations held across the government, the private sector, and civil society helped ensure consistent policy messaging and wider public understanding of the reform program.

## II. EVALUATION OF PERFORMANCE AND RATINGS

### A. Relevance of Design and Formulation

15. The PCR rated the program highly relevant. The program was aligned with the government's priorities of fiscal responsibility, enhanced services, and generation of additional revenue sources. In the short term, this covers three NSDS priorities: (i) establishing a new national trust fund, (ii) providing a reliable source of power, and (iii) provision of clean water. The PCR noted the volatility of revenue streams—from unexpectedly high fishing revenues to uncertain future of the RPC. Both present new challenges for fiscal management and raise concerns about the sustainability of public spending. Improved PFM will include putting aside a significant portion of the windfall revenue into a trust fund with clearly defined contribution and distribution rules to ensure that it would be preserved. Providing subsidized power had also become a major fiscal burden due to weak management and use of inefficient diesel generators. If the NUC's financial and organizational management were strengthened and there is effective asset management, these will reduce daily power outages. Reforms at the NUC will also improve living standards through better access to clean water.

16. This validation considers the program well aligned with Nauru's NSDS development priorities to ensure fiscal responsibility, increased revenue generation through the efficient and effective use of the few available revenue sources, and the provision of enhanced utility services. The program was also aligned with two of the country's development goals—the provision of enhanced social infrastructure and utility services, including well-maintained infrastructure; and the development of an economy built on multiple sources of revenue and supported by a national trust fund.<sup>11</sup> The program also built on Nauru's 2012 PFM reform program of ADB, which included the development of an FMIS, the adoption of a new tax policy framework, and implementation of reforms to improve corporate governance, and economic performance in selected SOEs.<sup>12</sup> ADB's economic and fiscal analysis, poverty and social analysis, and strategy informed program development.

---

3 July (internal). Lack of skills among the MOF staff in accounting, expenditure management, profit and loss statements, and asset management threaten the sustainability of reforms. This was raised in the Review Mission's back-to-office report as an area that needed to be addressed as part of future Public Financial Management.

<sup>10</sup> Footnote 1, para. 10. The PFM Action Plan was formulated with assistance from ADB. (ADB. 2008. *Technical Assistance for Strengthening Governance and Accountability in Pacific Island Countries (Phase 2)*. Manila (TA 6499-REG).).

<sup>11</sup> Footnote 6. The five long-term goals for Nauru are (i) a stable, trustworthy, and fiscally responsible government; (ii) the provision of enhanced social, infrastructure, and utilities services; (iii) the development of an economy based on multiple sources of revenue; (iv) the rehabilitation of mined out lands for livelihood sustainability; and (v) the development of domestic food production.

<sup>12</sup> Footnote 4, para 11.

17. The alignment between the program's outcome of improved fiscal sustainability and the expected impact of an improved and sustainable quality of life for all Nauruans was reasonably strong. A sustainable fiscal environment is likely to contribute to improving the quality of life if the people are provided with enhanced social infrastructure and utility services, and if the economy is developed based on multiple sources of revenue. However, there was no apparent link between the outcome of improved fiscal sustainability and the impact objective of a stable and trustworthy government, and no tangible way of measuring this.

18. The design could have been improved if the policy actions had been linked to the outputs and measured appropriately. For example, although better planning by NUC is important, it does not necessarily lead to efficient service delivery to the public or reduced fiscal costs. Performance indicators that measured the reduction of fiscal cost, and improved service delivery should have been developed and reported in the design and monitoring framework. The design should have included built-in transparency and accountability measures to determine if the government's achievements were accurate. For example, it would give more confidence if the FMIS, which is a performance target of output 1, is producing an accurate government balance sheet by 2017 that had included "... a government balance sheet for government that had been audited by an independent body." As this was the basis for the first government financial statement since 1995, it would have been useful to know which fiscal year it covered.

19. One of the two outcome targets (recovery of 50% of NUC costs by the end of 2018) was not amended during program implementation, although changes to internal performance payments during program implementation made its achievement unlikely.

20. Finally, the design and monitoring framework performance indicators for both outputs and outcomes did not clearly describe how the outcome of improved fiscal sustainability would be judged other than by inputs to the NTF. On the output for improved PFM, it was not clear how the production of an FMIS balance sheet would demonstrate improved financial management. The PCR also did not provide evidence that the program was innovative and/or transformative to warrant a highly relevant rating.

21. Nevertheless, this validation views the program relevant as it is in accordance with the priorities in Nauru's 20-year plan, the NSDS, which articulates the country's long-term goals and major priorities.

## **B. Effectiveness in Achieving Project Outcomes and Outputs**

22. The PCR rated the program effective in achieving the outcome of improving Nauru's fiscal sustainability. The performance target, where the government is to contribute at least an additional \$20.0 million to the NTF by 2018, is likely to be met. There had been considerable improvement in the NUC's performance through improved fiscal management, and better and more reliable access to water and electricity. Three output targets were met with the achievement of policy reform actions (i) improved financial management reporting on revenue and expenditure projections for FY2016–FY2018, (ii) development of NUC's strategic and operational plans to help improve service delivery, and (iii) the signing of the MOU with the Government of Australia to establish the NTF.

23. After contributing A\$20.4 million in 2016 to the NTF, the government confirmed that it would contribute A\$32.2 million<sup>13</sup> (\$24.4 million equivalent using the exchange rate as of 16 June 2017) by the end of 2018. While the additional contribution of A\$11.9 million to the NTF can be verified from the NTF annual report (for the period 1 July 2016 to 30 June 2017), the other contributions are either for the future or have not been reported. The contribution of A\$10.2 million in four installments has an end date of 30 June 2018, and the A\$10.0 million budgeted contribution for 2018–2019 cannot be confirmed until the accounting reports are finalized. This validation acknowledges that while the government has committed to provide contributions to the NTF and there has been progress with the fund's establishment since 2015,<sup>14</sup> the forecasted contraction in the economy of –4% in 2018<sup>15</sup> may make it difficult for the government to continue to contribute in the future without affecting the well-being of its citizens.

24. There had been considerable improvement in the NUC's performance with efficiencies across the organization that resulted in a budgetary contribution of A\$4.9 million in FY2018–FY2019. However, the PCR considered it unlikely that the NUC would meet the target of 50% recovery of operational costs through tariffs by 2018 because the target was set against costs that did not include performance-based bonus payments. As a result, one of the two outcome measures was not met.

25. Of the three outputs, the following were achieved:

- (i) The FMIS was able to produce a government account balance sheet (output 1).
- (ii) The NUC completed its strategic plan for 2015–2020 to further commercialize its operations, including developing an informed approach to tariff reform. The NUC also completed its strategic maintenance plan for 2017 and 2018, which has improved financial and operational efficiency (output 2).
- (iii) NTF was made operational by 2016 with a governance, economic, and financial framework; and a custodian bank and investment manager were appointed. The NTF received committed funding from the government and donors<sup>16</sup> on time (output 3).

26. On policy reform actions (Table 1), the PCR showed that all were achieved. Output 1 actions were part of a continuing PFM Action Plan based on the 2011 Public Expenditure and Financial Accountability Report that sought to (i) strengthen expenditure controls, (ii) improve cash management practices, (iii) operationalize the functions of the FMIS, (iv) prepare aggregate revenue and expenditure projections, and (v) implement the Employment and Services Tax, which generated A\$12.6 million in FY2016 and was expected to raise A\$9.4 million in FY2017.<sup>17</sup> Output 2 actions were to deepen reforms that will develop and adopt (i) a strategic plan that would further commercialize operations, link employee performance to the achievement of the NUC business strategy, and upgrade the high voltage power network; and (ii) a strategic maintenance

<sup>13</sup> The government contributed an additional A\$12.0 million from domestic revenues earned in FY2016, confirmed in May 2016 that a contribution of A\$10.2 million would be paid in four installments by 30 June 2018, and had budgeted a contribution of A\$10.0 million for FY2018–FY2019.

<sup>14</sup> Government of Nauru, Department of Finance. 2017. *Intergenerational Trust Fund for the People of the Republic of Nauru: Annual Report 2017*. [http://www.naurugov.nr/media/55826/2017\\_annual\\_report\\_-\\_final.pdf](http://www.naurugov.nr/media/55826/2017_annual_report_-_final.pdf). The NTF had total net assets of A\$56 million as of 30 June 2017.

<sup>15</sup> ADB. 2018. *Asian Development Outlook 2018: How Technology Affects Jobs*. Manila.

<sup>16</sup> The Government of Australia contributed A\$5 million and A\$2.5 million annually thereafter, while the Government of Taipei, China contributed A\$5.4 million and an additional A\$2.0 million in April 2018.

<sup>17</sup> Footnote 4, paras. 14-15, and 19.

plan for NUC assets that would ensure the maintenance and upgrading of its power distribution network, metering equipment, and water production and delivery. Output 3 actions, which would lead to improved funding mechanism for future service delivery, were achieved by establishing the NTF through an MOU between the governments of Nauru and Australia. The purpose was to build up a perpetual fund<sup>18</sup> that would provide a future stream of public revenue to support investment in education, health, and infrastructure post-2033 or at a time sooner to be decided by the committee.

27. This validation considers that producing an accurate balance sheet for the government through the FMIS would have been more credible if the government account were audited to attest the fairness of the account. Although there has been progress in completing the audit of the government's 2013–2014 financial accounts in 2016 and 2017, the auditor-general's office lacks trained audit staff and relies on the support from the Pacific Association of Supreme Audit Institutions to complete the audits.<sup>19</sup> There are still audit backlogs for FY2014–2015, FY2015–2016, and FY2016–2017 financial accounts, and these are yet to be completed. This means that the accuracy of the balance sheets may not be audited until FY2018–2019 at the earliest.

28. This validation considers the program effective with the establishment of a well-structured and well-managed NTF, which was the main feature of the program. Hence, the achievement of the three output targets overrides the other weaknesses.

### **C. Efficiency of Resource Use**

29. The PCR rated the program efficient. The program-related reforms were implemented efficiently with a 3-month extension to allow the government to meet the disbursement conditions. Based on the RRP and the PCR, the program's resources were used to operationalize the FMIS, develop the strategic plans for the NUC, and support the establishment of the NTF. No TA was directly attached to the program, but the program was developed in close cooperation with the Government of Australia and was built on the work of previous ADB programs. Based on the above information, this validation assesses the program efficient.

### **D. Preliminary Assessment of Sustainability**

30. The PCR rated the program likely sustainable. The government is aware of the sustainability challenges with the country's uncertain and finite revenue sources, limited opportunities to broaden revenue sources, and the need for effective management of expenditures. The NTF is now operational and has received timely commitment on funding from the government and development partners. The revenue base has been broadened and budget management strengthened through improved FMIS. Reforms at the NUC have been successful – with reduced subsidy from the government, and improved power and water supply.

31. This validation acknowledges the improvements in PFM, and the positive results from the NUC reforms. The major element of the program, the NTF, is in operation and unlikely to suffer from poor management just like its predecessor. The NTF's governance framework is a

<sup>18</sup> A fund where the principal will be secured over a long term by eventual annual distributions that are less than the annual estimated long-term investment return rate.

<sup>19</sup> The Pacific Association of Supreme Audit Institutions (PASAI) is the official association of supreme audit institutions in the Pacific region. PASAI promotes transparent, accountable, effective and efficient use of public sector resources in the Pacific by helping its members improve the quality of public sector auditing in the region to uniformly high standards. <https://www.pasai.org/about-pasai/>.

three-person committee, comprising representatives from the Nauru government, and the governments of Australia and Taipei, China. NTF's independent service providers (comprising an executive administrator, investment adviser, auditor, and review consultant) operate based on generally accepted principles and practices in managing the sovereign wealth funds. The NTF has an initial buildup phase of 20 years during which no withdrawals will be made, followed by a distribution phase to smooth revenue flows while seeking to preserve the real value of the fund in perpetuity. The NTF has net assets of A\$56.0 million, 9.8% fund performance in 2016–2017, and annual commitments from development partners of A\$2.5 million (footnote 14) from the Governments of Australia and Taipei, China. In addition, a business profit tax was implemented and is expected to generate about \$0.8 million in the next fiscal year.

32. However, there are threats to the sustainability of the program. Economic contraction is expected in 2018 due to the planned scaling down or closure of the RPC,<sup>20</sup> and the revenue from the employment and service tax for nonresidents is likely to decline to A\$5.0 million in 2018 from a high of A\$12.6 million in 2016, which may make it difficult for the government to continue contributing to the fund.

33. Nevertheless, this validation considers the program likely sustainable as there is considerable political support within Nauru for the goals and priorities of NSDS. Government has acknowledged that effective management of expenditures is critical and is committed to achieve the goals and priorities of the NSDS. The key bilateral donor, the Government of Australia,<sup>21</sup> remains committed to provide support to the government during its reform stage, and financial support to the NTF is building-up. The government is also seeking other bilateral donors to contribute to the NTF to help smooth out income streams in the medium term.<sup>22</sup>

### III. OTHER PERFORMANCE ASSESSMENTS

#### A. Preliminary Assessment of Development Impact

34. The PCR did not rate program impact. However, the PCR considered that the program, in seeking to improve the sustainable quality of life for all Nauruans, had made good progress with the development of a fiscally responsible government, the provision of enhanced social, infrastructure, and utility services, and development of an economy based on multiple sources of revenue (para 50).

35. This validation considers that the program will contribute to the improvement of the sustainable quality of life for Nauruans through improved PFM and NUC management, and establishment of the NTF, but does not support the view that a single-tranche program can make good progress with the development of a fiscally responsible government. In addition, the program will make little impact on the strategic agendas of inclusive growth, environmentally

<sup>20</sup> R. Rajah. 2017. Securing Sustainability: Nauru's New Intergenerational Trust Fund and Beyond. *Issues in Pacific Development*. No.1. Manila. ADB. The current operational RPC arrangement is underpinned by a 5-year agreement with the Government of Australia, which will expire in 2019. Although the agreement may be extended, this remains uncertain, and in any case, it is not expected to continue indefinitely.

<sup>21</sup> Government of Australia, Department of Foreign Affairs and Trade. 2017. Nauru Aid Program Performance Report 2016-17. <https://dfat.gov.au/about-us/publications/Documents/nauru-appr-2016-17.pdf>. During 2016–2017, Australia's total official development assistance to Nauru was \$22.4 million, and supported the objectives of a socially stable and economically resilient Nauru. The assistance aimed to achieve an effective and accountable public sector management, invest in nation-building infrastructure, improve the quality of education, and enhance the provision of health services.

<sup>22</sup> R. Rajah. 2017. Securing Sustainability: Nauru's New Intergenerational Trust Fund and Beyond. *Issues in Pacific Development*. No. 1. Manila. ADB.

sustainable growth, or regional cooperation or on the strategic drivers of change (private sector development, governance and capacity development, gender equity and mainstreaming knowledge solutions and partnerships). Thus, this validation assesses the development impact satisfactory.

## **B. Performance of the Borrower and Executing Agency**

36. The PCR rated the performance of the recipient and the executing agency satisfactory. The MOF carried out the required policy actions coordinated effectively with ADB to administer, implement, and monitor the program through regular performance monitoring and evaluation. Based on the information in the PCR, this validation assesses the performance of the borrower and executing agency satisfactory.

## **C. Performance of the Asian Development Bank and Cofinanciers**

37. The PCR assessed the performance of ADB satisfactory. ADB's engagement with the government on the reform agenda is ongoing and technical inputs are integrated in the government's reforms with other ADB and development partners' complementary assistance activities. This validation assesses the performance of ADB satisfactory for its major involvement through the TA support, for developing the program through concept and other analytical papers; and for designing and establishing the NTF to ensure that problems that beset the previous trust fund are avoided.

# **IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS**

## **A. Overall Assessment and Ratings**

38. The PCR rated the program successful as it focused on high priority reforms to address the acute fiscal sustainability challenges facing Nauru (Table 2). It was also based on sound technical analysis and technical support from other development partners. The program was implemented effectively and efficiently.

39. This validation considers the overall project successful. Program design and formulation were relevant as they satisfied the need for an improved PFM, more efficient service of the NUC, and an improved government funding mechanism to smooth out revenue streams in the medium-term. However, there was no apparent link between the outcome of improved fiscal sustainability and the impact objective of a stable and trustworthy government. There was also no tangible way to measure this, while one outcome target was not amended during program implementation, despite increased costs as the program progressed, making achievement unlikely.

40. The PCR rated the program effective as one of the two outcomes and all three output performance targets and indicators were met. The program was efficient since reforms were implemented efficiently and program resources were used to operationalize the FMIS, develop the NUC's strategic plans, and support the establishment of the NTF. The program is likely sustainable because (i) there is political support within Nauru to continue the development under NSDS, (ii) development partners are committed, and (iii) the NTF has a strong governance framework and a staged approach to the accumulation and distribution of funds.

**Table 2. Overall Ratings**

<b>Validation Criteria</b>	<b>PCR</b>	<b>IED Review</b>	<b>Reason for Disagreement and/or Comments</b>
Relevance	Highly relevant	Relevant	No apparent link between outcome of improved fiscal sustainability and the impact objective of a stable and trustworthy government. One outcome target was also not amended during program implementation despite its unlikely achievement.
Effectiveness	Effective	Effective	
Efficiency	Efficient	Efficient	
Sustainability	Likely sustainable	Likely sustainable	
<b>Overall Assessment</b>	<b>Successful</b>	<b>Successful</b>	
Preliminary assessment of impact	Not rated	Satisfactory	
Borrower and executing agency	Satisfactory	Satisfactory	
Performance of ADB	Satisfactory	Satisfactory	
Quality of PCR		Satisfactory	Para. 48-49.

ADB = Asian Development Bank, IED = Independent Evaluation Department, PCR = program completion report.  
Source: ADB Independent Evaluation Department.

## **B. Lessons**

41. The PCR identified four lessons and two key factors in the success of the program were reported. One was country ownership since the program was strongly aligned with Nauru's own strategic policy agenda. The other was development partner coordination, particularly with that of the Government of Australia. Simplifying the number of policy actions to help avoid the dilution of focus ensured that the reforms were of high quality and delivered within the appropriate time frames. The success of the NUC reforms are best measured over time as sustainability is only seen as working if assessed over a certain period. The reforms were designed with a strong focus on organizational behavior, while the introduction of tariffs was contentious amid public pushback due to increasing service costs.

42. This validation concurs generally with these lessons. However, if policy actions are to be simplified, the actions need to be the key ones that can be linked to the outputs and measured appropriately. For example, although better planning by the NUC is important to help reduce fiscal costs and improve the enabling environment for private sector development and government operations, it does not necessarily lead to an efficient service delivery to the public. Performance indicators that measured the reduction of fiscal costs and improved service delivery should have been developed.

43. This validation identifies the following additional lessons:

- (i) **Country-level lesson.** On fiscal transparency, there is greater recognition of the importance of independent financial and operational audit in providing up-to-date financial reports. Performance audit reports can help ensure the accountability and transparency of government operations so that there is confidence in the information provided by the government.

- (ii) **Results framework and methodology-level lesson.** In measuring performance, the results framework should allow for the success of the program to be judged over a longer term, with interim outcomes confirming that the long-term outcomes would be met. Performance indicators should be sufficiently relevant and measurable for the achievements to be judged against the purpose of the outputs and outcomes of the program.

### **C. Recommendations for Follow-Up**

44. The PCR provided four program-related recommendations. These included the (i) need for further monitoring of the program, (ii) requirement for the commercialization of SOEs, (iii) need for the government to establish a clear fiscal strategy and a medium-term fiscal framework, and (iv) need to address long-standing infrastructure deficiencies in the coming years.

45. The PCR also provided four general recommendations for future program grants. These included the need for (i) a succession planning to support the sustainability of reforms as the government's dependence on TA and SOEs is high, (ii) reforms to have strong and broad ownership and be based on robust TA support, (iii) close coordination with development partners, and (iv) required policy actions to focus on a limited set of critical reforms.

46. This validation agrees with the thrust of the recommendations. The commercialization of SOEs in a country the size of Nauru is unlikely to be feasible, however, and is not an NSDS priority.

## **V. OTHER CONSIDERATIONS AND FOLLOW-UP**

### **A. Monitoring and Reporting**

47. The ADB worked with the government in designing and implementing the program. The PCR showed that there were two program review missions—April and September 2016—although there were no records of what were discussed at the meetings.

### **B. Comments on Project Completion Report Quality**

48. The PCR was comprehensive in its coverage, well written, structured in accordance with the Project Administration Instruction 6.07a of ADB, and gave a convincing commentary on the performance of the project. It provided a good explanation of the need for the program, its linkages to the government's reform agenda and ADB's development agenda, its relationship to the ADB's 2012 Public Financial Reform Program, and the coordination done with other development partners.

49. This validation views the PCR quality satisfactory. However, it could have been improved by elaborating why one of the two outcome targets were unlikely to be met, and why the program's outcome was still rated effective. Also, the PCR recommendations were not particularly insightful but could have been improved with a clear statement of what were recommended, and which body was responsible.

### **C. Data Sources for Validation**

50. The data sources for this validation were the (i) RRP and its attached documents; (ii) PCR; (iii) NSDS 2005–2025, as updated in 2009; (iv) ADB *Asian Development Outlook 2017*;

(v) Nauru Country Operations Business Plan, 2015–2017; (vi) loan review mission reports, where available; (vii) Annual Report 2017 for the Intergenerational Trust Fund for the People of the Republic of Nauru; (viii) Australia’s Department of Foreign Affairs Aid Nauru Aid Program Performance, 2016–2017 report and overview; and (ix) Pacific Association of Supreme Audit Institutions’ December 2017 Bulletin.

**D. Recommendation for Independent Evaluation Department Follow-Up**

51. This validation recommends no further IED follow-up.