April 8, 2020
Approval: 4/15/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/57-3

12:05 p.m., June 22, 2018

3. Tuvalu—2018 Article IV Consultation

Documents: SM/18/151 and Supplement 1, and Supplement 2

Staff: Shin, SPR; Fletcher, SPR

Length: 30 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	D. Mahlinza (AE)
	M. Raghani (AF)
	E. Rojas Ulo (AG), Temporary
	G. Johnston (AP)
	P. Fachada (BR)
	K. Lok (CC), Temporary
	J. Rojas (CE)
	M. Sylvester (CO), Temporary
	O. Bayar (EC)
	A. Sode (FF), Temporary
	K. Merk (GR)
	M. Siriwardana (IN)
	T. Persico (IT), Temporary
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	M. Choueiri (MI), Temporary
	Z. Kalezic (NE), Temporary
	T. Gade (NO), Temporary
	P. Snisorenko (RU), Temporary
	B. Alhomaly (SA), Temporary
	E. Villa (ST)
	P. Inderbinen (SZ)
	J. Stockill (UK), Temporary
	S. Vitvitsky (US), Temporary

C. McDonald, Acting Secretary
H. Malothra, Summing Up Officer
J. Acheson, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
World Bank Group: D. Kaya. Asia and Pacific Department: O. Brekk, J. Daniel, C. Nguyen, A. Stuart. European Central Bank: T. Persico. Information Technology Department: F. Gheriss. Knowledge Management Unit: S. Davidovic. Strategy, Policy, and Review Department: J. Shin. Senior Advisors to Executive Directors: W. Abdelati (MI), G. Preston (AP), M. Sidi Bouna (AF), A. Tivane (AE). Advisors to Executive Directors: H. Alias (ST),

E. Amor (AP), S. David (AP), G. Khurelbaatar (AP), M. Kikiolo (AP), H. Mori (JA), A. Olhaye (AF), A. Park (AP), L. Rauqeuqe (ST), A. Souza (BR).

3. TUVALU—2018 ARTICLE IV CONSULTATION

Mr. Johnston and Mr. Kikiolo submitted the following statement:

Our Tuvaluan authorities wish to express their appreciation to the IMF team for the candid and constructive discussions they had during the Article IV mission and for the policy advice they offered. Tuvalu has the smallest economy of any member country and a population of only 11,000. Its atolls have a total area of 26 square kilometers and there is limited arable land available for agricultural purposes. The average height of the islands is only 2 meters above sea level. The remoteness of the country, its limited business opportunities and narrow production base, and its vulnerability to natural disasters give rise to development challenges. Economic activities are necessarily dominated by the public sector, including state owned enterprises, and tourism is small and underdeveloped. Despite these challenges, the authorities are committed to pushing forward a strong development agenda, and enhancing economic resilience with continued assistance from the international community.

The authorities agree with the outlook and risks presented in the staff report. The Tuvaluan economy is expected to pick up in the near term on the back of large capital projects undertaken by the government with assistance from development partners. Inflation is expected to moderate from higher levels in 2017 to 4 percent in 2018, due mainly to falling international food prices. Most of the risks, however, are on the downside. Tuvalu regularly experiences natural disasters and is dependent on foreign aid. Tuvaluan households also consume many imported items and the country is susceptible to international food and oil price shocks. Fishing revenues—which make up around half the revenue in the budget—are volatile, giving rise to uncertainties in fiscal planning.

The authorities remain committed to sound fiscal management, alongside necessary investments in development and social programs. There is no central bank in Tuvalu and macroeconomic management depends on fiscal policy. Tuvalu has maintained fiscal surpluses over recent years, except in 2017 when there were large one-off capital expenditures associated with the construction of facilities to host Pacific leaders' meetings. Expanding the revenue base is an ongoing priority. The Ministry of Finance and Economic Planning has started to strengthen its coordination with the Ministry of Natural Resource to improve interagency information on fisheries revenue for budget planning purposes. Given the country's narrow revenue base, the authorities are grateful to development partners for providing general budget support as well as funding for specific projects.

The authorities have aligned their expenditure priorities with Te Kakeega III—the National Strategy for Sustainable Development 2016-2020—which is itself aligned with the UN Sustainable Development Agenda. The key priority areas in this strategy are health and education, infrastructure, transport and communication, climate change and support to islands development. The most recent budget aimed to provide greater education opportunities for Tuvaluans by increasing funding for government scholarships, early childhood education and an e-learning system for students across Tuvalu. It also provided for ten new doctors at Princess Margaret Hospital. The Tuvalu overseas medical treatment scheme, though costly, is an important service for the elderly population. However, the authorities are determined to reduce the cost of this scheme and have strengthened the screening process and explored cheaper alternative overseas arrangements. Despite expenditure commitments, the authorities are determined to build fiscal buffers, including through the country's trust funds. The authorities are aiming to increase the Tuvalu Trust Fund to A$200 million from the current level of A$175 million through allocations from the annual budget and unexpected windfall fisheries income.

Given the island nation's vulnerability, climate change adaptation and resilience measures are a key priority. The World Bank has estimated that building resilience against climate change will require Tuvalu to invest annually around 2 percent of GDP. In 2015, the government established the Tuvalu Survival Fund to respond to climate change impacts and disasters, and have made contributions to this Fund from the annual budget. The authorities also welcome the US$36 million assistance from the Green Climate Fund to finance the Tuvalu Coastal Adaptation Project over a period of seven years. To raise community awareness about climate change effects, the authorities are mainstreaming climate change as a subject in the school curriculum.

The authorities agree with staff on the need to strengthen the banking sector's supervisory framework and credit intermediation. The authorities, with the support of Pacific Financial Technical Assistance Centre (PFTAC), will develop a supervisory capacity within the Ministry of Finance and Economic Planning with the direct support of an externally-contracted supervision expert. PFTAC will also support the supervision project by providing training and institutional capacity development on supervision framework tools and processes. The Development Bank of Tuvalu is currently working on lending and policy manuals to guide its business operations, and is administering a government-backed small business guarantee scheme.

Ongoing reforms are aimed at improving public sector efficiency. The authorities have achieved some of the planned activities in the Public Financial Management Reform Roadmap Matrix 2017-2021 and will continue to attend to outstanding tasks. They will also continue to strengthen macroeconomic statistics. However, limited capacity and turnover of personnel is a major constraining factor. The authorities are pleased with the help they have received from development partners and would welcome more technical assistance to help with structural and legislative reforms and with macroeconomic data provision.

Mr. Inderbinen and Mr. Imashov submitted the following statement:

We are grateful to staff for the good documentation, and agree with their appraisal. We also thank Mr. Johnston and Mr. Kikiolo for their buff statement that adds helpful information from the authorities' perspective. Growth rates have been solid over the past years, and important efforts have been made to strengthen the fiscal position and improve disaster preparedness. Nonetheless, the Tuvaluan economy remains very vulnerable to external shocks, particularly from natural disasters, and is highly dependent on volatile fishing revenue and donor grants. Debt is at a high risk of distress, and measures are needed to rein in public expenditure and repair the financial sector.

Measures will be needed to contain public expenditure. We appreciate the alignment of spending with the priorities under the authorities' Te Kakeega III plan. We also note the efforts to increase education opportunities and to improve domestic health care. This said, there would clearly be merit in reviewing the efficiency of public spending. Containment of the wage bill would also be beneficial. It is encouraging that the authorities broadly concur the staff's appraisal of fiscal policy. Do the authorities also see value in targeting the current domestic balance to effect consolidation, as suggested by staff?

Continued efforts to strengthen public financial management will be essential. We take good note of the work in train under the authorities' PFM Roadmap. We also encourage further to multilateral schemes to fund the TCAP and infrastructure investment. As staff point out, continuous access to multilateral financing will require frameworks that ensure that those funds are used efficiently. Strengthening PFM, and building the requisite administrative capacity, should thus remain a priority.

Measures to strengthen the financial sector are encouraged. We note staff's concerns with the high level of NPLs in the banking sector, notably in the Development Bank. Even after substantial write-offs, lending is anemic, and performance of the sector is weak in regional comparison. We take good note of the authorities' efforts to build supervisory capacity, and the assistance provided by PFTAC. Looking ahead, measures to strengthen the regulatory framework and bankruptcy laws would seem critical. We understand that some legislative work has been done to this end. Could staff elaborate on the reasons why the 2011 Banking Commission Act has not been implemented?

Ms. Horsman and Mr. Sylvester submitted the following statement:

We thank staff for their useful report and Messrs. Johnston and Kikiolo for their informative and insightful buff statement.

Tuvalu has made important progress in maintaining macroeconomic stability and building resilience, but continues to face significant development challenges. Real GDP is estimated to have accelerated in 2017 and, despite downside risks, the medium-term outlook appears favorable. Furthermore, fiscal and other buffers have remained relatively satisfactory. Also, critical progress has been made in building resilience over the years. Notwithstanding the foregoing, significant challenges continue to stand in the way of Tuvalu's progress. We commend the authorities for their handling of this fragile micro state, and their commitment to continue to implement sound policies consistent with staff's advice. As we broadly concur with staff's appraisal and recommendations, we would like to add the following comments for emphasis.

A strengthened fiscal position and framework is key to maintaining buffers. Tuvalu's high vulnerability to climate change and natural disasters, strong dependence on foreign aid, high volatility of revenue flows, and other risks highlight the need for continued effort and vigilance. As staff assessment shows, a significant shock, or a combination of shocks, to the baseline can seriously worsen Tuvalu's debt dynamics and erode existing buffers. In this context, we support staff's recommendation for continued fiscal consolidation, including through strengthening domestic revenue mobilization and increasing the efficiency of spending. Reducing fiscal risks emanating from SOEs is a critical component in this regard. Likewise, we support staff's call for continued efforts to enhance Tuvalu's policy framework to mitigate climate change effects.

There is scope for broadening private sector's contribution in Tuvalu's resilience building strategy. Over the years, Tuvalu's growth has been largely driven by the public sector. Reforms to encourage private sector participation can help diversify the country's narrow economic base and boost potential output. We concur with staff that key policies for boosting potential growth and diversifying the growth base include improving the business climate, developing human capital, promoting tourism, and improving financial intermediation and supervision. We take positive note that the authorities have prioritized these reforms and are looking forward to the Fund's continued support to complement their efforts.

We wish to further highlight the authorities' commitment to financial sector reforms. As staff rightly pointed out, efforts to improve supervision and financial intermediation remain critical. We take note that Tuvalu has not suffered any significant loss of correspondent banking relationships (CBRs). Their efforts in this regard must be commended, but we urge them to remain steadfast in strengthening their financial system, including through reducing non-performing loans (NPLs), and strengthening their AML/CFT framework.

Finally, we share staff's concerns about data shortcomings, and encourage the authorities to take decisive steps in this area to support policymaking and surveillance.

Mr. Merk and Mr. Rosenberger submitted the following statement:

We thank staff for their informative set of reports and Mr. Johnston and Mr. Kikiolo for their insightful buff statement. We broadly agree with the thrust of the staff's appraisal.

The Tuvaluan economy is expected to pick up in the near term, however remains vulnerable to external shocks including from natural disasters and high dependence on volatile fishing revenue. We agree with staff, that building climate change resilience through infrastructure investment while simultaneously strengthening resilience against external shocks through strong fiscal balances is essential for sustainable growth in the long run.

Tuvalu remains at a high risk of debt distress, due to elevated current spending, a projected decline in fishing revenue and grants, and risks to natural disasters. Under the baseline scenario, the fiscal balance is projected to move into a deficit in the medium term. We encourage the authorities to increase their efforts to adopt a course of fiscal consolidation, and maintaining fiscal buffers, by containing current spending, prioritizing investments and eliminating tax exemptions. Strengthening the medium-term fiscal strategy would help ensuring fiscal sustainability.

Tuvalu is one of the countries most exposed to the effects of climate change and rising sea levels. We welcome the authorities progress in strengthening the climate change resilience, which needs to be achieved in a fiscally sustainable manner. In this context, it stays key to ensure continuous access to multilateral climate change schemes, while making sure those funds are used efficiently.

We encourage the authorities to further strengthen the banking sector supervisory framework by developing supervisory capacity with the support of the Pacific Financial Technical Assistance Center (PFTAC).

On the structural reform agenda, authorities should increase efforts to broaden the private sector growth base, by improving the business environment and fostering private-sector development. Diversifying the economy would help to absorb macroeconomic volatility.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for their well-written reports and Mr. Johnston and Mr. Kikiolo for their informative buff statement.

The macroeconomic performance in Tuvalu has improved in the recent past. Growth remains robust. Fiscal buffers are strong and reserves are relatively high. Although inflation has accelerated recently, the outlook is broadly positive. We commend the authorities for their efforts in improving the macroeconomic framework and implementing structural reforms for continued progress. However, going forward, important challenges remain in addressing climate change and natural disaster related risks and maintaining fiscal sustainability, requiring further efforts. We agree with the thrust of the staff appraisal and policy recommendations, and wish to provide following remarks for emphasis.

Being very small and most vulnerable to climate change and natural disasters, building resilience and adaptation is a key policy priority. Hence, the maintenance of critical expenditures for mitigating the effects of climate change in a fiscally sustainable manner is essential. The establishment of the Tuvalu Survival Fund is an important step to respond to climate change impacts. The completion of the assessment phase of coastal adaptation projects under the Green Climate Fund will also strengthen these efforts. This should be supported by international donor community and IFIs. We commend the authorities for mainstreaming climate change as a subject in the school curriculum to raise the awareness.

The improvement in fiscal buffers was mainly due to higher revenue from fishing licenses and donor grants. The DSA reveals that Tuvalu remains at high risk of debt distress due to elevated current spending, any decline in fishing revenue and grants, and risks of natural disasters. Hence, any absence of reforms and the resultant persistent fiscal deficits could deplete fiscal buffers with the gradual normalization of fishing licence revenues. Given the narrow and volatile nature of revenue sources, staff comments are welcome on potential for broadening the revenue base. The reduction of recurrent expenditure, particularly through restraining wages, is important to contain fiscal pressures and loss of competitiveness. We welcome the authorities' focus on education, health, and knowledge and skills development of the people to improve human resources. Given the specific characteristics of the country, the government may continuously have to play an important role in the economy through SOEs. Hence, acceleration of SOE reforms focusing on governance and competitiveness, is essential to reduce government transfers to SOEs.

We note the need for further improving the financial sector. Introduction of a financial supervisory framework, reduction of NPLs and enhancement of access to financial services are among the key areas of improvement. In the absence of ATMs, we concur with staff about the role of mobile banking and other innovative financial solutions to enhance financial inclusion. The staff's comments on further improving financial inclusion and literacy are welcome.

Finally, we note that avenues for economic diversification by moving considerably away from fishing and agriculture are limited. The opportunity to enhance private sector involvement also remains low given the small size, remoteness of the country and its narrow production base. We see that the development of tourism would be an important alternative. However, structural constrains could be a barrier for its significant expansion. Given the high unemployment rate and limitations in expanding tourism industry, staff comments are welcome on other avenues for employment generating economic activities in Tuvalu.

With these remarks, we wish all the very best to Tuvaluan authorities in their future endeavors.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for their detailed reports and Mr. Johnston and Mr. Kikiolo for their informative statement. We are encouraged to see that Tuvalu maintains relatively stable macroeconomic condition and the outlook is broadly positive. However, the economy is susceptible to risks from such as climate change and natural disasters, volatile fishing revenues, reliance on external grants, weak state-owned enterprises, and limited financial supervision. We agree with staff that building climate change resilience through infrastructure investment while simultaneously strengthening resilience against external shocks through strong fiscal balances is essential for sustainable growth in the long run. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Climate Change Mitigation

We welcome the progress in strengthening climate change resilience including the access to the Green Climate Fund, adoption of Public Financial Management (PFM) Roadmap 2017-21, and establishment of the Tuvalu Survival Fund and the National Advisory Council on Climate Change for coordination. Given the risks stemming from climate change and natural disaster and the projected widening of fiscal deficit over the medium term, we agree with staff that it should be implemented in a fiscally sustainable manner with improving efficiency of expenditure.

Fiscal Policy

Gradual fiscal consolidation is needed to maintain the government's net financial worth to buffer most shocks. Given the high dependency on volatile fishing revenue and donor grants, strengthening fiscal framework is crucial. While fiscal balance in 2018 is projected to be a surplus of 6 percent of GDP, fiscal deficit is projected to widen in the medium and long term due to moderating fishing revenue and elevating current spending. In this light, fiscal adjustment measures including containing current spending, prioritizing capital spending, and mobilizing tax revenues are indispensable.

At the same time, strengthening fishing revenue forecasts with close coordination between ministries is critical as the revenue is a main resource of revenue. In this regard, could staff elaborate more on how to strengthen forecasts through enhanced coordination, and whether any TAs either from the Fund or other institutions are planned for this issue? We agree with staff that weak balance sheet of SOEs and heavy reliance on fiscal support is a source of concern and strengthening the SOEs' financial performance is critical to contain the risk of contingent spillovers to the budget. It is encouraging that the authorities are committed to strengthening the monitoring of SOEs. We urge the authorities to improve the transparency of fiscal support and electricity tariff schemes as well.

Financial Sector

Strengthening financial supervision framework is essential to reduce NPLs and improve financial sector efficiency, and thereby increase bank credit to private sector. To address the high NPLs, the authorities need to develop bankruptcy legislation and improve enforcement of existing regulations, and all financial institutions including pension fund providing loans should be subject to supervision.

Structural Reforms

Broadening the private-sector growth base through strengthening human capital and improving business environment is crucial for sustainable growth. We note that unemployment rate is substantial at 37 percent and public-sector is dominant in economic activities. Against this background, we encourage the authorities to consider measures such as partial privatization of non-essential government functions and creation of a national tourism strategy, together with improvement of infrastructure and water management.

Mr. Rojas Ramirez submitted the following statement:

Tuvalu's economy is highly vulnerable to natural disasters. Authorities have adopted sound economic policies oriented at promoting stability, fiscal consolidation, a sound external position, sustained inclusive growth and buffers to mitigate climate change effects. We welcome the 2018 Article IV consultation report and thank staff and Messrs. Johnston and Kikiolo for their buff statement.

Tuvalu’s fiscal policy aims at restoring fiscal balance and fiscal consolidation in the short term and strengthening the public financial management framework by implementing the Roadmap 2017–21 reforms program, in the medium term. This will lead to a reinforced budget administration and give access to international sources of financing. Another important aspect of the fiscal policy is to build buffers for climate change resilience in a sustainable way. We concur with authorities and staff on rationalizing current spending and prioritizing capital spending by a more efficient travel cost administration, reforming health care programs and improving education benefits. On capital spending, it is crucial to highlight projects according to the capacity of absorption and growth of Tuvalu’s economy. On the revenue side, we concur with the need of improving tax administration, eliminating exemption and broadening the tax base. An efficient electricity tariff scheme and reform of SOEs administration will contribute significantly to improve fiscal stability.

The banking sector consists of two public banks with low performance, high levels of NPL and portfolio concentration. Tuvalu needs to promote private initiatives in the financial system. We encourage authorities to develop a macroprudential policy to improve the financial supervisory framework, a comprehensive prudential framework and resolution, as well as bankruptcy legislation. We also encourage authorities to implement AML/CFT regulations.

Tuvalu’s structural reforms and economic diversification are crucial for inclusive and sustainable growth. For this aim it is necessary to improve the business climate, promoting employment and private investment. Tuvalu has the potential for diversifying the growth base on tourism, agriculture, fisheries, strengthening human capital, and education.

Mr. Armas and Mr. Rojas Ulo submitted the following statement:

We thank staff for the reports and Mr. Johnston and Mr. Kikiolo for their helpful buff statement.

The economy of Tuvalu is showing a positive performance but the outlook remains challenging. The country has made important progress implementing corrective actions favoring strengthening climate change resilience and improving the fiscal sector. Growth is projected to reach 4.3 percent in 2018 and remain robust at 4.0 percent in the medium term, due to the implementation of infrastructure projects and positive spillovers from infrastructure funded by development partners. Nevertheless, as the staff report indicates, the economy has a high vulnerability to the effects of climate change and natural disaster shocks, which call for building resilience, executing strong policies to maintain sufficient buffers, and implementing structural reforms.

Implementing a gradual fiscal consolidation remains import for backing economic growth in the long run. The fiscal balance, following a surplus in 2018, is projected to deteriorate in the long term due to the fiscal deficit which is set to widen from 5 percent of GDP to 7 percent of GDP. This performance exposes vulnerabilities, mainly due to the government's revenue base facing uncertainty from volatile fishing revenues and high investment in projects which mitigate climate-change effects and support economic growth. We concur with the staff report that improving in the fiscal balance requires reform efforts centered on boosting revenues, containing the current spending, prioritizing capital spending, and supervision of SOEs.

Tuvalu's debts dynamics require significant and sustained efforts to bring the debt path on a sustainable track. As shown in the debt sustainability analysis report, under the baseline scenario, external debt has breached several thresholds and, in the long term, it is projected that this performance will be maintained, indicating that the debt trajectory is not sustainable and particularly vulnerable to natural disasters and fishing revenue shocks. In turn, it suggests the need for decisive policy actions to return the debt to a more sustainable path. We support the fiscal consolidation by mobilizing tax revenue, improving spending efficiency, strengthening the medium-term budgeting and PFM framework to improve growth prospects, and climate change resilience.

Efforts to strengthen the financial intermediation and adequate financial supervision are required. The bank's lending is constrained by high NPLs and insufficient risk management due to an inadequate supervision framework and, therefore, the credit growth provides only modest support to economic growth. We support staff's recommendation on the authorities' need to continue efforts to develop the supervisory framework and bankruptcy legislation and to improve existing regulations which include the pension fund, financial inclusion, and exploring innovative fintech solutions. Efforts to continue to strengthen the AML/CFT framework and the establishment of a Transaction Tracking Unit are remarkable.

We support the implementation of structural reforms to operationalize an inclusive growth and to increase the potential output. The study of macrostructural challenges shows that the economy has a narrow production base, which is highly dependent on imports and restrictions for widening the export base. The limited legal and institutional capacity, together with the infrastructure gap, are structural constraints for Tuvalu's development. We encourage the authorities to continue and accelerate the implementation of structural reforms that diversify the growth of the base economy, absorb macroeconomic volatility, improve the business climate and enhance the quality of human capital. In this framework, the national tourism strategy should be implemented to help the tourism industry grow, improve infrastructure, and increase employment.

With these comments, we wish Tuvalu and its people success in their future endeavors.

Mr. Fachada submitted the following statement:

We thank staff for the report, and Mr. Johnston and Mr. Kikiolo for their concise statement. We welcome the focus of Tuvalu's Article IV consultation on the need to increase the country's resilience to adverse exogenous shocks. Tuvalu is a microstate, the smallest member of the Fund, with a population of only 11 thousand people. Challenges that are shared by many other small states, such as remoteness, narrow production base, high cost of public services, limited human capacity, and restricted policy space, are amplified. Against this background, Fund recommendations need to be realistic.

We agree with staff that Tuvalu's policy priorities should include strengthening fiscal buffers, and continuing to improve natural disasters and climate change preparedness, mitigation, and adaptation. We commend the authorities for being the first Pacific island state to secure access to the Green Climate Fund. We take note that the authorities have demonstrated fiscal responsibility in recent years, and accumulated considerable fiscal buffers thanks to support from donors and fishing license revenues. However, considering Tuvalu's enormous vulnerabilities, it is prudent to preserve and strengthen fiscal buffers.

We appreciate staff's cautious stance about vulnerabilities stemming from high current spending, low domestic revenue base, dependency on grants and fishing license revenues, and reliance of state-owned enterprises on the budget. However, as noted above, we believe that the fiscal assessment and recommendations should be calibrated to reflect Tuvalu's size and specific circumstances. For instance, comparisons of health spending in Tuvalu vis-à-vis other much larger Pacific countries could be misleading, given the costs to transfer and treat Tuvaluans in other countries. On capital spending, we agree with staff that an expansive infrastructure agenda is necessary given the need to promote sustainable growth, but scale and pace should align with the economy's absorption capacity. We also agree that authorities should try to prioritize high-impact projects, and strengthen the medium-term budgeting framework.

We welcome the recommendations by staff to broaden private sector participation in the economy, and agree that structural policies to increase potential output, diversify the growth base, and improve the business environment remain crucial. We concur that a national tourism strategy, combined with improved infrastructure, could help kindle the tourism industry and increase employment opportunities. In this regard, can staff assess the availability and prospects of airlinks to Tuvalu?

Finally, we have concerns about staff's recommendation to maintain Tuvalu's Article IV in the 24-month cycle. According to Article IV consultation cycles policy, members could be placed in cycles longer than 12 months if, among other things, they are not perceived to be at some risk because of policy imbalances or threats from exogenous developments. This does not seem to be the case of Tuvalu. We also trust that the country could profit from more regular engagement with the Fund. The staff's comments would be welcome.

Mr. Doornbosch and Ms. Kalezic submitted the following statement:

Tuvalu's economy performed well, despite persistent risks to the country's sustainable development, volatile budget revenues and costs related to mitigating the effects of climate change. While improvement of the economy resilience to adverse weather-related shocks is noteworthy, continuous efforts to preserving fiscal space necessary to accommodate these costs are warranted. We thank staff for the comprehensive report and Messrs. Johnston and Kikiolo for their informative buff statement, and have the following remarks for emphasis.

Maintaining fiscal buffers at sustainable levels and long-term capital budgeting are pivotal in mitigating risks associated to climate change. We welcome the authorities' proactive approach in developing viable policy frameworks and mechanisms to build resilience against risks stemming from climate change, like the Tuvalu Infrastructure and Adaptation Project (TCAP), Tuvalu Survival Fund (TSF) and National Advisory Council. We hope that the PFM Roadmap, will leverage these efforts by assuring better capital expenditure quality. In the same vain, the authorities should insist on close monitoring of the recurrent expenditure rise. Namely the persistent public wages increase calls for anchoring of the wage bill in line with productivity, limiting adverse impact of competitiveness loss. Similarly, we urge the authorities to consider streamlining tax exemptions and improve forecasting of the fishing revenues which would help sustain revenues over the medium-term. We share staff's recommendation to target small structural fiscal surpluses to prevent depletion of fiscal buffers.

The authorities should accelerate efforts in reforming SOEs, while gradually sun-setting their fiscal support. Given the size of Tuvalu, it is obvious that the role of the state and SOEs goes beyond mere engagement when it comes to market failure. Therefore, running efficient SOEs with the highest governance standards is of upmost importance. Consequently, the authorities should put special emphasis on finalizing SOEs reform, while improving transparency of the annual allocation of fiscal support and settling sizable tax arrears. To this end, we are especially worried about the outstanding debt of the National Fishing Corporation of Tuvalu (NAIFCOT). Could staff share more information on the financial performance of NAIFCOT, its debt carrying capacity and potential resolution of the incurred debt?

Comprehensive reform of the financial sector is warranted, shielding against financial stability risks stemming from high NPL. Although we acknowledge some decrease in the level of non-performing loans, with 47 percent of NPLs of the overall portfolio calls for swift capacity developing to ensure effective oversight of the financial sector. These efforts should be leveraged by developing bankruptcy legislation and integrating the pension fund into the supervision framework. Broadening the access to financial services and creating supervisory infrastructure that would foster competition on the supply side of financial services would support financial deepening efforts.

The authorities should continue promoting policies aimed at private sector development and nurture core competencies and economic diversity, to the extent possible. While recognizing that remoteness and small size are an inherent limitation to the expansion of business and investment, we encourage the authorities to identify and promote policies to create a more business-friendly environment, while paying special attention to the development of the human capital and addressing high unemployment. We encourage the authorities to apply for a Doing Business assessment, as this indicator will help the Tuvalu's authorities to improve those segments of the business environment in which investors are interested the most.

Finally, we urge the authorities, while aware of the capacity limitations, to enhance efforts to improve macroeconomic data, pivotal for appropriate policymaking decisions.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for an interesting Article IV on Tuvalu. As a fragile micro state, Tuvalu is subject to large downside risks, including natural disasters, volatile fishing revenues, and reliance on external donors. A small private sector amid a narrow production base also contributes to deep-seated structural challenges, including a very high unemployment rate of 37 percent. In this context, we broadly agree with the staff appraisal in the Article IV to invest in resiliency and help diversify the economy, among other recommendations.

We concur with staff on the need for greater funding—preferably via concessional lending and grants—to build resilient infrastructure, while also adhering to a sound fiscal framework. As a country with relatively weak capacity, absorbing large-scale funding for projects in a short time periods requires prudent public financial management (PFM). We encourage regional and multilateral technical assistance to help facilitate effective absorption of external funding. The degree of external risks Tuvalu is subject to also points to a need to build and maintain fiscal buffers.

We take note of serious data provision challenges. As a relatively new member of the IMF (2010), this strikes us a key area where IMF technical assistance would be very helpful. Elaboration from staff on TA related to data provision, as well as in other areas, would be welcome.

Mr. Mahlinza, Mr. Raghani, Mr. Tivane, and Mr. Olhaye submitted the following joint statement:

We thank staff for the comprehensive report and Mr. Johnston and Mr. Kikiolo for their informative buff statement. We broadly share the thrust of staff appraisal and make the following comments for emphasis.

Tuvalu's economic growth has gathered momentum owing to increased investment in large infrastructure and housing projects. GDP growth is projected to edge up to 4.3 percent in 2018 from 3.2 percent in 2017, while inflation is expected to remain slightly elevated. The near-to-medium term economic outlook, while favorable, is subject to downside risks, particularly those emanating from climate-related shocks, and reliance on volatile fishing revenues and external grants. We commend the authorities for their reform efforts which have helped improve macroeconomic fundamentals and enhance climate change resilience.

Addressing downside risks would require continuous access to multilateral climate change funds as well as scaling up implementation of high priority investments needed to build resilience to natural disasters and other external shocks. In this regard, we commend the authorities for securing access to the Green Climate Fund, development of the Tuvalu Costal Adaptation Project (TCAP), and the establishment of the National Advisory Council on Climate Change (NACCC) tasked, inter alia, to coordinate the implementation of the country's infrastructure and investment plan for 2016–25.

Fiscal policy should be aimed at ensuring efficiency, tackling debt sustainability challenges, preserving fiscal space for development needs and building buffers. Given the uncertainty in fishing revenues and grants, and the projected deterioration of the domestic current balance to 65 percent of GDP in 2018 due to current spending pressures, maintaining adequate buffers through continuing fiscal consolidation efforts, including by containing wage bill pressures, remains critical. We share staff's view that an adjustment scenario which entails reducing the domestic current deficit by 0.5 pp of GDP per annum until 2030 would be an appropriate fiscal anchor against risks related to natural disasters and volatile fishing revenues.

We encourage the authorities to undertake fiscal reforms aimed to improve revenue mobilization, through broadening the tax base, improving tax compliance, streamlining tax exemptions, and enhancing capacity for fishing revenue forecast. These reforms should be complemented by stepped up efforts to improve public financial management (PFM), strengthen capacity for oversight of fiscal risks emanating from stated-owned enterprises, and enhance the medium-term budgeting.

Addressing financial sector risks by tackling high non-performing loans (NPLs) and strengthening bank credit intermediation and financial inclusion, is essential to safeguard financial stability and support broad-based growth. To this end, decisive steps to establish a financial supervisory framework, develop a bankruptcy legislation framework, and strengthen the Development Bank's credit risk management, should be given priority going forward.

Finally, broadening macrostructural reforms is paramount to fostering economic diversification and building long run resilience to climate change. To this end, we encourage the authorities to improve human capital development; create a conducive legal and regulatory environment to unleash private sector development; increase access to finance; and establish a bankruptcy law, while enforcing the existing legislation. Similarly, the ongoing actions aimed at addressing infrastructure gaps and institutional capacity constraints will contribute to unlocking the country's tourism potential and boost job creation.

Ms. Villa and Mr. Alias submitted the following statement:

We thank staff for the informative set of reports and Messrs. Johnston and Kikiolo for their helpful buff statement.

Tuvalu's economic prospects remain favorable in the face of continued macroeconomic challenges. Growth is expected to accelerate to 4.3 percent in 2018 from 3.2 percent in 2017 on higher fiscal expenditure and infrastructure projects. Notwithstanding, more needs to be done to protect growth against downside risks. These relate to the high investments needs associated with climate change and natural disaster, volatile fishing revenue and heavy reliance on external grants. Tuvalu's geographical remoteness, small population and narrow production base present unique macroeconomic management challenges for the authorities. We broadly agree with staff appraisal and offer the following comments for emphasis.

We welcome that the policy frameworks are in place to guide expenditure priorities and align the scale and pace of capital investment with the economy's absorptive capacity. The core of the expenditure rationalization exercise is to restrain strong growth in recurrent spending. Reducing some of these costs could help create buffers for social spending. The staff highlighted high official travel costs and overseas medical treatment are the main sources. We appreciate that these are already being addressed in the National Strategy for Sustainable Development (Te Kakeega III) 2016-2020. To bolster government income and reduce reliance on fishing revenue, we support staff's call to reduce tax arrears, enhance tax administration capacity and tax compliance. We invite staff comments on whether weaknesses in fishing revenue management can be found in the other members of the Parties to the Nauru Agreement (PNA), and whether there are already plans to address these. We strongly encourage the authorities to strengthen their medium-term budget and public financial management frameworks. This is to help improve debt sustainability and sustain funding for capital investment critical to improve Tuvalu's growth potential and resilience to climate change. While we recognize the role of SOEs in the Tuvaluan economy, it is important to prudently manage SOEs' financial performance to contain contingent spillover risk to the budget. In this regard, we view staff's recommendations to strengthen fiscal support transparency and monitor the financial performances of joint venture companies as crucial. We trust this is also covered in the Public Financial Management Reform Matrix 2017 and encourage the authorities to move swiftly with the reform.

Measures to clean-up bank balance sheet from the high NPLs and enhance banks' ability to mobilize customers' deposits to finance productive economic activities should be prioritized. In addition, efforts to introduce prudential supervision should continue, and we encourage the authorities to make best use of the technical assistance provided by Pacific Technical Assistance Center. We agree that the authorities should take advantage of Tuvalu's high internet usage and mobile cellular subscription to explore mobile banking and peer-to-peer payment solutions to promote financial inclusions.

Recognizing Tuvalu remoteness, small size and limited infrastructure, we encourage the authorities to continue to promote policies to create a business-friendly environment for private sector development. The policies to develop the tourism industry and strengthen human capital is consistent with these objectives, and we encourage the authorities to carefully implement these policies.

Being one of the most vulnerable countries to climate change, we continue to encourage the authorities to seek access to multilateral funding for climate change mitigation. We call on Tuvalu's development partners and the international community to continue to assist Tuvalu and for the Fund to actively engage with the authorities, especially with TA provision.

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

Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their report and Mr. Johnston and Mr. Kikiolo for their buff statement. Tuvalu faces acute economic challenges due to its geographical position. The staff report insightfully shows that against the backdrop of this difficult environment, well-calibrated economic reforms could significantly improve the medium-term outlook.

Due to the very high cost of potential external shocks, we share staff's concerns on the sustainability of public debt. Gradual fiscal consolidation through expenditure containments and higher revenues (notably by eliminating costly tax exemptions) seems indeed warranted, while improved public financial management (including through better forecast of fishing revenue) will be a key structural fiscal reform.

Mitigation and adaptation to climate change is essential for Tuvalu and we welcome the Green Climate Fund's Tuvalu Coastal Adaptation Project which should reduce coastal vulnerabilities and help build stronger institutional capacity in the field of coastal area management. We wonder how Fund's technical assistance, notably through the Pacific Technical Assistance Center, plans to address climate change adaptation and mitigation priorities and how the coordination is done between the IMF, the World Bank and the GCF's project.

We share the thrust of staff's analysis and recommendations on the broadening of the private sector growth base. As in other small remote islands, economic diversification in Tuvalu is particularly challenging. Still, staff's analysis shows that there exists an untapped potential in the tourism industry which could be addressed through better regulatory environment and investment in human capital. In future article IV, it could be interesting to study best performing peers' strategy in the area of tourism development.

Mr. Mahlinza made the following statement:

We would like to make a few points for emphasis. We note the solid growth that has been recorded by Tuvalu over the past few years and that the authorities have made important efforts to strengthen the fiscal position and enhance climate change protection. Nonetheless, the economy remains vulnerable to shocks, especially climate-related shocks.

We take the floor to comment on structural reforms. We support the efforts to improve human capacity development, promote tourism and participation of the private sector. That being said, we note the small size of the economy and its narrow production base. In this respect, we urge the staff to continue to sharpen its recommendations on diversification, particularly in order to ensure the traction of those recommendations in Tuvalu.

Efforts to promote diversification and private-sector development should be complemented by a clear trade integration strategy, and in this respect, we would appreciate the staff's comments on trade integration opportunities beyond the Pacific Agreement on Closer Economic Relations (PACER) Plus initiative.

On diversification, we are puzzled by the lack of concreteness in the recommendations, and we wonder to what extent the authorities can look for alternatives to expand their production base given the country's small size. There is a bit more work that needs to be done in cases like this, where some of those recommendations for these small economies appear to be standard recommendations for economies that are dependent on one or two commodities. It seems logical to recommend diversification, but a bit more work needs to be done in providing more concrete advice on which sectors to diversify into.

Mr. Raghani made the following statement:

I thank the staff for the informative report and the responses to Directors' questions. I also thank Mr. Johnston and Mr. Kikiolo for their insightful buff statement. We issued a joint statement with Mr. Mahlinza and would like to raise a few additional points for emphasis.

As a number of Directors indicated in their statements, we encourage the authorities to continue to make progress to enhance human capital, improve the business environment, and implement a national tourism strategy. We would also like to associate ourselves with the comments by Mr. Gokarn and other Directors on the need to strengthen financial inclusion. In this context, we wonder whether it would be appropriate to set up a microfinance development strategy to enhance financial inclusion in Tuvalu. The staff's comments are welcome.

Like Ms. Horsman, we commend the authorities for preserving correspondent banking relationships. We also find the authorities' strengthening of their Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework and the establishment of this Transaction Tracking Unit remarkable, as also highlighted by Mr. Armas.

Therefore, we wonder whether there are lessons to be learned from Tuvalu's example for other countries that have experienced difficulties in CBRs. The staff's comments are welcome.

Mr. Fachada made the following statement:

I thank the staff for the report. I will be frank; the report is very good, with lots of policy advice. We have to be realistic about the absorption capacity of the authorities in Tuvalu, but there is a lot of food for thought in terms of what they can implement.

I asked a question, and I wanted to hear from Mr. Johnston about the usefulness of the Article IV for a country like Tuvalu. Tuvalu is in the 24-month cycle, so this is a good opportunity for the authorities to receive policy advice from the Fund. I asked this question in my gray statement, and the staff responded that Tuvalu has long-term vulnerabilities, so the 24-month policy cycle is acceptable, despite the fact that there are short-term gains in terms of policy implementation. Perhaps this is a broad policy discussion about micro states and how the Fund can be useful if a country is interested in having shorter cycles.

With regard to third-party indicators, we have discussed this issue many times. My chair has no problem with the fact that the staff uses third-party indicators to make a point in a staff report. It is fine. What I think is not good practice is that when the staff refers to a third-party indicator that is not useful in Fund documents, there is no explanation. Page 3 refers to the Economic Vulnerability Index elaborated by the UN. I have no doubt that this is a good index with great credibility, but then the staff describes the index in Footnote 1. The index is a composition of eight indicators, including population, remoteness, export concentration, impact of natural disasters, et cetera. I do not know what the et cetera is referring to in this case. The staff has word limits for the staff report, but in this specific case, the staff could explain.

My concern in this specific case is that one country, such as Timor-Leste, is actually more vulnerable than Tuvalu, according to this indicator. I was a bit surprised, so I researched the indicator and discovered that there are other variables that are included like instability of agriculture production, instability of the export of goods and services, et cetera. If we want to use third-party indicators that we have never seen, it should be considered a best practice to include a footnote that explains the rationale and the economic sense of the indicator.

The staff representative from the Strategy, Policy, and Review Department (Mr. Shin), in response to questions and comments from Executive Directors, made the following statement:[1]

> On the trade integration, Tuvalu is facing significant challenges in integrating trade with regional peers because they are remote, and they have a weak infrastructure for export markets, and a weak domestic production base. Significant challenges remain, but recently the government is in the process of rectifying PACER Plus. We believe that this will provide opportunities to develop export products, particularly small crop products, and PACER Plus will also provide more opportunities to find funding with the assistance from the major trade partners.
>
> The authorities are trying hard to make best use of this trade arrangement to educate people about the benefits of trade integration and to improve human capital in the context of improving labor mobility in the region. The staff's view is that the authorities should make it a priority to maximize the benefits of the forthcoming agreement because it integrates Australia, New Zealand, and other island countries. This is a great opportunity for the authorities; and the authorities are willing to use it to develop small export markets and also human capital so as to improve labor mobility. This is an opportunity.
>
> On diversifying the growth base, there is great scope for the authorities because the government accounts for more than 90 percent of economic activity on the island. They can continue to develop human capital because the quality of secondary education is still low, and they lack materials and textbooks to educate students.
>
> Previously the main avenue to create employment was through seafaring training, but the global economy has changed, so the authorities need to adapt training and education to the needs of the global economy. We also see great scope to improve tourism, because the number of people arriving into Tuvalu is limited. With a better strategy and better infrastructure, there is great scope to mobilize tourism revenues, which will contribute to creating employment opportunities.
>
> On the question about microfinance institutions, the priority is to improve existing financial institutions because they have a large amount of

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

assets to lend, but because of a lack of financial supervision or a framework, they are quite conservative in their risk management, and then they refrain from lending non-commercial loans except in small amounts. With financial supervision in place, and with the improvement of credit risk management in those existing financial institutions, they can meet the basic needs for normal and small-sized loans.

On the issue of CBRs, there are two banks, and only one has maintained CBRs. Previously, it had closer relations with one of the Australian banks. The authorities have been aware of the risks arising from correspondent banking; and they are aware of the challenges facing the other countries in the region. The authorities have improved their AML/CFT framework, and they recently issued an ID card for transacting with the foreign banks, and they have also developed a tracking unit in the police department. Because this is the only lifeline for the economy, they are carefully maintaining the existing CBRs.

The staff representative from the Strategy, Policy, and Review Department (Mr. Fletcher) agreed with the general principle that third-party indicators should be described and explained as clearly as possible, but noted that this must be balanced against space and resource constraints.

Mr. Saito asked the staff to respond to his written question about strengthening fishing revenues forecasts and the role of technical assistance (TA) in this regard.

The staff representative from the Strategy, Policy, and Review Department (Mr. Shin), in response to further questions and comments from Executive Directors, made the following additional statement: [2]

To accurately forecast the fishing revenue, it is critical to have detailed information on each license category. In the case of Tuvalu, the fishing revenue consists of bilateral options and regional arrangements and a U.S. treaty pool and sub-regional pooling. So far, the Ministry of Finance has received only the total amount of fishing revenue from the Ministry of Natural Resources; and because of a lack of detailed information, it is hard to forecast accurately.

[2] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.30

The Ministry of Finance now is trying to improve its forecasting, so it has started to build its own tools and methodology to forecast each license category in consultation with the Ministry of Natural Resources. It is the staff's views that with the passage of time, and as their capacity builds, they will be able to more accurately forecast fishing revenues.

The Fund and regional institutions are ready to assist in improving fishing revenue forecasts. For example, the Pacific Financial Technical Assistance Center (PFTAC) recently held a regional workshop on managing fishing revenues, in which the regional authorities participated. The regional workshop was organized in consultation with the other regional parties such as Foreign Fisheries Agencies (FFA), the Parties to Nauru Agreement (PNA), and the Asian Development Bank. PFTAC and other regional agencies are willing to assist the authorities in improving fishing revenue forecasts.

Mr. Johnston made the following concluding statement:

I thank Directors for their attention to Tuvalu, the smallest of the Fund's 189 members. It is the smallest in terms of population and land area, but it is certainly the smallest in terms of the size of its economy. It is quite hard to exaggerate. I was planning to go on this mission initially, so I looked up a few places to stay in Tuvalu, and the first place I looked at mentioned on its website that it is situated 50 meters from the airport, similar to the distance between here and HQ2. From what Mr. Kikiolo, who did go on the mission, tells me, the 24 people around this table is probably a bigger group than the Ministry of Finance. The smallness and remoteness pose many challenges, including transport, communication links, provision of basic services, and trade with the rest of the world. I am aware it is difficult to get people to go on missions to Tuvalu and other very small countries. The good thing is one gets to make valuable contributions to countries, and the advice is treated seriously, and that is a big responsibility.

I thank the mission chief, Mr. Shin, and his team for the excellent work and the constructive engagement they had with the Tuvaluan authorities. More generally, we appreciate the work the Fund is doing on issues related to small states like Tuvalu in terms of natural disasters, climate change preparedness, and as Mr. Mahlinza was saying, in terms of diversification, which is a different story in an area like the Pacific that relies very heavily on just a few industries such as fishing, a small amount of agriculture, and tourism. In Tuvalu's case there is very little tourism, but they have a very handy "dot-TV" internet domain which has earned them a considerable amount of revenue. It probably should be described as accidental or serendipitous diversification.

I do not want to repeat what is in the staff report or our buff statement, just to assure the Board that the Tuvaluan authorities are well aware of the challenges that they face, and they are working on all the right things within the constraints that they are under. For example, they are working through climate change issues with the notable assistance of the Green Climate Fund. They remain committed to sound fiscal management, including through the use of various trust funds that act as fiscal buffers. They are very grateful for the financial and technical assistance they get from their international partners and will continue to work closely with them. It goes without saying they want to thank the Fund for the valuable advice and support.

On Mr. Fachada's point about the 24- versus 12-month cycle, which has sparked some discussion in our office, the main question is whether things change enough over 12 months to warrant more intensive surveillance. The Article IV consultation is very useful for the authorities that do not have armies of public and private sector economists and rating agencies poring over their economy all the time; but Article IV consultations are not costless for them either. As the staff pointed out, many of the challenges facing Tuvalu are longer-term issues like climate change.

I have not asked the authorities, but I suspect if they were offered a choice between more TA or more frequent Article IV missions, they would probably choose TA.

The Acting Chair (Mr. Zhang) noted that Tuvalu is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the improved macroeconomic performance and for their work on strengthening climate change resilience. Directors welcomed the broadly positive outlook but noted that Tuvalu remains highly susceptible to external shocks, especially to climate change effects and uncertainties stemming from volatile fishing revenues and reliance on grants. The country's geographical remoteness, small size, and limited infrastructure pose additional challenges. Directors emphasized that strong commitment to sound policies and structural reforms is necessary to build resilience to shocks and generate sustainable growth.

Directors welcomed the progress made in promoting climate change resilience, including securing access to the Green Climate Fund. Going forward, Directors highlighted the importance of ensuring continuous access to multilateral climate change schemes. They noted that the priorities are implementing reforms under the PFM Roadmap, exploring multilateral risk-sharing mechanisms, and improving the financial management of the Tuvalu Survival Fund.

Directors underscored that strengthening the medium-term fiscal framework is key to macroeconomic stability. They emphasized that undertaking gradual fiscal consolidation should help contain fiscal and debt pressures, and build fiscal buffers. In this context, they encouraged the authorities to mobilize tax revenue, eliminate tax exemptions, and contain current spending. Prioritizing capital spending and strengthening fishing revenue forecasts will also be important. Directors also encouraged accelerating reforms of state-owned enterprises, including raising electricity tariffs and linking them to oil price changes.

Directors emphasized that greater financial sector oversight will help tackle the high non-performing loans, increase financial sector efficiency, and promote financial inclusion. They stressed the need for a financial supervisory framework covering the two banks and the pension fund. Directors called for measures to improve credit risk management of the Development Bank, enforce existing financial regulations, and develop bankruptcy legislation.

Directors emphasized that structural reforms aimed at increasing potential output and diversifying the growth base are critical. They encouraged the authorities to give priority to stimulating private sector development by improving the business environment. Directors called for stepped up efforts to strengthen human capital, develop tourism and goods exports, and enhance water resource management. They noted that continued action to enhance macroeconomic statistics will assist in policy formulation and agreed that technical assistance from the Fund will be helpful.

It is expected that the next Article IV consultation with Tuvalu will be held on the 24-month cycle.

APPROVAL: April 15, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

1. Given the narrow and volatile nature of revenue sources, could the staff comment on the potential for broadening the revenue base?

- Tuvalu can broaden the revenue base by mobilizing tax revenue. This includes reducing tax exemptions and improving tax compliance. Tax revenue declined to 16 percent of GDP in 2017 from 20 percent of GDP in 2013, due to tax exemptions and weak compliance. Broadening the private-sector growth base, aided by improved financial access, will also help create businesses and employment, thus expanding the tax revenue base.

2. Could the staff elaborate more on how to strengthen fishing revenue forecasts through enhanced coordination, and whether any TAs either from the Fund or other institutions are planned for this issue?

- The staff intends to address orally.

3. Do the authorities see value in targeting the current domestic balance to effect consolidation, as suggested by the staff?

- The authorities see some value in targeting the current domestic balance, but have noted that volatility has declined in fishing revenue under the Vessel Day Scheme (VDS) and considered fishing revenue a domestic revenue source. The staff views that although volatility of fishing revenue has slightly declined in recent years, it remains a volatile non-domestic income source due to changing weather patterns and related fishing migration. Therefore, staff deems it appropriate to target the current domestic balance excluding fishing revenue.

4. Could the staff share more information on the financial performance of NAIFCOT, its debt carrying capacity and potential resolution of the incurred debt?

- NAFICOT has not produced financial statements since 1999. The staff also has limited information on the financial performance of NAFICOT's three joint ventures with no available financial performance data since 2015. The authorities also have limited information on the financial performance of NAFICOT.

Financial Sector

5. Could the staff elaborate on the reasons why the 2011 Banking Commission Act has not been implemented?

- It was due to lack of capacity and expertise partly due to staff turnover. The Finance Minister took over the role of the banking supervisor, but not much has been implemented. In the face of weak capacity, efforts have been under way, including the hiring of external banking supervisor, with support from the Pacific Financial Technical Assistance Center (PFTAC).

6. Could the staff comment on ways to further improve financial inclusion and literacy?

- Strengthening financial supervision and implementing financial regulations would help improve banks' credit risk management and free up lending capacity, thus contributing to financial inclusion. Introducing educational programs aimed at building financial literacy skills would help improve the credit culture and financial literacy.

Structural Reforms

7. Given the high unemployment rate and limitations in expanding tourism industry, could the staff comment on other avenues for employment generating economic activities in Tuvalu?

- Small business development, aided by credit availability and improved education, would help create employment opportunities. The Pacific Agreement on Closer Economic Relations (PACER) Plus could also provide opportunities for export product development and sophistication.

8. Could the staff assess the availability and prospects of airlinks to Tuvalu?

- There are only 3 to 4 flights to Tuvalu per week depending on the season, from either Fiji or Kiribati. The flight link to Kiribati just started this year. The authorities are considering expanding airlinks in the future, but remoteness, high costs, and infrastructure capacity have been big constraints (e.g., bigger jets can't land).

Fund Engagement

9. Given the risk of policy imbalances or threats from exogenous developments, could the staff comment on their recommendation to maintain Tuvalu's Article IV in the

24-month cycle?

- In regard to the length of the consultation cycle, the question is whether risks rise to a level that preclude a 24-month consultation cycle. In Tuvalu, the largest risks are mainly of a longer-term nature (e.g., climate change, long-run debt sustainability). In the near term, risks are significantly mitigated by Tuvalu's assets in its buffer funds. In this context, staff is of the view that the 24-month cycle remains appropriate, consistent with Tuvalu's previous Article IV consultations. We note also that a staff visit occurs in between Article IV consultations and provides a further opportunity for staff to engage the authorities.

10. Could the staff elaborate on TA related to data provision, as well as in other areas?

- The authorities lack the capacity to compile data without TAs. Against this backdrop, the Fund has provided TA on national accounts compilation, improving the authorities' methodologies and building capacity. The Fund has also compiled a Government Financial Statistics time series and preliminary BOP data. PFTAC has also provided macroeconomic analysis and financial forecasting to develop GDP forecasting methodology and enhance cash and revenue forecasting.

11. How does Fund technical assistance, notably through the Pacific Technical Assistance Center, plan to address climate change adaptation and mitigation priorities and how is the coordination done between the IMF, the World Bank and the GCF's project?

- As ways to build resilience against climate change effects, the Fund has provided TA on public financial management, macroeconomic programming and analysis, revenue administration, and financial sector supervision. PFTAC also held workshop on "Building Resilience to Natural Disasters and Climate Change" in April 2017, which covered adaptation to natural disasters and climate change, and fiscal responses to natural disasters and climate change. PFTAC is also working with GIZ (German aid agency) to include GCF compliance measures in Public Expenditure and Financial Accountability (PEFA) assessment and PFM roadmap. The staff has been in close contact with the World Bank on the macroeconomic assessment, debt sustainability analysis, and updates on recent macroeconomic developments.