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GRAY/21/2069

July 15, 2021

Statement by Mr. Dresse and Mr. Tevdovski on Tuvalu (Preliminary) Executive Board Meeting July 19, 2021

We thank staff for an informative report and Mr. Huh and Mr. Iona for the insightful Buff statement. We commend the authorities for the swift implementation of the containment measures that helped keep Tuvalu COVID-free. We agree with staff that the main challenges are centered around revenue volatility and meeting the long-term costs associated with climate change and structural transformation while maintaining a sound fiscal position. We broadly share staff's appraisal and offer the following comments for emphasis.

A gradual fiscal consolidation is necessary to secure fiscal sustainability and guard against future shocks, especially natural disasters, while financing climate adaptation and infrastructure maintenance needs. We welcome the authorities' commitment to establish a long-term fiscal anchor on a domestic current deficit to help secure fiscal buffers and offset a potential decline in fishing revenues or natural disaster costs. *Could staff elaborate on the adequacy of adoption of more complex fiscal rule that can consider total revenues and a business cycle?* Given the need to increase spending on climate adaptation and physical infrastructure, we emphasize the importance of strengthening the public procurement process. In this regard, staff rightly recommend Public Financial Management (PFM) reforms. Moreover, we welcome the authorities' efforts to mobilize international resources for building resilience to climate change. We concur with staff that improvement of local capacity to develop and ensure suitable financing for climate change projects is an urgent priority.

Structural transformation is key for achieving an inclusive and sustainable economy. Reforms to promote private sector development would help diversify the economy and reduce Tuvalu's dependence on fishing revenues and external aid. We encourage the authorities to implement staff's recommendations to improve the business climate and support the small-scale production of goods, subsistence agriculture development, develop the tourism sector through niche markets, as well as SOEs reforms. *Given the significant investment in a new domestic airline, could staff provide more details about the expected return on investment?* We highlight the need for strengthening human capital formation given Tuvalu's lower ranking in the World Bank Human Capital Index in comparison with the average of its Pacific Islands peers. The improvement of the quality of primary and secondary education on the island should be prioritized, in parallel with efforts to increase the enrollment rates. *Could staff provide more details about the impact of overseas education scholarships in transfer of knowledge, including the proportion of students that return to work in Tuvalu?*

We agree with staff that the development of effective prudential regulation and supervision would help promote the health of financial institutions and improve access to credit. Improving supervisory capacity of the Public Enterprise Reporting and Monitoring Unit, as well as the inclusion of the government-run Tuvalu National Provident Fund under the supervisory framework would be steps in the right direction. Upgrading the credit assessment capacity of banks, introducing risk-based loan pricing, a collateral framework, and a resolution regime for non-performing loans would help improve access to credit. Given the significance of cross-border payments for Tuvalu, we encourage the authorities to overcome AML/CFT weaknesses and to ensure robust correspondent banking relationships.

With these remarks, we wish the authorities success in their future endeavors.