Kiribati’s economy is estimated to have contracted by 2 percent in 2020, while Nauru and Tuvalu avoided a recession with about 1 percent growth. Looking forward, Kiribati faces fiscal sustainability challenges from rising public spending, while Nauru and Tuvalu will need to adjust to projected sharp declines in public revenues. All three Central Pacific countries face long-run challenges to growth and poverty reduction from their narrow economic base and vulnerability to climate change.

Recent developments

Kiribati’s economy is expected to have contracted by about 2 percent in 2020, due mainly to the impact of border closures on donor-financed construction activity and fresh tuna exports, as well as lower public spending during a long election caretaker period. Kiribati’s Regional Processing Centre (RPC) for asylum-seekers, phosphate mining and fishing. However, phosphate resources have now been fully exploited, and the RPC is also expected to wind down by December 2021. Nauru now faces the challenge of adjusting to reduced fiscal revenues and finding new sources of economic growth over the medium term. In Tuvalu, fishing license fees are projected to decline as the El Niño cycle wanes. Strengthening public financial management is a priority, in particular reining in the elevated fiscal costs of overseas health care and improving procurement procedures to ensure more cost-effective capital spending. Though no recent data on poverty is available, in 2010 an estimated 26 percent of the population lived below the national poverty line.

Key conditions and challenges

The Central Pacific countries have been spared from severe impacts due to the pandemic. Strict border controls have kept the three countries COVID-free and largely avoided the need for lockdowns, while the small size of the tourism sector has meant that the economic impact has not been as severe as elsewhere in the region. However, the Central Pacific faces major long-run challenges due to extreme vulnerability to climate change, small size, remoteness, heavily reliance on external grants, near-total dependence on imports for foods and fuel, and limited sources of revenue. All three countries have invested in trust funds in order to stabilize volatile revenues and provide long-term development financing.

Kiribati experienced a fourfold increase in public revenues from the fishing sector in the past decade, and now receives fishing license revenues worth 66 percent of GDP on average per year. These new revenues present an unprecedented opportunity to address the country’s severe infrastructure deficit, promote climate resilience and reduce poverty. 21.9 percent of the population in Kiribati were poor in 2019/20 compared to national standards of living, and high shares of the population were deprived of non-monetary needs, such as access to clean water, sanitation, and electricity. Recurrent spending has grown rapidly to match the new fishing revenues, and with the available fiscal space now exhausted, Kiribati will need to increase the quality of spending in order to achieve further development gains and poverty reduction.

Nauru is also undergoing a significant economic transition. Economic growth and public revenues have been highly dependent on activity associated with Australia’s Regional Processing Centre (RPC) for asylum-seekers, phosphate mining and fishing. However, phosphate resources have now been fully exploited, and the RPC is also expected to wind down by December 2021. Nauru now faces the challenge of adjusting to reduced fiscal revenues and finding new sources of economic growth over the medium term. In Tuvalu, fishing license fees are projected to decline as the El Niño cycle wanes. Strengthening public financial management is a priority, in particular reining in the elevated fiscal costs of overseas health care and improving procurement procedures to ensure more cost-effective capital spending. Though no recent data on poverty is available, in 2010 an estimated 26 percent of the population lived below the national poverty line.
period. Revised estimates suggest a fiscal surplus of around 3 percent of GDP in 2020, with total spending falling by 3 percent compared with 2019. Strong donor support limited additional spending needs for the COVID-19 response, and the elections meant that the implementation of new budget initiatives was delayed until the final quarter. There was a major shift in expenditure composition during 2020, with lower capital spending being offset by a more than 20 percent increase in recurrent spending on social benefits. This included a new unemployment benefit (unrelated to the pandemic) and an expansion of the old age pension. The new benefits are expected to help reduce poverty given that more than three quarters of Kiribati’s adult population are eligible to receive support, but the broad coverage of the program dilutes the benefits to the Bottom 40. As of end-2020, the value of the sovereign wealth fund stood at 409 percent of GDP.

In Nauru, growth is projected to have reached 1.6 percent in FY21, due to stronger than expected activity related to the RPC and a major port redevelopment project. In FY21, the fiscal response to COVID-19 amounted to 5 percent of GDP, including funding for the vaccine rollout and subsidies to maintain vital air and sea freight links. However, with better-than-expected revenues from the RPC, Nauru was still able to achieve an estimated fiscal surplus of 11 percent of GDP in FY21. With this surplus and a drawdown on cash reserves, Nauru made a contribution worth 19 percent of GDP to its Intergenerational Trust Fund in FY21, bringing the fund balance to 109 percent of GDP.

In Tuvalu, the pandemic impacted travel and trade but the country avoided a recession. The economy grew an estimated 1 percent in 2020, down from the high rates of growth seen in recent years due to infrastructure project activity. The Government implemented a COVID response package equivalent to 30 percent of GDP to provide social protection, facilitate health care needs and support economic growth. Buoyant fishing license revenues, the country’s main source of revenue, rose to an estimated 56 percent of GDP in 2020, much higher than expected. These revenues, together with budget support grants from development partners, equivalent to 32 percent of GDP, funded the response package and generated a fiscal surplus of 5 percent of GDP in 2020. As of end March 2021, the market value of the Tuvalu Trust Fund (TTF), an international donor trust fund, was equivalent to around 235 percent of GDP.

**Outlook**

With only about 7 percent of the Kiribati population fully vaccinated as of early September, the full reopening of borders is not expected till mid-2022. However, a bounce back in growth of around 3 percent is expected in 2021 despite the ongoing border closure, thanks to consumer demand from the new social benefits and a public sector pay rise. Over the medium term, there are significant risks to macroeconomic stability stemming from the fiscal sector. The 2021 budget includes new recurrent spending of 8 percent of GDP, with an additional 5 percent of GDP in new spending projected from 2022 onwards. The fiscal deficit is expected to reach over 15 percent of GDP in 2021 and will be financed with a drawdown from the sovereign wealth fund. If the deficit remains elevated in the coming years, Kiribati will quickly erode its available cash reserves and the sustainability of the sovereign wealth fund could also be put at risk.

Nauru’s highly successful vaccination campaign, which has already seen the entire adult population fully vaccinated, is now facilitating the gradual return of international travel. Nonetheless, modest growth of only around 1 percent is expected over the medium term. The wind-down of the current RPC arrangements at the end of 2021 is expected to weigh heavily on the outlook and generate growing fiscal deficits. Staff project a balanced budget overall for FY22, but this is largely due to off-budget RPC income from previous years being recognized as revenues, cushioning the impact of the RPC wind-down. Growing outlays for state-owned enterprises pose a further downside risk to the fiscal outlook, including the risk of cost overruns for the state airline’s loan-financed aircraft replacement program (worth 19 percent of GDP).

In Tuvalu, the vaccine rollout is nearly complete, and the easing of travel restrictions is expected by late 2021 in collaboration with key countries, such as Fiji (the main hub for Tuvalu). Growth is therefore forecast to rebound to 2.5 percent in 2021 and to climb steadily to 4 percent by 2024. A fiscal deficit of around 7 percent of GDP is expected in 2021 driven primarily by one-off expenditures related to the planned launch of a national airline and additional COVID-related spending. Fishing license fees are expected to fall by 18 percent in 2021 but revenues are expected to be sustained by grants and .tv domain license fees. The fiscal deficit is projected to contract to 2.9 percent of GDP in 2022 as expenditures fall back to pre-COVID levels. Similar to the other Central Pacific countries, risks to the outlook are substantial and include the unpredictability of the pandemic; volatility in revenue flows, including budget support from development partners; and the ever-present threat of climate-related natural disasters.

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**TABLE 2 Central Pacific Islands / Macro poverty outlook indicators**

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<th>2018</th>
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Sources: Country authorities and World Bank and IMF staff estimates.
Notes: f = forecast.
Nauru values correspond to their fiscal year ending June 30; Kiribati and Tuvalu are calendar years.