

**EXECUTIVE
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MEETING**

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To: Members of the Executive Board

From: The Secretary

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Informational Annex**

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***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**



TUVALU

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 26, 2016

Prepared By

Staff Representatives for the 2016 Consultation with Tuvalu

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FUND RELATIONS

(As of July 31, 2016)

Membership Status

Joined June 24, 2010; Article XIV

General Resource Account

	SDR Million	% Quota
Quota	2.50	100.00
Fund holdings of currency (Exchange Rate)	1.89	75.72
Reserve Tranche Position	0.61	24.32

SDR Department

	SDR Million	% Allocation
Net cumulative allocation	1.69	100.00
Holdings	1.09	64.33

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to the Fund: None

Exchange Arrangements

Tuvalu's legal tender is the Australian dollar. There is no central monetary institution. The National Bank of Tuvalu is the only commercial bank in Tuvalu handling foreign exchange transactions. Tuvalu avails itself of transitional arrangements under Section 2 of Article XIV, but does not maintain exchange restrictions or multiple currency practices subject to Article XIV or Article VIII.

Article IV Consultation

The previous Article IV consultation discussions were held in Funafuti in May 2014. The staff report (IMF Country Report No. 14/253) was discussed by the Executive Board on August 25, 2014.

Technical Assistance

The Pacific Financial Technical Assistance Centre (PFTAC) has provided assistance on tax policy and administration (2007, 2008, 2010' 2016); financial sector supervision (2008); and balance of payments and national accounts statistics (2006, 2008, 2009, 2010, 2012, 2013, 2015 and 2016).

Resident Representative

The Regional Resident Representative Office for Pacific Islands is based in Suva, Fiji and was opened on September 13, 2010. The office covers Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Mr. Tubagus Feridhanusetyawan is the current resident representative.

WORLD BANK-IMF COLLABORATION

The Bank and the Fund teams maintain a close working relationship and have an ongoing dialogue on macroeconomic and structural issues. Since Tuvalu's decision to pursue membership of the Bretton Woods institutions in 2009, the Bank team has joined all IMF missions to Tuvalu since the country's membership mission, including the Article IV missions. The teams agreed that Tuvalu's main macroeconomic challenges are to ensure fiscal sustainability, strengthening public service delivery, and create a more supportive environment for development. Based on this shared assessment, the teams identified the following structural reform areas, all of which are also addressed in the authorities' reform plan, as macro-critical:

- **Strengthening fiscal buffers.** In the absence of its own currency and monetary policy, sound fiscal policy is key to maintaining macroeconomic stability. Maintenance of buffer assets is key to ensuring sustainability. Maintaining adequate buffer assets will require sound fiscal policy including saving of cyclical revenues and expenditure restraint, including containing wage bill pressures. Moreover, there remains room to improve public financial management as well as strengthen public sector management to improve budget execution and effectiveness in public resource utilization.
- **Adapting and responding to climate change.** Tuvalu is one of the countries to be most affected by climate change and rising sea levels. In this context, climate change can lead to both structural and cyclical fiscal costs. To this end, explicitly recognizing the adaptation and response cost in budget will help ensure the continuity and efficiency on both spending and funding fronts. However, donor financing will remain important in enhancing the country's ability to cope with natural disasters and climate change, given that the total costs may be too high for small states like Tuvalu to fully internalize by building buffers.
- **Exploring opportunities for poverty reduction, job creation, and private sector development.** Tuvalu's geographic isolation, small size, and poor land quality have made it challenging to generate domestic private sector employment. Adequate education and training need to be provided for Tuvaluans to better utilize overseas job opportunities and to reduce rising poverty. Strengthening oversight on the financial sector will also facilitate improved access to finance and private sector activities.
- **Strengthening public service delivery.** The Government of Tuvalu in the Te Kakeega III and the medium term reform agenda identified improving service delivery in the health and education sectors as key objectives. Based on earlier analysis and sector strategic plans, the Government is continuing reforms to improve allocative and technical efficiency as well as to ensure sector financing sustainability.

The teams expect to sustain the close cooperation going forward. Attachment 1 details the specific activities implemented and planned by the two teams over the period 2016 to 2018.

Tuvalu: Bank and Fund Implemented/Planned Activities in Macro-Critical Areas [2016-2018]		
	Products	Expected/Actual Delivery
World Bank Work Program	<ul style="list-style-type: none"> • Joint participation in Article IV Mission • Country Policy Institutional Assessment • Tuvalu Aviation Investment Program • Third Budget Support Operation • Pacific Regional Oceanscape Project • Energy Project • Telecom Project 	<p>Annual/Biennial</p> <p>Annual</p> <p>Implementing</p> <p>FY2017</p> <p>Implementing</p> <p>Implementing</p> <p>FY2017 – FY18</p>
IMF Work Program	<ul style="list-style-type: none"> • PFTAC: National Accounts Mission • PFTAC: Review Tax Reform • PFTAC: Onsite Examination of Financial Sector • PFTAC: National Accounts Mission 	<p>January 2016</p> <p>June 2016</p> <p>Planned for October 2016</p> <p>Planned for January 2017</p>

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

Partnerships

ADB has been working with Tuvalu since 1993 and has approved 3 loans totaling \$7.8 million, 4 program grants totaling \$9.59 million, and over 22 technical assistance projects totaling \$7.72 million, largely supporting public sector management, education, and maritime transport sectors. Cumulative disbursements to Tuvalu for lending and grants, financed by ordinary capital resources, the Asian Development Fund, and other special funds amount to \$15.5 million.

ADB's approach and operations in Tuvalu are aligned to Tuvalu's eighth national development plan, the National Strategy for Sustainable Development (Te Kakeega III), 2016–2020. ADB's operational focus over the medium term supports the Te Kakeega III's cross-cutting objectives of Infrastructure and Support Services; the Economy, Growth and Stability; Environment, and Climate Change. These strategic priorities are in line with ADB's corporate strategy 2020.

ADB, together with development partners, remain committed to supporting government's roadmap for improving the management of public resources, exercising prudent public expenditure and fiscal management, strengthening corporate governance, and delivering better public services to the people of Tuvalu.

ADB participates as a team member of the International Monetary Fund Article IV Mission to Tuvalu, and liaises closely with the Pacific Financial Technical Assistance Centre—particularly on macroeconomic management and fiscal conditions.

ADB observes the biannual meetings of the Tuvalu Trust Fund Board and cooperates with civil society organizations in Tuvalu to strengthen the effectiveness, quality, and sustainability of its services.

ADB is also committed to undertaking joint missions with development partners to improve coordination and lessen demands on country capacity.

ADB Supported Projects and Programs

The government embarked on a comprehensive reform program from 2012 to 2015 implemented through technical assistance and a coordinated program of flexible budget support grants provided by ADB, the governments of Australia and New Zealand, and the World Bank. Collaborative efforts towards improved governance, social development, education and human resources, and macroeconomic growth and stability helped mitigate the social and economic impact of the global financial crisis and strengthened Tuvalu's fiscal sustainability against future shocks.

ADB provided grants in 2008, 2012, and 2015, totaling \$7.6 million, towards sound macroeconomic and fiscal management and improved public enterprise performances. The latest grant of \$2.0 million, approved in September 2015, completed the final set of reforms begun with ADB support in

2012. Public procurement reforms supported by ADB have resulted in competition among suppliers, cost-savings, transparent procurement proceedings, and improved public confidence in the use of public finances. Reforms to contract out selected construction works currently undertaken by the Public Works Department and privatize the government-owned hotel will help reduce the drain from ad hoc government subsidies on the national budget, attract greater private sector participation, and generate employment. Improvements to the management and maintenance of government's fiscal buffer fund will help ensure long-term macroeconomic stability and economic self-sufficiency.

ADB approved preparatory work in July 2015 for the proposed Outer Island Maritime Infrastructure Project, which will rehabilitate and improve maritime infrastructure in selected outer islands of Tuvalu; and improve safety, efficiency, and sustainability of maritime transportation between Funafuti and the eight outer islands. This investment project, likely to cost around \$25 million, is expected to be approved in late 2016.

ADB technical assistance has supported public financial management, governance, education, and capacity development in Tuvalu. Tuvalu also benefitted from regional technical assistance in economic management, audit capacity, aviation safety, private sector development, infrastructure planning, climate change, and safeguards.

Future Directions

The introduction of a base annual allocation of \$3.0 million for small developing member countries from January 2015, which will double to \$6.0 million in 2017, has boosted ADB's scope for investment opportunities in Tuvalu.

In mid-March 2015, tropical cyclone Pam caused significant damage to agriculture and infrastructure, estimated at over \$15.0 million. The government is seeking contributions from development partners for prioritized interventions in the Tuvalu Recovery and Vulnerability Reduction Plan, which requires over \$70.0 million to implement. Towards this objective, ADB will seek approval for the proposed Outer Island Maritime Infrastructure Project in 2016.

Over the medium term, ADB's focus on the transport sector and strengthening public sector management will help improve the efficiency and safety of outer island transportation through upgraded port facilities and help sustain good fiscal management. Regional approaches to information and communication technology, disaster risk management, and climate change will be explored.

PFTAC COUNTRY STRATEGY 2012-2016

Background

Tuvalu's strong fishing and .tv revenues during the past 3 years have allowed it to overcome some of the difficulties created by the earlier global financial crisis. The short-term outlook appears stable on the back of continued favorable fishing and .tv revenues as well as large donor-financed investments, but vulnerabilities in the state owned enterprises and financial sector continue to pose challenges to macro stability.

PFTAC Technical Assistance (TA) has been moderate and concentrated in the revenue and statistics sectors. Recent PFTAC TA has been focused on assisting the authorities achieve the gains planned from revenue reforms through on-the-job assistance in revenue administration following the completion of an ADB project that supported the PFTAC-designed reforms. There has also been significant assistance in developing national accounts and balance of payments statistics, in part to allow Tuvalu to meet the requirements of IMF membership. PFTAC provided TA in 2012 to develop a PFM Reform Roadmap.

Strategy 2012-2016

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the results framework for the current PFTAC funding cycle.

PFTAC TA aims to support the authorities sustain progress on improving fiscal sustainability. PFTAC will continue to work closely with the broader development partner group to ensure coherence and will aim to support implementation of actions in the authorities' shared policy matrix.

In the **Public Financial Management** area, PFTAC provided support in 2012 to develop a PFM roadmap to prioritize the strengthening of PFM weaknesses identified in the 2011 PEFA (1.2). Support to implementation of specific elements will also be available, in coordination with other development partners and in particular the Australian Agency for International Development or AusAID -supported budget and treasury advisors. In 2014 PFTAC provided TA to rewrite Tuvalu's Financial Instructions, and worked with Ministry of Finance officials in 2015 to conduct a PEFA Self-Assessment and revise their 2011 Roadmap. The Self-Assessment identified many improvements since the 2011 PEFA. Officials from Tuvalu have regularly attended PFTAC's PFM workshops including the most recently delivered (with PFTAC's Macro-Fiscal Advisor) on medium-term expenditure forecasting. In the PFM area PFTAC anticipates continuing collaboration with the Australia-Department of Foreign Affairs and Trade funded Budget Advisor to assist Tuvalu staff in their development of medium-term budget planning and forecasting, including planning for asset repair/replacement financing.

In the **revenue** area, The Pacific Technical Assistance Mechanism (PACTAM)¹ has supported Tuvalu's Inland Revenue Department with a three year placement of a revenue advisor thus reducing reliance on PFTAC TA. The main objectives of PACTAM's TA package included: (a) providing on-the-job training in tax audit; (b) strengthening debt and returns management; and (c) mentoring and advising the Director of Inland Revenue by providing technical tax advice. Indications are that good progress has been made to the extent that PACTAM recently scaled down its TA package from a full time advisor to quarterly short term expert visits. To obtain an objective and independent view of how far the organization has progressed its modernization journey the authorities have requested a PFTAC review to provide an assessment of current revenue administration performance and to help identify future reform priorities.

In **statistics**, PFTAC resumed the provision of regular assistance on national accounts compilation (4.1), taking over from the SPC which has been doing this since 2010. PFTAC carried out national accounts TA missions in February 2015 and January 2016 to help incorporate major administrative and survey data sources, improve methods and build capacity. However, the latter has been hampered by staff absence and with the sole compiler now embarking on long-term study leave, the productive outlook is uncertain. PFTAC originally provided support on balance of payments compilation) but this was then covered by the Japan Administered Account for Selected IMF Activities or JSA Project on the Improvement of External Sector Statistics in the Asia and Pacific Region, which formally concluded in October 2015. Further discussion is required to scope out how such support might be provided from now on.

In financial sector supervision, PFTAC provided strategic support to the authorities by reviewing the Banking Commissions Act and making some recommendations as to changes to the oversight authority, which were accepted and in 2015 the Act was amended. The Banking Commission and Banking Commissioner's position remain, however if no one is appointed the Minister of Finance will be the Commissioner or someone appointed by him. The Minister exercised his prerogative and appointed the Permanent Secretary who will also hold the Banking Commissioner's position. PFTAC staged two TA missions to Tuvalu in 2015 to review and assess the banking sector.

Given the lack of in country capacity, establishing a basic on and off site supervision office will be problematic and will require TA resources. PFTAC did draft a basic set of prudential reporting and held a few workshops with the Ministry of Finance and local bank on how to implement this approach. A follow-up TA to the Ministry of Finance aimed at performing an on-site review of the Bank of Tuvalu and requiring, on a regular basis, the reporting of financial data would be the next step.

No direct **macroeconomic** support is currently envisaged, with the TTFAC and ADB's Public Expenditure Management TA currently taking the lead in these areas.

¹ The Pacific Technical Assistance Mechanism (PACTAM), an Australian Government initiative, places highly skilled employees in the Pacific to assist local employers to meet their human resource needs and contribute to developing capacity in the workplace.

STATISTICAL ISSUES

(As of August 1, 2016)

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provided to the Fund have serious shortcomings that significantly hamper surveillance. Shortcomings are most serious in the national accounts and monetary statistics. The Pacific Financial Technical Assistance Centre (PFTAC) and the Statistics Department (STA) have provided technical assistance (TA) to the Central Statistics Division (CSD) of the Ministry of Finance to help compiling statistics for surveillance and the authorities' own policy analysis and formulation. The CSD will need to train additional staff to improve data provisioning.</p>
<p>National accounts: With PFTAC assistance, the compilation methodology for the national accounts is gradually improving. Attention needs to be paid to improving source data for national accounts.</p>
<p>Price statistics: The consumer price index (CPI) is the only price index compiled in Tuvalu. The CSD produces a quarterly CPI, which is timely and of reasonable quality. The CPI expenditure weights were revised in 2011, based on the 2010 Household Income and Expenditure Survey. Ideally, weights should be not more than five years old so as to ensure that the index remains representative of current expenditure patterns.</p>
<p>Government finance statistics (GFS): Tuvalu neither compiles nor publishes GFS data. However, MOF issue monthly fiscal statements (of central government data) for budget analysis and control, and apply IPSAS (cash) and IFRS (accrual) accounting standards for all public sector entities. However, the classifications of some accounts, particularly on capital spending, need to be improved to be in line with international standards. Previous TA compiled draft GFS and Classification of the Functions of Government (COFOG) tables for budgetary central government. Follow on steps were automation within the financial accounting system; and collection of source data to fill existing data gaps in debt and aid data. Staff resource levels remain an impediment to efficient and effective GFS data compilation.</p>
<p>Monetary and financial statistics: Tuvalu uses the Australian dollar as its legal tender and does not have a central bank. Monetary and financial statistics are currently not produced in Tuvalu. The National Bank of Tuvalu and the Development Bank of Tuvalu provided the Article IV mission with their balance sheets, which were used to produce the monetary data on the two banks.</p> <p>Financial sector surveillance: Financial Soundness Indicators (FSIs): Tuvalu does not compile FSIs.</p>

Balance of payments and International Investment Position (IIP): Tuvalu's External Sector Statistics (ESS) has been considerably improved with the IMF TA under the recently ended JSA Project on the Improvement of ESS in the Asia and Pacific Region. Balance of payments and international investment position data are compiled annually following the *BPM6*. However, compilation of the ESS data are not regular due to heavy dependency on the lone CSD compiler and need to be streamlined. With regard to quality of the data, shortcomings still remain in the coverage of nonfinancial private sector, FDI, exports, and debt-related transactions and positions.

II. Data Standards and Quality

Tuvalu began participating in the General Data Dissemination System (GDDS) in 2013 and joined the enhanced GDDS (e-GDDS) as of May 2015.

No data ROSC are available.

III. Reporting to STA

Annual balance of payments and IIP statements, both in *BPM6* format, were submitted to STA in May 2014 for the first time.

Tuvalu: Table of Common Indicators Required for Surveillance (As of August 1, 2016)					
	Date of Latest Observation	Date Received	Frequency of Data ⁸	Frequency of Reporting ⁸	Frequency of Publication ⁸
Exchange rates ¹	04/2016	05/2016	D	NA	NA
International reserve assets and reserve liabilities of the monetary authorities ²	12/2015	04/2016	M	I	NA
Reserve/base money ³	NA	NA	NA	NA	NA
Broad money ³	NA	NA	NA	NA	NA
Central bank balance sheet ³	NA	NA	NA	NA	NA
Consolidated balance sheet of the banking system	12/2015	05/2016	M	I	NA
Interest rates	12/2015	05/2016	M	I	NA
Consumer price index	03/2016	05/2016	Q	Q	NA
Revenue, expenditure, balance and composition of financing ⁴ —general government ⁵	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing ⁴ —central government	12/2015	04/2016	M	M	M
Stocks of central government and central government-guaranteed debt ⁶	12/2015	04/2016	A	A	NA
External current account balance	12/2013	05/2016	A	A	A
Exports and imports of goods and services	12/2013	05/2016	A	A	A
GDP/GNP	12/2012	05/2016	A	A	NA
Gross external debt	12/2015	05/2016	A	A	NA
International investment position ⁷	12/2013	05/2016	A	A	A
<p>¹Tuvalu uses the Australian dollar as its legal tender.</p> <p>² Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.</p> <p>³Tuvalu does not have a monetary authority. Foreign assets of National Bank of Tuvalu and the Consolidated Investment Fund constitute the official reserves of Tuvalu.</p> <p>⁴ Foreign, domestic bank, and domestic nonbank financing.</p> <p>⁵The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. Data on local government operations (kaupules) are not compiled but constitute a very small portion of general government operations. For analytical purposes, central government data are a close proxy to general government operations.</p> <p>⁶Including currency and maturity composition.</p> <p>⁷ Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p>⁸Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).</p>					