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R89-15

9 September 2015

Proposed Policy-Based Grant Strengthened Fiscal Sustainability Program (Tuvalu)

1. The Report and Recommendation of the President (RRP: TUV 47318-001) on the proposed policy-based grant to Tuvalu for the Strengthened Fiscal Sustainability Program is circulated herewith.
2. This Report and Recommendation should be read with *Country Operations Business Plan: Tuvalu, 2015–2017*, which was circulated to the Board on 29 September 2014 (DOC.IN.337-14).
3. This Report and Recommendation is being submitted to the Board for discussion as it does not meet the following criterion for summary procedure:
(iii) the financial assistance should not be for a program, a sector development program, or a project with a major policy reform component.
4. The attached document was prepared under the streamlined business processes. A shortcut to the linked documents listed in Appendix 2 can be found under the relevant entry in the 3-month Board calendar on e-Board.

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Report and Recommendation of the President to the Board of Directors

Project Number: 47318-001
September 2015

Proposed Policy-Based Grant Tuvalu: Strengthened Fiscal Sustainability Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 26 August 2015)

Currency unit	–	Australian dollar/s (A\$)
A\$1.00	=	\$0.7128
\$1.00	=	A\$1.4029

ABBREVIATIONS

ADB	–	Asian Development Bank
CIF	–	Consolidated Investment Fund
CPU	–	central procurement unit
GDP	–	gross domestic product
MFED	–	Ministry of Finance and Economic Development
PRM	–	policy reform matrix
PWD	–	Public Works Department
TA	–	technical assistance
TTF	–	Tuvalu Trust Fund

NOTE

In this report, "\$" refers to US dollars unless otherwise stated.

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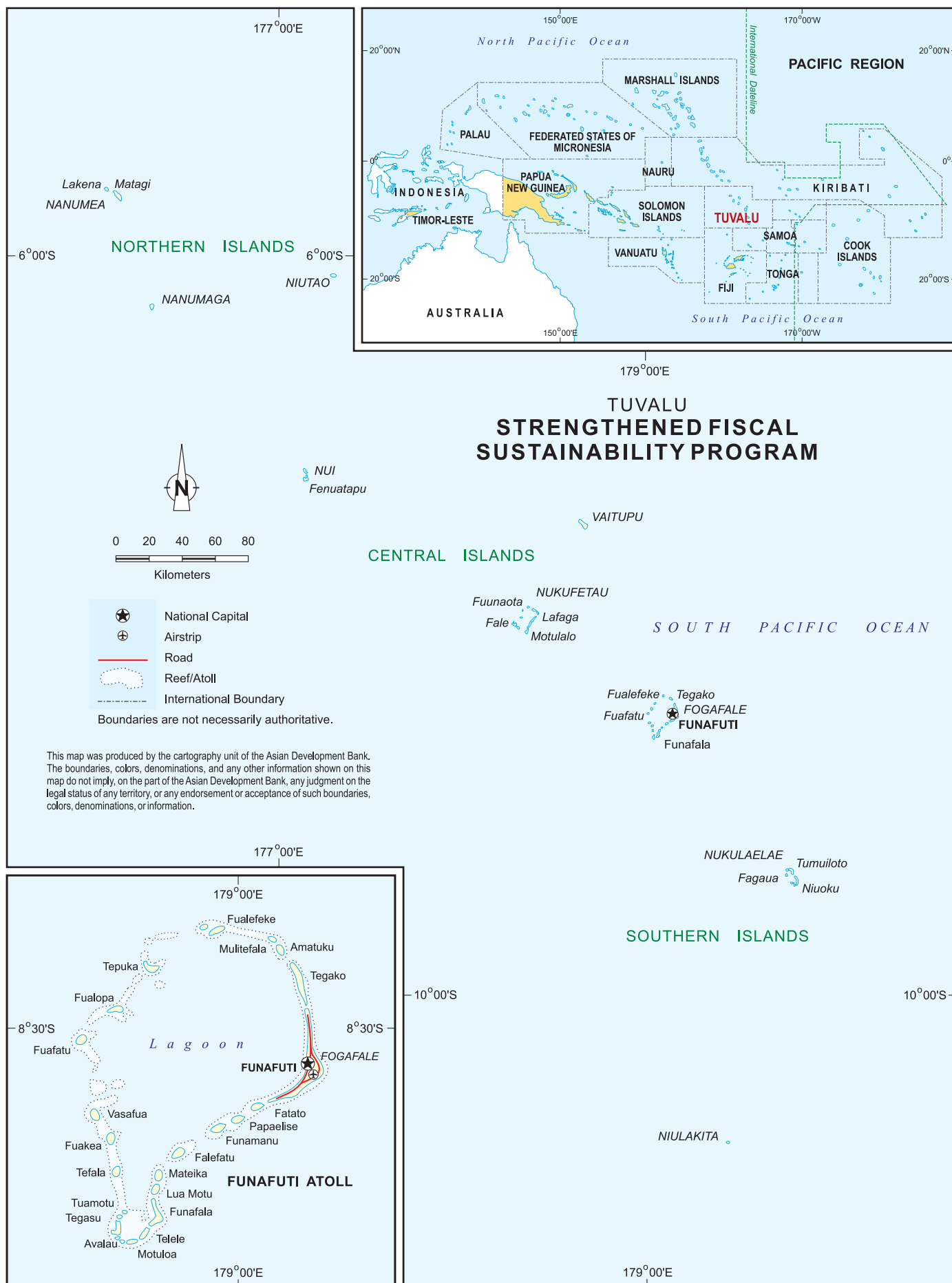
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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 47318-001	
Project Name	Strengthened Fiscal Sustainability Program	Department /Division	PARD/SPSO
Country Borrower	Tuvalu Government of Tuvalu	Executing Agency	Ministry of Finance and Economic Development
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		1.00
	Reforms of state owned enterprises		1.00
		Total	2.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Public financial governance	No gender elements (NGE)	✓
Partnerships (PAR)	Bilateral institutions (not client government) Implementation		
Private sector development (PSD)	Promotion of private sector investment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		2.00	
Sovereign Program grant: Asian Development Fund		2.00	
Cofinancing		3.00	
Australian Grant		1.10	
New Zealand Grant		0.40	
World Bank		1.50	
Counterpart		0.00	
None		0.00	
Total		5.00	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	



I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based grant to Tuvalu for the Strengthened Fiscal Sustainability Program.¹

2. The program aims to achieve a strengthened fiscal position for Tuvalu. It will provide financial resources to implement selected reforms under the third and final phase of the Government of Tuvalu's current multiyear policy reform matrix (PRM) and will build on earlier reforms supported by the Asian Development Bank (ADB) in strengthening (i) public procurement, (ii) public enterprises to improve their commercial orientation and support private sector development, and (iii) the fiscal buffer for improved fiscal sustainability.²

II. THE PROGRAM

A. Rationale

3. Tuvalu is a fragile microstate and ADB's smallest member. It comprises nine low-lying atolls with a total land area of 26 square kilometers. More than half the population of 10,800 (2013) reside on the main island of Funafuti—an area of only 2.8 square kilometers. The economy is small, narrowly based, and highly dependent on external sources of income and imports. The public sector accounts for around two-thirds of gross domestic product (GDP), and there is limited scope for economic diversification or for private sector development. At its highest point, Tuvalu is only 4.6 meters above sea level, making it highly vulnerable to climatic events such as tropical storms and sea level rise. For example, Tuvalu experiences an average of two king tides per annum where sea level rise exceeds 3.2 meters, causing seawater to inundate homes, submerge roads, wash away crops, and contaminate freshwater supplies. In March 2015, tropical cyclone Pam—a category 5 cyclone that coincided with a king tide—brought storm surges that inundated Tuvalu's low-lying atolls. Damage and loss to infrastructure and livelihoods resulting from this single event has been estimated at \$15 million, or 34% of GDP.³

4. **Tuvalu's fiscal challenges.** Under the circumstances, achieving fiscal sustainability is a challenge for the government. It requires (i) prudent management of volatile and often unpredictable revenue sources, including fishing license fees, licensing royalties for the commercial use of the "dot.tv" internet domain name, and development assistance; (ii) expenditure restraint at a long-term sustainable level, even if revenues are high in the short-term; and (iii) the need to manage the fiscal risks from external economic shocks and regularly occurring climatic events such as natural disasters.

5. To help smooth revenue volatility, the Tuvalu Trust Fund (TTF) was created in 1987. In years when the market value of the trust fund exceeds its real maintained value, the surplus is transferred to the Consolidated Investment Fund (CIF) that the government can draw upon to finance fiscal deficits.⁴ Following the 2008 global economic crisis, from 2009 to 2011 Tuvalu experienced 3 consecutive years of economic contraction and low and declining returns on TTF

¹ The design and monitoring framework is in Appendix 1.

² The policy reform matrix phase 3 is in Appendix 4.

³ World Bank. 2015. *Tuvalu Damage and Loss Assessment Summary Report*. Washington, DC. An ADB investment project to improve outer islands' port facilities, some of which were damaged during the tropical cyclone, is planned for 2016.

⁴ Government of Tuvalu. 2008. *Agreement Concerning An International Trust Fund for Tuvalu*. Funafuti. The targeted CIF account balance is equivalent to 16% of the TTF's real maintained value (around 45% of GDP), which is estimated to cater for up to 4 years of continuous drawdowns absent of any new distributions from the TTF account or budget.

investments.⁵ Consequently, there were no transfers from the TTF to the CIF from 2009 to 2012. The downturn in the economy led to budget deficits of 22.5% of GDP in 2010 and 9.0% in 2011 (compared to 1.5% in 2008 and 3.2% in 2009), which, in the absence of TTF transfers, contributed to an unsustainable drawdown of funds from the CIF. By 2012, CIF cash reserves had declined to 1.1% of GDP from 9.2% in 2008, putting at risk the government's ability to maintain essential public services. At the same time, the government and its agencies entered into new debt, predominantly to finance capital investment. External debt rose rapidly, peaking at 56% of GDP in 2010 against a target of 30% of GDP.⁶

6. **Government response.** To improve the fiscal outlook, ensure prudent fiscal management, and prevent the accumulation of debt, in 2012, the government—supported by ADB, the governments of Australia and New Zealand, and the World Bank—embarked on a comprehensive reform program. The government adopted a medium-term PRM that outlines three phases of time-bound reforms from 2012 to 2015, each one supported by development partners according to their areas of comparative advantage, and implemented through technical assistance and a coordinated program of budget support. The PRM explicitly targets a sustainable fiscal framework through reform actions in six areas: public financial management, fiscal policy, public administration, public enterprise performance and rationalization, and health and education management. Reforms achieved under phases 1 and 2 have triggered around \$8 million in budget support from ADB and the other development partners.⁷

7. Since 2012, the government has worked closely with development partners through the PRM to create strategies to keep fiscal deficits at sustainable levels (i.e., below 10% of GDP) and reduce debt to manageable levels. Fiscal management is tracked by government on a quarterly basis through the use of fiscal ratios, which provide a basis for benchmarking the government's performance.⁸ Revenue and expenditure review committees were established in 2012 to identify new sources of revenue and to advise the cabinet on strategies to control costs. Government revenues increased as a share of GDP from 56.6% in 2012 to 73.4% in 2014, driven by strong fishing license revenues, which increased by 55% over the same period; improved tax compliance following a tax audit of public enterprises; and an increase in the consumption tax rate from 4% in 2012 to 7% in 2013.⁹ Government expenditures, however, grew steadily from 2012 to 2014, driven largely by increased spending on the overseas medical treatment and scholarships schemes and public sector wages.

8. Recognizing these three long standing expenditure pressures, the government has formulated clear strategies to control these costs. Increased spending on the government scholarship and overseas medical treatment schemes from 2010 to 2014 has been contained by PRM initiatives that were implemented between 2012 and 2014, specifically (i) halting of government-funded scholarships; (ii) reduction in the accommodation component and accompanied allowances of the overseas medical treatment scheme; (iii) building up of domestic health service capacity; and (iv) exploration of more affordable options for overseas treatment, such as sending heart patients to India. Outside the PRM, the government is undertaking a phased series of civil service reforms to reduce the wage bill from 38% of

⁵ Real GDP growth was -2.3% in 2009, -1.4% in 2010, and -0.6% in 2011. Government of Tuvalu. *National Budget Documents, 2008–2012*. Funafuti.

⁶ Government of Tuvalu. *Tuvalu Trust Fund Accounts Committee Reports, 2010–2013*. Funafuti.

⁷ The policy reform matrix combining phases 1, 2, and 3 is in Appendix 5. All actions under phases 1 and 2 have been achieved.

⁸ The seven fiscal ratios are (i) tax revenue to GDP target of 20%; (ii) recurrent expenditure to GDP target of 60%; (iii) wages and salaries to domestic revenue target of 55%; (iv) Tuvalu Overseas Medical Treatment Scheme to domestic revenue target of 6%; (v) Tuvalu Overseas Scholarship Scheme to domestic revenue target of 5%; (vi) primary balance to GDP target of 11%; and (vii) net present value of public debt to GDP target of 30%.

⁹ Public Sector Management Sector Assessment (Summary): (accessible from the list of linked documents in Appendix 2).

recurrent expenditure in 2014 to its target of 30% by 2018. These reforms include (i) the adoption of performance management guidelines to support the performance appraisal and remuneration process in 2015; (ii) a wage freeze during 2015–2017; and (iii) the implementation of recommendations from a planned wage review in 2016–2017, which will focus on adoption of a wage-setting mechanism to ensure that public sector wage increases are in line with productivity gains in the economy.

9. The rapid growth in revenue by 127% from 2011 to 2014 saw a return to substantial fiscal surpluses in 2012–2014. The government has used these surpluses to rebuild the CIF from \$3.7 million in 2008 to \$20.4 million in 2014, again providing an effective fiscal buffer.¹⁰ Nevertheless, the Tuvalu economy is vulnerable to adverse climatic events, and the shock to the economy from Cyclone Pam (para. 3) is already having a large impact on the fiscal balance, with a budget deficit of 7.7% of GDP projected for 2015 and 9.5% for 2016 as reconstruction gets underway (Table 1). The reconstruction spending, financed by development partner grants but also drawing on accumulated buffers, is expected to be largely completed by 2016.

Table 1: Tuvalu Medium-Term Fiscal Framework, 2015–2017
(% of GDP, unless otherwise stated)

	2012	2013	2014	2015 Budget	2015 Project	2016 Project	2017 Project
<i>Total revenue and grants (\$m)</i>	23.5	30.9	34.9	40.3	35.4	37.1	35.4
Revenue	56.6	83.1	73.4	94.5	76.4	73.6	70.9
Taxes	15.0	19.0	17.8	19.0	18.3	17.5	16.8
Nontax	41.5	64.1	55.6	75.3	58.1	56.1	54.1
Grants	27.2	24.6	48.3	24.9	39.7	22.1	20.5
<i>Total expenditure (\$m)</i>	20.9	23.3	30.2	40.6	47.7	41.5	30.7
Current expenditure	68.7	73.5	85.6	84.2	86.5	83.9	81.4
Wages and salaries	31.9	32.2	35.6	38.0	36.4	34.4	32.8
Capital expenditures	5.7	7.7	9.2	35.9	37.3	21.3	8.9
Reconstruction-related	...	...	...	...	18.5	11.9	...
Recurrent balance	(12.2)	9.6	(12.1)	10.3	(10.1)	(10.3)	(10.5)
Overall balance	8.4	27.5	35.0	(0.7)	(7.7)	(9.5)	1.1
\$m	2.6	7.6	4.7	(0.3)	(12.5)	(4.4)	4.7
TTF distributions to CIF	...	...	15.2	5.1	19.4	4.5	4.5
Debt Indicators							
Gross public debt (incl. guarantees)	43.0	41.1	56.9	...	48.6	41.2	33.4
\$m	11.9	11.7	17.0	...	15.3	13.6	11.4
of which: publicly guaranteed debt	2.7	2.7	2.5	...	2.5	2.2	1.6
of which: contingent liabilities ^a	4.6	4.0	10.3	...	9.1	7.9	6.8
Debt Service ^b	11.2	11.6	12.8	13.2	13.2	12.5	10.7

... = data not available, () = negative, \$m = million dollars, CIF = Consolidated Investment Fund, GDP = gross domestic product, PPG = public and publicly guaranteed, TTF = Tuvalu Trust Fund.

^a Contingent liabilities are associated with a fishing joint ventures, of which 50 percent is owned by the National Fishing Corporation of Tuvalu, a public enterprise.

^b reflected as % of exports of goods and services.

Sources: Government of Tuvalu estimates; International Monetary Fund estimates; World Bank estimates; Asian Development Bank estimates.

¹⁰ Government of Tuvalu. *National Budget Documents, 2011–2015*, Funafuti; Government of Tuvalu. *Tuvalu Trust Fund Accounts Committee Reports, 2011–2015*. Funafuti.

10. The introduction of the Debt Risk Management and Mitigation Policy in 2009 provides clear guidelines on the contracting of debt. Since 2012, the government has completed and published, as part of the government financial accounts, a stock-take of bank accounts and government debt and guarantees, obtaining a comprehensive position of its net liabilities. A fishing joint venture with equal partnership between the National Fishing Corporation of Tuvalu, a public enterprise, and a Taiwanese fishing company, took out commercial loans in 2009 and 2014 without government guarantees to finance the building of fishing vessels—a measure to improve productivity of the local fishing industry and create local jobs. The joint venture has subsequently paid off the 2009 loan through profits and continues to make subsequent payments to reduce their debt.

11. To protect the economy against external shocks while laying the basis for more sustainable fiscal balances, the government is seeking to complete the program of reforms begun with ADB support in 2012. Reforms include (i) completing ongoing public procurement reforms; (ii) improving the performance of public enterprises to enhance service delivery, reducing contingent liabilities on the budget, and promoting private sector development; and (iii) improving management and maintenance of the CIF buffer fund for long-term macroeconomic stability and economic self-sufficiency.

12. **Public procurement reforms.** The program completes the final phase of public procurement reforms begun in 2012. Public procurement has been a high priority for the government, and its inclusion in the PRM has led to significant progress. From 2012 to 2014, ADB supported the adoption of the 2012 National Procurement Policy, the Public Procurement Act 2013, and the Public Procurement Regulations 2014. These collectively regulate public procurement to (i) maximize efficiency; (ii) achieve transparency in procurement proceedings; (iii) promote competition among suppliers, contractors, consultants, and non-consulting service providers; (iv) provide for fair, equal, and equitable treatment of all those seeking to obtain contracts with the government; and (v) promote public confidence in the integrity and fairness of procurement proceedings. The central procurement unit (CPU) was also established to ensure that government resources were being effectively used for procurement transactions, and standard bidding and other documents were developed for use by procurement practitioners. The development of the CPU annual report and a centralized procurement website will help strengthen public procurement governance.

13. **Public enterprise rationalization.** Tuvalu has eight public enterprises.¹¹ With support from the Government of Australia and ADB, significant progress has been made in improving the policy and regulatory framework for public enterprises. This progress includes the establishment of the Public Enterprise Reform and Monitoring Unit in 2009; the enactment of the Public Enterprises Act in 2009; the removal of politicians and civil servants from public enterprise boards; the timely submission of audited annual reports to Parliament for all public enterprises; and the merger of the Tuvalu Philatelic Bureau, Tuvalu Post Office, and Tuvalu Travel Office into a single entity known as the Tuvalu Post and Travel Office. Government's efforts to pursue professional management options for the Vaiaku Lagi Hotel unfortunately failed in 2012 due to limited private sector interest. Nevertheless, more reforms are needed to enable public enterprises to operate on a commercial basis, reduce the drain from ad hoc government subsidies on the national budget, and attract greater private sector participation. Resolving the cross-liabilities of unpaid bills to public enterprises by the government and unpaid taxes to the government by public enterprises would also help operational management. More work is also needed to contract out selected activities of the Public Works Department (PWD). The

¹¹ Tuvalu's public enterprises are the National Bank of Tuvalu, Development Bank of Tuvalu, National Fishing Company of Tuvalu, Tuvalu Telecommunications Corporation, Vaiaku Lagi Hotel, Tuvalu Electricity Corporation, Tuvalu Maritime Training Institute, and Tuvalu Post and Travel Office.

construction of capital works has typically involved the use of hired labor with procurement contracts for the supply and delivery of building materials issued to the PWD. This practice is neither competitive nor transparent, and it extends the responsibility of the PWD beyond its original design and supervision role. The recent escalation of government-funded capital works and cyclone reconstruction efforts has prompted the government to develop a rationalization strategy to improve the commercial and financial viability of the PWD.

14. **Transforming the Consolidated Investment Fund to build a fiscal buffer.** The government recognizes that much of the improvement in the fiscal balance during 2012–2014 was due to temporary cyclical factors and nonrecurrent revenue. The government is improving the way it operates the CIF to better insulate the budget and the economy from external shocks. On the advice of the International Monetary Fund, the government will aim to achieve a “structural fiscal balance”—a surplus of 0.5%–1.0% in 2016–2018—with excess surpluses being transferred into the CIF.¹² To operate as a fiscal stabilization fund, changes to existing accumulation and withdrawal rules will be implemented to better regulate the use of the CIF and ensure its replenishment. These changes will help avoid ad hoc fiscal tightening and the need to search for new, economically harmful revenue sources during economic downturns, and the focus on the structural deficit will strengthen the foundation for policy setting.

15. **ADB’s value addition, lessons learned, and program modality.** ADB’s strong partnership with the government through two policy-based lending operations in 2008 and 2012 and ongoing TA for substantial and highly sensitive public enterprise and procurement reforms has enabled the government to undertake reforms that might otherwise be difficult to implement. In a microstate such as Tuvalu, personal relationships and formal bureaucratic rules inevitably shaped government decisions when implementing hard reform actions.¹³

16. The program builds on lessons from previous ADB programs in Tuvalu and elsewhere in the Pacific, which highlight the importance of (i) maintaining a single, government-led, policy matrix to enhance coordination and collaboration among development partners; (ii) using a single tranche modality within a programmatic, multiyear approach supported by several partners; (iii) implementing fewer reforms that have a large potential impact; and (iv) linking capacity building TA support to PRM implementation, as capacity constraints can hamper the government’s ability to follow through on agreed reforms.¹⁴ The program is, therefore, a stand-alone policy-based grant operation that will focus on the implementation of the final phase of the current PRM. ADB engagement post-PRM will be sustained through ongoing policy dialogue and follow-up TA to improve public sector management and greater investments in economic infrastructure; for example, \$3 million in disaster response financing will be provided through ADB’s Disaster Response Facility, which will build ports in the outer islands of Tuvalu.

B. Impact and Outcome

17. The program is aligned with improved good governance, macroeconomic growth, and fiscal stability, as prioritized in Tuvalu’s National Strategy for Sustainable Development, 2005–

¹² International Monetary Fund. 2014. *Tuvalu: Staff Report for the 2012 Article IV Consultation*. Washington, DC. The structural fiscal balance is derived from breaking down the observed budget result into a cyclical and a structural component.

¹³ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Improved Financial Management Program*. Manila; ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to Tuvalu for the Strengthened Public Financial Management Program*. Manila; ADB. 2012. *Technical Assistance to Tuvalu for Institutional Strengthening of the Ministry of Finance and Economic Development*. Manila.

¹⁴ ADB. 2012. *Improved Financial Management Program Completion Report*. Manila; ADB. 2014. *Strengthened Public Financial Management Program Completion Report*. Manila.

2015.¹⁵ The outcome will be the achievement of a strengthened fiscal position for Tuvalu. This will be achieved through the implementation of selected outputs endorsed by the government under phase 3 of the PRM, and it will be supported by ADB TA (footnote 13).¹⁶

C. Outputs

18. The program will consolidate earlier reforms supported by ADB in (i) public financial management, (ii) public enterprise rationalization and private sector development, and (iii) fiscal policy setting. All six policy actions have been completed.

19. **Output 1: Public procurement strengthened.** The program supports the final phase of public procurement reforms begun in 2012.

- (i) **Output 1.1.** The first annual report of the CPU was published and approved by the cabinet in 2015. The annual report details procurement transactions undertaken by the CPU on behalf of the government in 2014, key achievements and challenges faced during 2014, and outstanding actions that require further attention. The inclusion of a 2015 work plan enables timely action on individual procurement transactions to avoid bunching at the end of the year. For better procurement planning, future work plans are expected to be prepared simultaneously with the budget, as the two are closely linked, especially in respect of capital expenditure. The government plans to make this report publicly available on the newly created centralized procurement website.
- (ii) **Output 1.2.** The government's procurement website, which serves as a centralized resource for all public procurement-related information, was developed and launched in 2015. This will enhance the government's ability to obtain better value for money and use scarce public resources more efficiently. It serves as a tool to (a) increase the government's accountability on its use of public funds, (b) enhance the fight against corruption, and (c) increase transparency and legal certainty. The website is also expected to help widen the interest of overseas suppliers, including from Australia and New Zealand, and possibly generate more competition among bidders while generating some cost-saving measures for Tuvalu.

20. **Output 2: Commercial orientation for public enterprises and private sector development strengthened.** The program supports the continuation of vital public enterprise reforms, focusing on efforts to attract private sector participation.

- (i) **Output 2.1.** The Public Enterprise Reform Plan was developed and adopted by the cabinet. The plan will guide government decision making towards enhancing the commercial orientation and financial soundness of public enterprises, and clearly define and cost their social responsibilities. This, together with strengthened accounting and auditing practices, will enhance the transparency and accountability of public enterprises.
- (ii) **Output 2.2.** The cabinet approved the sale of a concession for the Vaiaku Lagi Hotel to a private operator, which is expected to raise operational standards and performance, address maintenance issues, and improve guest facilities.
- (iii) **Output 2.3.** The cabinet approved a rationalization strategy for the PWD, which allows the contracting out of selected construction works such as building repairs. The PWD rationalization strategy aims to promote the contracting out of capital construction to private sector contractors, including the purchase of required

¹⁵ Government of Tuvalu. 2004. *National Strategy for Sustainable Development, 2005–2015*. Funafuti.

¹⁶ The Government of Tuvalu's Development Policy Letter is in Appendix 3.

building material. This will help build local private sector capacity to undertake capital works in Tuvalu.

21. **Output 3: Sustainability of the fiscal buffer strengthened.** The program supports the strengthening of CIF management rules to transform it into a fiscal stabilization fund.

- (i) **Output 3.1.** The cabinet endorsed changes to the financial instructions under the Public Finance Act to include detailed rules to guide, replenish, and regulate the use of the CIF, ensuring that the target CIF savings balance shall be equivalent to 16% of the maintained value of the TTF and regulated through a CIF contributions and savings plan.¹⁷ This reform will help transform the CIF into a fiscal stabilization fund that follows a clear rule of accumulation and withdrawal, whereby temporary windfalls from external revenue sources (e.g., fishing revenues) are saved and can be drawn down when there is a revenue shortfall. During the national budget process, where the CIF balance at the start of the following budget year is forecast to be at a level below the target CIF saving balance, the finance minister will now be required to present to Parliament a CIF contributions and savings plan as a component of the national budget.

D. Development Financing Needs

22. The government has requested a grant not exceeding \$2.0 million from ADB's Special Funds resources to help finance the program.

23. ADB is basing the size of its \$2.0 million grant on the government's financing requirements and the cost of the government's reform program. Projections of budget financing requirements (post-cyclone Pam) indicate a fiscal deficit of 7.7% of GDP in 2015 and 9.5% in 2016, equivalent to about \$7.9 million.

24. The governments of Australia and New Zealand, and the World Bank, confirmed they will provide parallel, collaborative grant cofinancing on the completion of their selected reforms under the third phase of the PRM. The World Bank approved its second development policy operation on 16 June 2015 following completion of their actions. Approvals from the Governments of Australia and New Zealand are expected in December 2015 once their actions are completed.¹⁸ The contributions from each partner are highlighted in Table 2.

Table 2: Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Special Funds resources (grant)	2.0	40.0
Government of Australia (grant)	1.1	22.0
Government of New Zealand (grant)	0.4	8.0
World Bank (grant)	1.5	30.0
Total	5.0	100.0

Source: Asian Development Bank.

E. Implementation Arrangements

25. **Program management.** The Ministry of Finance and Economic Development (MFED), as the executing agency, oversaw timely implementation of the agreed policy actions by the

¹⁷ Government of Tuvalu. 1991. *Public Finance Act*. Funafuti.

¹⁸ Refer to the list of PRM Phase 3 actions in Appendix 4. Selected actions supported by ADB and the World Bank have been completed. The outstanding actions, which are supported by the Governments of Australia and New Zealand, are expected to be completed by 1 December 2015.

implementing agencies, and is responsible for program administration, disbursements, and maintaining all records. The MFED, through the CPU, was the implementing agency for output 1. The MFED, through the Public Enterprise Monitoring Unit, (i) implemented output 2.1; (ii) acted as the joint implementing agency with the Ministry of Foreign Affairs, Environment, Trade, Labor and Tourism for output 2.2; and (iii) acted as the joint implementing agency with the Ministry of Public Utilities for output 2.3. The MFED was the sole implementing agency for output 3. Ongoing TA (footnote 13) helped the government fulfill program conditions. ADB and other development partners supporting the PRM process agreed to a high-level coordination and monitoring mechanism comprising members of the TTF advisory committee—representatives of the governments of Tuvalu, Australia, and New Zealand—who will monitor the implementation progress of the PRM.

26. **Implementation period.** The program is being implemented from 1 August 2014 to 30 October 2015, consistent with the government's medium-term fiscal framework and budget cycle.

27. **Procurement and disbursement.** The proceeds of the grant will be disbursed in accordance with ADB's simplification of disbursement procedures and related requirements for policy-based grants.¹⁹ The proceeds will be used to finance the foreign exchange cost of items produced and procured in ADB member countries, excluding items included in a list of ineligible items and imports financed by other bilateral and multilateral sources.²⁰ Grant proceeds disbursed against imports will require a certificate from the government stipulating that the value of the total imports of Tuvalu, minus its imports from nonmember countries, ineligible imports, and imports financed under other official development assistance, is greater than the amount of the grant expected to be disbursed during a particular year. ADB will have the right to audit the use of the grant proceeds and to verify the accuracy of the government's certification.

28. **Tranches.** The grant will be provided in a single tranche and will be withdrawn upon satisfaction of grant effectiveness conditions, i.e., fulfillment of all the actions in the program policy matrix. Local currency generated from the grant will be directed to the government's bank account with the National Bank of Tuvalu to allow provision of supplementary financing for the 2016 national budget.

29. **Program performance monitoring and evaluation.** The government will monitor the implementation and outcome of the program using a set of indicators and targets agreed between the government and ADB. For each of the agreed indicators, progress will be measured against the baselines in the design and monitoring framework. The responsible implementing agencies will support the review of agreed actions to determine progress and identify constraints. Because the outcome of the program will be felt beyond the period of its implementation, the monitoring of the PRM will be carried out on a continuous basis by the TTF advisory committee, and the information from this will be included in the program completion report.

III. DUE DILIGENCE

30. The program's major benefit will be its contribution to Tuvalu's long-term fiscal sustainability. Fiscal sustainability will in turn help maintain macroeconomic stability in the country and boost growth. Strengthened public sector management will also allow for improved

¹⁹ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

²⁰ List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

service delivery, which is essential to making the growth process inclusive and to fostering employment and poverty reduction.

A. Economic and Financial

31. Improving the government's expenditure management and reducing the demand on the budget made by public enterprises will create fiscal space and allow the government to shift expenditures to priority areas. Tuvalu's overall fiscal performance will therefore improve. Budget restraint and strengthened fiscal management will allow the government to use the CIF more effectively as a fiscal stabilizer and reduce Tuvalu's vulnerability to fiscal shocks. The program's long-term impact will be greater government capacity for sound fiscal management, which will help bring the budget deficit to sustainable levels while still enabling increased capital expenditure.

B. Governance

32. The government's ability to implement its budget is integral to the success of the program. Internal controls and external oversight gaps identified by a public expenditure and financial accountability assessment in 2011 have been strengthened through, although not limited to, better financial record keeping, conduct of annual independent audits, and centralized treasury commitment and expenditure controls. The appointment of a government ombudsman in 2014 will also help eliminate or greatly reduce corrupt practices in government.²¹ The emphasis of the PRM on improving public financial management, including measures to improve revenue administration, accounting procedures, reporting, procurement policy, audit, budget formulation, and planning, demonstrates the government's commitment to managing the budget credibly and effectively.

33. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government. Consistent with its commitment to good governance, accountability, and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the program. The program will adhere to ADB's Guidelines for Implementing the Second Governance and Anticorruption Action Plan (2014).²²

C. Poverty and Social

34. Improved public sector management will have positive impacts on the delivery of social services. Layoffs will be avoided during public enterprise rationalization, and where they may occur, it is expected that employees will either transition into the private sector or be retained in the public sector. Any adverse labor market implications on future privatization efforts will be undertaken in dialogue with the government and development partners and supported with pipeline TA.²³

²¹ The assessment was supported under ADB. 2011. *Technical Assistance for Strengthening Governance and Accountability in Pacific Island Countries (Phase 2)*. Manila. An update is underway with support from the International Monetary Fund's Pacific Financial Technical Assistance Centre. Further assessment is available in the Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2).

²² ADB. 2014. *Revised Staff Guidance for Implementing the Second Governance and Anticorruption Action Plan: Assessing and Managing Governance Risks in ADB Operations*. Manila.

²³ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

D. Safeguards

35. Program activities will be confined to policy and institutional reforms, and none of the activities will result in, or lead to, involuntary resettlement, nor will they affect indigenous people. Safeguard categories for environment, involuntary resettlement, and indigenous peoples are all C. Regular and close dialogue with the government and development partners was carried out during country visits and throughout implementation of the program.

E. Risks and Mitigating Measures

36. The program faces three key risks:

- (i) The narrow economic base leaves the country vulnerable to shocks. Should these occur, the reform focus would likely switch from strengthening public financial management to short-term stabilization.
- (ii) The political consensus needed to mount program reforms could prove difficult to maintain, particularly for public enterprise reforms.
- (iii) Capacity constraints and staff turnover could limit the government's ability to manage the program.

37. The program design mitigates these risks. The rebuilt fiscal reserves are helping the government weather potential external shocks. Political consensus has been reinforced through the government's ownership and leadership of the PRM process and the subsequent reform effort. In addition, the MFED, with support from ADB TA (footnote 13), has conducted a concerted outreach program to build wider support for reform among parliamentarians and across government ministries. Capacity constraints will be offset in part through new and ongoing TA provided by ADB and other partners. Overall risk is assessed to be medium. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.²⁴ Integrated benefits and impacts are expected to outweigh the costs.

IV. ASSURANCES

38. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the grant agreement. The government has agreed with ADB on certain covenants for the program, which are set forth in the grant agreement. The grant will become effective after ADB is satisfied that all conditions for the release of the program tranche, as specified in the policy matrix and set out in Attachment 2 to Schedule 2 of the grant agreement, have been complied with.

V. RECOMMENDATION

39. I am satisfied that the proposed policy-based grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant of \$2,000,000 to Tuvalu for the Strengthened Fiscal Sustainability Program, from ADB's Special Funds resources; and such other terms and conditions as are substantially in accordance with those set forth in the grant agreement presented to the Board.

Takehiko Nakao
President

7 September 2015

²⁴ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Impacts the Program is aligned with:

Good governance, macroeconomic growth, and fiscal stability improved (National Strategy for Sustainable Development, 2005–2015^a)

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome Fiscal position strengthened	The CIF minimum target balance is at least 16% of the TTF's real maintained value during 2016–2020 (2009–2013 baseline: Average balance of 6.8%)	Government of Tuvalu's annual budget documents TTF Account Committee bi-annual reports	Broad reform consensus weakens due to political pressure External shocks requiring CIF drawdown
Outputs 1. Public procurement strengthened	1.1 Procurement annual report for 2014 developed by the CPU and approved by Cabinet. (2014 baseline: Not applicable; this is the first annual report) 1.2 Government procurement website developed and launched as a centralized resource for all public procurement-related information. (2014 baseline: Not applicable; this is the government's first public procurement website)	1.1 Copy of CPU report certified by Finance Minister; Letter from Clerk to Cabinet confirming that CPU report was approved by Cabinet 1.2 Letter from Finance Minister confirming his approval of the website; Copy of webpage certified by Finance Minister; MFED circular announcing the new website and its functions	Stakeholders with vested interests interfere with the reform process. Staff changes and workload pressures reduce continuity and quality of reform implementation. Limited capacity in the MFED and Public Enterprise Reform and Monitoring Unit to reform public enterprises and scrutinize financial performance of public enterprises.
2. Commercial orientation for public enterprises and private sector development strengthened	2.1 Cabinet approval of the PERP. (2014 baseline: Not applicable; This is the first PERP) 2.2 Cabinet approval of the concession sale of the VLH, VLH land surveyed, and preparation of sale and tender documents (2014 baseline: Attempt to tender out the management contract for the VLH failed in 2012 due to limited private sector interest; This is the first attempt to sell the VLH)	2.1 Copy of PERP certified by Finance Minister; Letter from Clerk to Cabinet confirming that PERP as submitted by MFED was approved by Cabinet 2.2 Letter from Clerk to Cabinet confirming that the concession sale of the VLH was approved by Cabinet; Copy of VLH land survey certified by Department of Lands; Copy of sale and tender	

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	2.3 Cabinet approval of the PWD rationalization strategy to promote contracting out of capital works to the private sector. (2014 baseline: Not applicable; no existing rationalization strategy for the PWD)	documents certified by Finance Minister 2.3 Copy of PWD rationalization strategy certified by Finance Minister; Letter from Clerk to Cabinet confirming that PWD rationalization strategy as submitted by MFED was approved by Cabinet	
3. Sustainability of the fiscal buffer strengthened	3.1 The revised financial instructions under the Public Finance Act endorsed by Cabinet. (2014 baseline: Not applicable; no earlier revisions to Public Finance Act to strengthen CIF rules)	3.1 Finance Minister's order on the Revised Financial Instructions signed off by Secretary to Government; Copy of revised Financial Instructions; Letter from Clerk to Cabinet confirming that the revised Financial Instructions as submitted by MFED was endorsed by Cabinet	
Key Activities with Milestones			
Not applicable			
Inputs			
ADB: \$2,000,000 (grant)			
Assumptions for Partner Financing			
Outputs necessary to reach DMF Outcome, not administered by ADB, include:			
Government of Australia: \$1.1 million grant (by December 2015)			
Government of New Zealand: \$0.4 million grant (by December 2015)			
World Bank: \$1.5 million grant (approved March 2015, disbursed 16 June 2015)			

ADB = Asian Development Bank, CIF = Consolidated Investment Fund; CPU = central procurement unit; DMF = design and monitoring framework, MFED = Ministry of Finance and Economic Management, PERP = Public Enterprise and Reform Plan, PRM = policy reform matrix, PWD = Public Works Department, TTF = Tuvalu Trust Fund, VLH = Vaiaku Lagi Hotel.

^a Government of Tuvalu. *National Strategy for Sustainable Development, 2005–2015*. Funafuti.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://adb.org/Documents/RRPs/?id=47318-001-2>

1. Grant Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items



TUVALU GOVERNMENT
OFFICE OF THE MINISTER FOR FINANCE
AND ECONOMIC DEVELOPMENT
 PRIVATE MAIL BAG, VAIAKU, FUNAFUTI, TUVALU.
 Phone: (688) 20202 – Ext. 3068; Email: mtoafa@gov.tv

29 July 2015

Mr. Takehiko Nakao
 President
 Asian Development Bank
 6 ADB Avenue
 Mandaluyong, Metro Manila
 Philippines

Dear President Nakao,

Subject: Strengthened Fiscal Sustainability Program Grant to Tuvalu.

1. Tuvalu, a Pacific micro-state, is made up of a series of small, low-lying coral atoll and reef islands. It is isolated, vulnerable to adverse climatic events and economic shocks, and is lacking many of the resources needed for sustainable growth and poverty reduction. More than half of our population resides on the 2.8 square kilometers of the over-crowded capital city, Funafuti. Our small population, a lack of economies of scale due to remoteness, and the high cost of doing business limit the opportunities for socio-economic development. As one of the world's most environmentally vulnerable countries, Tuvalu is extremely vulnerable to sea level rise as a result of climate change.

2. Our current development strategy, Te Kakeega II 2005-2015, which will be reviewed this year, prioritizes our goals for all Tuvaluans, including—more employment opportunities, higher economic growth, better health care, better education, better basic infrastructure, and continued social stability. However, a key challenge we face is the reliance on highly volatile and unpredictable external revenues such as earnings from our main trust fund (Tuvalu Trust Fund, TTF), fishing license fees and commercial use of the "dot.tv" internet domain name, earnings from Tuvaluans working overseas, and development aid. The global financial crisis in 2008 had a devastating impact on Tuvalu and recovery has been steady but slow.

3. Since 2012, government has undertaken a comprehensive medium-term public financial management sector reform program, based on the Policy Reform Matrix (PRM), a set of time-bound reform actions achieved with budget and technical support from the Asian Development Bank (ADB), the governments of Australia and New Zealand, and the World Bank, targeting a sustainable fiscal framework including reform actions in six areas: public financial management, fiscal policy, public administration, public enterprise performance and rationalization, and health and education management. During 2014, the government implemented upgraded systems in the areas of financial management, procurement, fisheries revenue management and budgeting. Future public financial management reforms in 2015, including the reforms supported by ADB's program grant, will look to build on efficiency improvements to move towards better results for the people of Tuvalu, particularly the need to strengthen the quality of public expenditure, including completing ongoing public procurement reforms, improving management and maintenance of our fiscal buffer in the Consolidated Investment Fund buffer (CIF) for long-term macroeconomic stability and economic self-sufficiency, and improving the performance of public enterprises to enhance service delivery.

and reduce contingent liabilities on the budget. On the latter, the government has approved an outright sale for the Valaku Lagi Hotel and will support the rationalization strategy of the Public Works Department to promote private sector development.

4. The 2015 National Budget, guided by the Medium Term Fiscal Framework 2015–2017, represents a significant investment in the future of Tuvalu and its people. Expenditure will be targeted at the highest priority areas consistent with the Te Kakeega II, Government Roadmap, and the PRM, particularly in health and education, infrastructure and support to the outer islands. While total spending is projected to increase, the government continues to review all of its expenditures and shift spending to high priority areas, to ensure it is meeting key objectives, while at the same time maintaining fiscal constraint. On the revenue side, expanding Tuvalu's very narrow revenue base to ensure that we have a reliable source of revenue by which to fund ongoing government programs is an ongoing priority. Towards this, we recently undertook public financial management changes to the Government of Tuvalu's Financial Instructions, ensuring that the target CIF savings balance shall be a level which is equivalent to 16% of the maintained value of the TTF and regulated through a CIF Contributions and Savings Plan. Currently, the balance of the CIF exceeds the minimum balance requirement of A\$22.4 million. This balance provides a buffer to finance budget expenditure in future years, should the need arise. Additionally, government made a further a contribution of A\$3 to the TTF as an investment in our people.

5. However, in March 2015, we were hit by Tropical Cyclone Pam, which caused between A\$15–A\$20 million (over 30% of GDP) in damages and affected livelihoods, infrastructure, human health, biodiversity, and food security, and particularly impacted the outer islands. On 11 July 2015, the government endorsed the Tuvalu Recovery and Vulnerability Reduction Plan, which identifies our immediate, medium, and long-term priorities towards lasting and sustainable recovery. Building resilience and reducing vulnerabilities underpin the whole package of the recovery plan. The plan, approved by the Honorable Prime Minister Enele Sopoaga, has a total budget of A\$99.2 million, to which government has committed A\$1.3 million and development partners have pledged A\$3.1 million in addition to current commitments of A\$20.5 million. A financial gap of A\$74.3 million is needed by the Tuvalu government to support the plan. Towards this, we acknowledge the support ADB will provide through this program and through the proposed project for outer island ports, some of which were damaged by the cyclone.

Government of Tuvalu's Request

6. I therefore seek ADB's favorable consideration of a program grant of US\$2.0 million, which is to be disbursed in a single tranche in 2015 in line with the policy reform milestones contained in our PRM. ADB's policy actions were formulated from this matrix. These actions are:

1 *Public procurement practices strengthened.* The program will support the final phase of public procurement reforms begun in 2012, with the overall objective to strengthen regulatory requirements and improve incentives for competition, value for money, transparency, and accountability. The specific actions to be met are:

1.1 Procurement annual report for 2014 developed by the Central Procurement Unit and submitted to Cabinet. Report includes procurement tenders completed, number and value of contracts issued, staff training conducted, and 2015 work plan.

1.2 Government procurement website launched as a centralized resource for all procurement-related information, including information on the Procurement Act and regulations, bidding documents and contracts registry.

2 *Commercial basis for public enterprises and private sector development strengthened.* The specific actions to be met are:

2.1 Cabinet approval of the Public Enterprise and Reform Plan, which sets out strategies to improve the commercial and financial viability of public enterprises; highlight issues and challenges faced, and determine which public enterprises should be retained, absorbed or privatized.

2.2 Cabinet approval of the concession sale of the Vaiaku Lagi Hotel, land surveyed, and preparation of sale and tender documents.

2.3 Cabinet approval of the Public Works Department rationalization strategy to promote contracting out of capital works to the private sector

3. *Fiscal buffer sustained.* The program will support the adoption of a more rigorous set of public financial management rules for the CIF to improve its effectiveness as a fiscal buffer and transformed into a fiscal stabilization fund. The specific action to be met is:

3.1 The revised Financial Instructions under section 5 of the Public Finance Act approved by Cabinet. The revision strengthens financial rules to manage, replenish, and regulate the use of the CIF as a long-term fiscal buffer, ensuring that the target CIF savings balance will be a level, which is equivalent to 16% of the maintained value of the TTF and regulated through a CIF Contributions and Savings Plan.

7. The implementation of these reform actions will give direction to the future public sector financial management reforms. Support provided by ADB, and other partners to the PRM will help us to achieve fiscal stability while putting the economy on a higher and more inclusive growth path. I am confident that our strong ownership, supported by financial and technical assistance from ADB and the other development partners, will assist us to achieve these reform goals.

Yours sincerely,



Hon. Maatia Toafa
Minister for Finance and Economic Development

POLICY REFORM MATRIX PHASE 3

Reform Action	Conditions for Grant Release	Timeline	Development Partner
1. Public Financial Management			
Public procurement practices strengthened	Procurement annual report for 2014 developed by the CPU and approved by Cabinet. Report includes procurement tenders completed, number and value of contracts issued, staff training conducted, and 2015 work plan. <i>(Copy of CPU report certified by Finance Minister; Letter from Clerk to Cabinet confirming that CPU report was approved by Cabinet)</i>	By 31 July 2015 COMPLETED	ADB
	Government procurement website developed and launched as a centralized resource for all public procurement-related information, including information on the Public Procurement Act 2013 and regulations, bidding documents and contracts registry <i>(Letter from Finance Minister confirming his approval of the website; Copy of webpage certified by Finance Minister; MFED circular announcing the new website and its functions)</i>	By 31 July 2015 COMPLETED	ADB
2. PE performances and private sector development			
PERP developed to enhance their commercial orientation and financial viability	Cabinet approval of the PERP, which sets out strategies to improve the commercial and financial viability of public enterprises, highlight issues and challenges faced, and determine which PEs should be retained, absorbed or privatized <i>(Copy of PERP certified by Finance Minister; Letter from Clerk to Cabinet confirming that PERP as submitted by MFED was approved by Cabinet)</i>	By 31 July 2015 <i>(However, Cabinet approval occurred on 10 August 2015)</i> COMPLETED	ADB
Privatization of the VLH	Cabinet approval of the concession sale of the VLH, VLH land surveyed, and preparation of sale and tender documents <i>(Letter from Clerk to Cabinet confirming that the concession sale of the VLH was approved by Cabinet; Copy of VLH land survey certified by Department of Lands; Copy of sale and tender documents certified by Finance Minister)</i>	By 31 July 2015 COMPLETED	ADB
PWD rationalization strategy approved to promote contracting out of capital works to the private sector	Cabinet approval of the PWD rationalization strategy to promote contracting out of capital works to the private sector. <i>(Copy of PWD rationalization strategy certified by Finance Minister; Letter from Clerk to Cabinet confirming that PWD rationalization strategy as submitted by MFED was approved by Cabinet)</i>	By 31 July 2015 <i>(However, Cabinet approval occurred on 10 August 2015)</i> COMPLETED	ADB

Reform Action	Conditions for Grant Release	Timeline	Development Partner
Corporate governance review of NAFICOT and JVs with aims to improve its operations	Comprehensive review of NAFICOT undertaken with a view to restructure and strengthen management and operations including an independent review of the joint venture agreements and bring its operations under the Public Enterprises Act 2009. <i>(Audit report of NAFICOT and associated JVs tabled to parliament; Cabinet decision to implement key recommendations following independent review of NAFICOT and JVs)</i>	By 1 December 2015 IN PROGRESS	New Zealand
3. Fiscal Policy			
Sustainable fiscal buffer (CIF)	The revised Financial Instructions under the Public Finance Act endorsed by Cabinet. The revision strengthens financial rules to manage, replenish, and regulate the use of the Consolidated Investment Fund as a long-term fiscal buffer, ensuring that the target CIF savings balance will be a level, which is equivalent to 16% of the maintained value of the TTF and regulated through a CIF Contributions and Savings Plan. <i>(Finance Minister's order on the Revised Financial Instructions signed off by Secretary to Government; Copy of revised Financial Instructions; Letter from Clerk to Cabinet confirming that the revised Financial Instructions as submitted by MFED was endorsed by Cabinet)</i>	By 1 December 2014 COMPLETED	ADB, Australia, New Zealand, World Bank
Measures undertaken to strengthen medium term fiscal sustainability	Strengthened treasury commitment and expenditure control by introducing centralized commitment control procedures <i>(Commitment Control Paper approved by Cabinet and a demonstration of a functioning purchase order module within ACCPAC)</i>	By 31 March 2015 COMPLETED	World Bank
	Oversight of fisheries revenues strengthened through efficient record keeping and financial reconciliation between Fisheries and Treasury Departments <i>(Fisheries Department updates all backlog of financial records in TUFMAN; Subsequently, Fisheries & Treasury Departments reconcile 2013 fishing revenue records from TUFMAN and ACCPAC accounting applications)</i>	By 31 March 2015 COMPLETED	World Bank
	All financial records in the customs database updated and a full reconciliation of customs revenues with Treasury records concluded <i>(Ministry of Finance letter on the establishment of a Customs revenue database that is reconciled with Treasury 2014 records)</i>	By 1 December 2015 IN PROGRESS	Australia, New Zealand
4. Public Administration			
Improved governance of Outer Island local government (kaupule) financial accountability system	Outer Island kaupule accounts updated and audited and a streamlined financial reporting framework to reduce administrative burden on the kaupules and enabling better tracking of funds piloted	By 31 March 2015 COMPLETED	World Bank

Reform Action	Conditions for Grant Release	Timeline	Development Partner
	<i>(Audit Report of the Auditor General of Kaupule accounts for 2012, 2013 and 2014 completed; Pilot 2014 Kaupule accounts submitted to Auditor General for audit using the new streamlined financial reporting framework)</i>		
5. Health			
Efficiency and transparency of the TMTS increased to enable a greater focus on Primary and Preventative Health Care ¹	Tuvalu Medical Treatment Policy revised, patient referral process strengthened and 2014 annual report for TMTS developed and approved <i>(Revised TMTS policy instituting piloted cost saving measures and strengthening the patient referral process approved by Cabinet; 2014 Annual Report submitted to Cabinet and made public)</i>	By 1 December 2015 IN PROGRESS	Australia, New Zealand
6. Education			
Efficiency of the tertiary education scheme improved including increased spending on basic and vocational education and overseas employment opportunities increased	Government continues to improve the efficiency of the tertiary education scheme, enabling government to increase spending on basic and vocational education <i>(SELF Annual Report tabled in Parliament covering regulations and implementation of the SELF program including repayments)</i>	By 1 December 2015 IN PROGRESS	Australia, New Zealand
	Sufficient resources allocated to improve basic education <i>(TTFAC report verifies that government met its fiscal ratios of at least 5% increase in primary non-salary education expenditure in 2014)</i>	By 1 December 2015 IN PROGRESS	Australia, New Zealand
	Tuvalu Maritime Training Institute curriculum revised to improve employment opportunities and encourage female students <i>(Letter from Minister of Education or Cabinet Decision to broaden the curriculum of TMTI to (i) include training for fishing vessel crews, with specific date for first intake; (ii) open TMTI to female participation and (iii) consider training options for service staff for cruise ships)</i>	By 31 March 2015 COMPLETED	World Bank

ADB = Asian Development Bank; CIF = Consolidated Investment Fund; CPU = Central Procurement Unit; JV = Joint Venture (Fisheries); MFED = Ministry of Finance and Economic Development; NAFICOT = National Fisheries Authority of Tuvalu; PEs = public enterprises; PERP = Public Enterprise and Reform Plan; PWD = Public Works Department; SELF = Student Education Loan Fund; TMTS = Tuvalu Medical Treatment Scheme; TMTI = Tuvalu Maritime Training Institute; TTFAC = Tuvalu Trust Fund Accounts Committee; VLH = Vaiaku Lagi Hotel

¹ 5 percent increase in PPH per annum is an action from previous PRM phase 2 and it will be useful to sustain it to ensure that there are sufficient resources to finance PPH.

**POLICY REFORM MATRIX
2012–2015**

Priority Reform Areas	Phase I Jan–Oct 2012	Phase 2 Jan 2012–Jun 2013	Phase 3 Aug 2014–Dec 2015
1. Public Financial Management Technical assistance (TA) provided by Government of Australia, Government of New Zealand, ADB and Pacific Islands Technical Assistance Centre (PFTAC).	Budget Support Policy Actions		
	<p>Public Financial Management Reform Roadmap approved by Cabinet (ADB, AUS, NZL, WB) - COMPLETED</p> <p>Medium Term Fiscal Framework updated and maintained; Budget manual developed; Annual Budget Calendar prepared and published; The Ministry of Finance produces at least quarterly reports; Bank reconciliations are completed on a monthly basis; Public accounts are brought up to date and kept current; Quarterly meetings of the Macroeconomic Policy Committee held (AUS, NZL, WB) - COMPLETED</p> <p>Cabinet approval for Ministry of Finance and Economic Development to develop a Public Procurement Policy (ADB, AUS) - COMPLETED</p>	<p>Procurement Policy, Procurement Act and associated regulations developed and endorsed by Cabinet (AUS, NZL, WB) - COMPLETED</p> <p>Adherence to the Tuvalu Debt Risk Management and Mitigation Policy including quarterly debt schedule and arrears update (AUS, NZL) - COMPLETED</p>	<p>Procurement annual report for 2014 developed by the CPU and approved by Cabinet. Report includes procurement tenders completed, number and value of contracts issued, staff training conducted, and 2015 work plan. (ADB) - COMPLETED</p> <p>Government procurement website developed and launched as a centralized resource for all public procurement-related information, including information on the Procurement Act and regulations, bidding documents and contracts registry. (ADB) - COMPLETED</p>
2. Public Enterprise Performances and private sector development TA provided by Government of Australia and ADB.	<p>Community Service Obligations defined between Government and public enterprises with corresponding budget allocations made in National Budget - COMPLETED</p> <p>All public enterprises except National Fishing Authority of Tuvalu completed Audits and Annual Reports (including audited financial statement) and presented to Parliament (ADB) - COMPLETED</p> <p>Cabinet approved management contract for the Vaiaku Lagi Hotel and the establishment of a taskforce to prepare and finalize the management contract.</p>	<p>All public servants removed from Public Enterprise Boards (except as allowed under the Public Enterprises Act 2009) (AUS, NZL) - COMPLETED</p>	<p>Cabinet approval of the PERP, which sets out strategies to improve the commercial and financial viability of public enterprises, highlight issues and challenges faced, and determine which PEs should be retained, absorbed or privatized. (ADB) - COMPLETED</p> <p>Cabinet approval of the concession sale of the VLH, VLH land surveyed, and preparation of sale and tender documents. (ADB) - COMPLETED</p> <p>Cabinet approval of the PWD</p>

Priority Reform Areas	Phase I Jan–Oct 2012	Phase 2 Jan 2012–Jun 2013	Phase 3 Aug 2014–Dec 2015
	<p><i>(ADB)</i></p> <p>Cabinet approved the merger of the Tuvalu Philatelic Bureau, Tuvalu Post Office, and Tuvalu Travel Office. <i>(ADB) - COMPLETED</i></p>		<p>rationalization strategy to promote contracting out of capital works to the private sector <i>(ADB) - COMPLETED</i></p> <p>Corporate governance review of National Fishing Authority of Tuvalu and Joint Ventures with aims to improve its operations including an independent review of the joint venture agreements <i>(NZL)- IN PROGRESS</i></p>
<p>3. Fiscal Policy</p> <p>TA provided by Government of Australia, Government of New Zealand and ADB.</p>	<p>Revenue and Expenditure Review Committee established and reports to Cabinet on the protection of social services expenditure and achievement of savings <i>(AUS, NZL) - COMPLETED</i></p> <p>Fiscal Ratios approved by Cabinet (Domestic revenue to GDP; Recurrent expenditure to GDP; Wages and salaries to domestic revenue; Tuvalu Medical Treatment Scheme to domestic revenue; Tuvalu Overseas Scholarship Scheme to domestic revenue; Primary balance to GDP; and Net Present Value of public debt to GDP) <i>(ADB) - COMPLETED</i></p>	<p>Increased Tuvalu Consumption Tax (TCT) compliance to 75% of TCT registered entities including 100% of public enterprises <i>(AUS, NZL) - COMPLETED</i></p> <p>Tax audit training conducted and tax audits undertaken for at least two large taxpayers <i>(AUS, NZL, WB) - COMPLETED</i></p> <p>TCT rate increased to 7% in 2013 and 10% by 2016 (4% in 2012) <i>(AUS, NZL) - COMPLETED</i></p>	<p>The revised Financial Instructions under the Public Finance Act endorsed by Cabinet. The revision strengthens financial rules to manage, replenish, and regulate the use of the Consolidated Investment Fund as a long-term fiscal buffer, ensuring that the target CIF savings balance will be a level, which is equivalent to 16% of the maintained value of the TTF and regulated through a CIF Contributions and Savings Plan. <i>(ADB, AUS, NZL, WB) - COMPLETED</i></p> <p>Strengthened treasury commitment and expenditure control by introducing centralized commitment control procedures <i>(WB) - COMPLETED</i></p> <p>Oversight of fisheries revenues strengthened through efficient record keeping and financial reconciliation between Fisheries and Treasury Departments <i>(WB)- COMPLETED</i></p>

Priority Reform Areas	Phase I Jan–Oct 2012	Phase 2 Jan 2012–Jun 2013	Phase 3 Aug 2014–Dec 2015
			All financial records in the customs database updated and a full reconciliation of customs revenues with Treasury records concluded (AUS, NZL) – IN PROGRESS
4. Public Administration TA provided by Government of Australia.	Public Service Reform Committee established; staff appraisal process updated; national taskforce to review wage structure established (AUS) - COMPLETED		Outer Island kaupule (local government) accounts updated and audited and a streamlined financial reporting framework to reduce administrative burden on the kaupules and enabling better tracking of funds piloted (WB)- COMPLETED
5. Health TA provided by Government of Australia and Government of New Zealand.	Implementation of cost reduction measures for the Tuvalu Medical Treatment Scheme (TMTS) including accommodation and caretaker costs (AUS, NZL, WB) - COMPLETED	TMTS review undertaken based on analyses provided on the medical system such as the Medium Term Expenditure Framework for Health (AUS, NZL, WB) - COMPLETED Non-salary budget allocation increased on preventative health care on the 2012 outturn and 2013 budget by at least 5% as a step towards achieving the long-term milestone in line with the Tuvalu National Strategy for Sustainable Development 2005-2015 (Te Kakeega II) Medium Term Review (MTR) priorities (AUS, NZL) - COMPLETED	TMTS Policy revised, patient referral process strengthened and 2014 annual report for TMTS developed and approved (AUS, NZL)- IN PROGRESS
6. Education TA provided by Government of Australia and Government of New Zealand.	Ministry of Education, Youth and Sports and the Office of the Prime Minister to report to Parliament annually on the costs of implementing the scholarship programs and on adherence to the training policy (AUS, NZL, WB) - COMPLETED	Government's training and scholarship policy review undertaken informed by analyses provided on the education and training system such as the Medium Term	Government continues to improve the efficiency of the tertiary education scheme, enabling government to increase spending on basic and vocational education (AUS, NZL) – IN PROGRESS

Priority Reform Areas	Phase I Jan–Oct 2012	Phase 2 Jan 2012–Jun 2013	Phase 3 Aug 2014–Dec 2015
	<p>Government limits new scholarships awards for the 2013 intake at 30 or less (AUS, NZL) - COMPLETED</p> <p>Implementation of cost reduction measures for the in-service scholarships including accompanied allowances cancellation and tighter enforcement of extensions and variations (AUS, NZL, WB) - COMPLETED</p>	<p>Expenditure Framework for Education (AUS, NZL, WB) - COMPLETED</p> <p>Report on the savings made from the cost reduction measures for the in-service scholarships (Aust, NZ) - COMPLETED</p> <p>Non-salary budget allocation increased on primary education on the 2012 outturn and 2013 budget by at least 5% as a step towards achieving the long-term milestone in line with the Te Kakeega II MTR priorities (AUS, NZL) - COMPLETED</p>	<p>Sufficient resources allocated to improve basic education (AUS, NZL) – IN PROGRESS</p> <p>Tuvalu Maritime Training Institute curriculum revised to improve employment opportunities and encourage female students (WB) - COMPLETED</p>
TOTAL FINANCING	\$3.05 million	\$4.90 million	\$5.00 million

ADB = Asian Development Bank, AUS = Government of Australia, NZL = Government of New Zealand, WB = World Bank.