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Tuvalu: 2010 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Tuvalu

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Tuvalu, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on January 3, 2011, with the officials of Tuvalu on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 12, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 28, 2011 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Tuvalu.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

TUVALU

Staff Report for the 2010 Article IV Consultation[1]

Prepared by Staff Representatives for the 2010 Consultation with Tuvalu

Approved by Ray Brooks and Thomas Dorsey

January 12, 2011

Key Issues and Recommendations:

- ***Context:*** Tuvalu became the Fund's 187th member in June 2010. Despite its geographic remoteness, Tuvalu has not been immune to the global financial crisis. Economic activity has been dampened by lower offshore earnings. The government continued to increase spending to support the economy, which resulted in a sharp decline in the fund available for budget financing.

- ***Growth prospects:*** The economy is expected to have almost no growth in 2010, and growth is projected to be zero or even turn negative in 2011, led by lower government spending, and remain low over the medium term. The outlook is subject to risks related to a delay in fiscal adjustment and the pace of the global recovery.

- ***Focus:*** Discussions focused on the fiscal adjustments required to avoid looming problems and ensure fiscal sustainability over the longer term. The policy options are limited. The government needs to take immediate action to cut spending and increase tax compliance. It also should strengthen fiscal management by saving windfall revenue, using a medium-term budget framework, and improving budget reporting and analysis.

- ***External stability:*** The use of the Australian dollar as its currency is appropriate. Exports are minimal and the country depends highly on imports given almost no domestic production base except subsistence farming and fishing. Fiscal adjustment will be key to maintaining external stability.

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[1] Discussions took place in Funafuti and Suva during November 11– 23, 2010, with Prime Minister Maatia Toafa, Finance Minister Monise Laafai, Permanent Secretary of Finance Minute Taupo, other senior officials, representatives of the private sector, and donors. The team also contacted new Finance Minister Lotoala Metia to discuss fiscal policy after the new government was formed on December 24, 2010. The team comprised Mr. Jang (head), Ms. Bouza, Mr. Mohommad (all APD), Mr. Merrick, Ms. Pan (both World Bank), and Mr. Lototele (Asian Development Bank). Ms. Tira (OED) also participated in the meetings.

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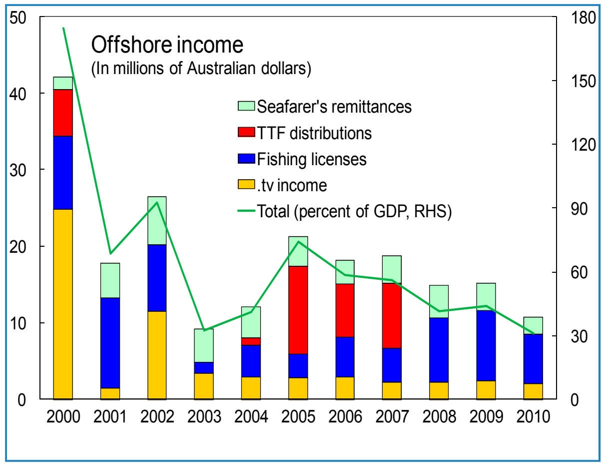
I. Introduction

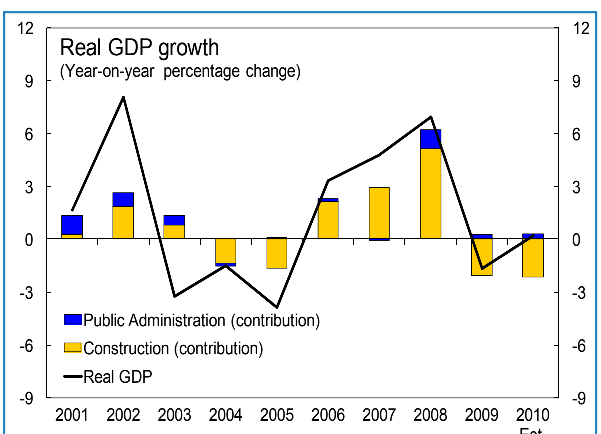
1. **Economic setting.** Economic performance has been volatile in recent years and largely determined by offshore earnings and government expenditure (Figure 1). The former comes from the Tuvalu Trust Fund (TTF) established in 1987 by donor countries; fees from fishing licenses and the country's ".tv" internet domain name lease; workers' remittances; and grants. Tuvalu has no central bank and the Australian dollar is the country's legal tender. Tuvalu has made commendable strides in meeting the basic needs of its population, with access to basic health services and formal education almost universal. Climate change looms as a major challenge in light of rising sea levels.



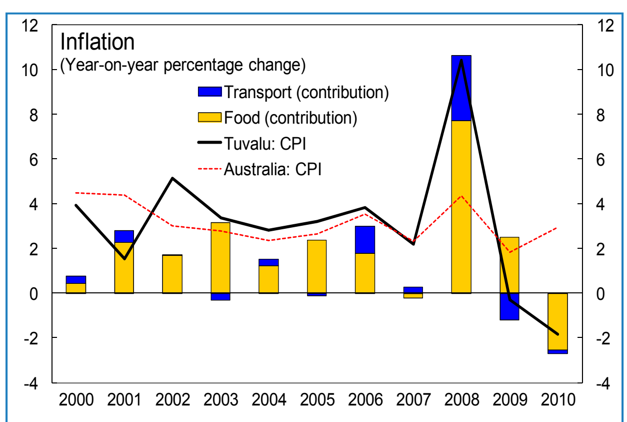
2. **Politics.** A new government was formed in late December after the previous government formed in late September 2010 was brought down through a motion of no confidence by eight votes to seven. There are no organized political parties in Tuvalu. The government is preparing the 2011 budget, which is expected to be discussed in Parliament in March.

II. Recent Developments

3. **Growth and inflation**. Despite its geographic remoteness, Tuvalu has not been immune to the global financial crisis. Even with higher government spending, staff estimates zero growth in GDP in 2010, after the economy contracted by about 2 percent in 2009 (Table 1 and Figure 2). Major construction projects to build a wharf and a power station have been completed, and seafarer employment—Tuvalu's main foreign exchange earning source



Source: Tuvalu authorities and IMF staff calculations.



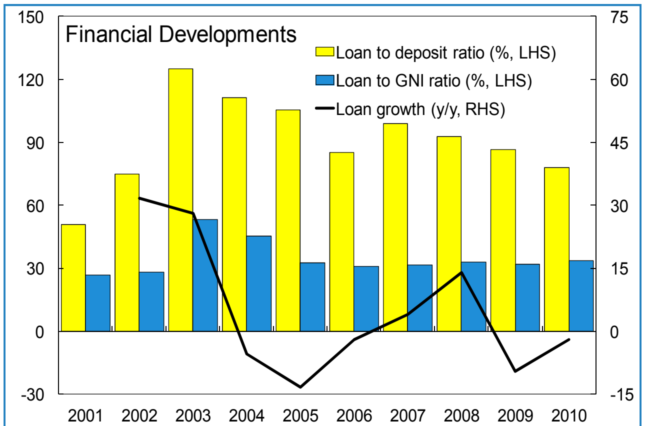
Source: Tuvalu authorities and IMF staff calculations.

for the private sector—is weak. Moreover, the Tuvalu Cooperative Society (the main wholesaler and retailer in Tuvalu) is facing difficult financial conditions so the government extended debt guarantees equivalent to 1½ percent of GDP. Annual inflation has been negative since mid-2009 (-1¾ percent in November 2010) due to lower global food prices and the strong Australian dollar.

4. **Fiscal performance.** In response to the global crisis, the government continued to support the economy by increasing spending. Parliament passed three supplementary appropriation bills in 2010, totaling about 10 percent of GDP to pay government-guaranteed debt for an airline company and increase capital spending. The fiscal deficit is estimated to increase sharply from 4 percent of GDP in 2009 to almost 30 percent of GDP in 2010 owing to weak domestic revenue and offshore income and increased spending (Table 2). As a result, the fund available for budget financing has declined rapidly to about 20 percent of GDP from 45 percent in 2009.

5. **Public debt.** Tuvalu's public debt has declined in the last two years, but remains high by regional standards at about 44 percent of GDP. The Asian Development Bank (ADB) provided grants to clear part of domestic debt and part of the EIB loan was converted to a grant in 2009. External public debt is at over 30 percent of GDP, but mostly on concessional terms, resulting in low debt servicing obligations. The government might have an additional external debt of US$10 million (about 30 percent of GDP) relating to joint ventures with foreign fishing companies.

6. **Financial sector.** The financial sector is underdeveloped and lending constrained, following rapid credit growth in the early 2000s (Table 3). Nonperforming loans are high at around 40 percent of total loans. The banking sector consists of the National Bank of Tuvalu (NBT) and one development bank, both of which are government owned.[2] The Tuvalu National Provident Fund (TNPF) also provides its members with loans, for which each member's account is used as collateral.[3] Interest



1/ Through September.
Sources: NBT, DBT and IMF staff calculations.

[2] The NBT performs some monetary functions, including the holding of government accounts and foreign assets.

[3] The TNPF has about 6,800 members, more than half of the total population, and its total assets amounted to 97 percent of GDP ($A34 million) at end-2009. The TNPF's total loans to its members were about 20 percent of its total assets at end-2009 and the remaining assets were invested abroad. Starting September 2009, all employees are required to contribute 13 percent of their salaries, including for the new medical and educational saving scheme, and employers contribute 10 percent of employees' salaries.

rates on lending have changed little in recent years, reflecting limited competition in the financial system.

7. **External position.** Staff estimates a current account deficit of almost 25 percent of GDP in 2010 due to low income and grants (Table 4). Tuvalu exports little and depends heavily on imports. Gross official reserves, including the SDR allocation, have declined substantially in 2010, but still remain high at about eight months of imports of goods and services.

8. **Public enterprises.** Most public enterprises are financially weak.[4] Only the NBT remains profitable, while three public enterprises have not been profitable in the last several years. The total debt of the sector, excluding the two banks, rose from 19 percent of GDP in 2004 to 42 percent in 2007, part of which is guaranteed by the government. Very low tariff structures, government arrears, and structural inefficiencies are the major impediments to sound balance sheets. Furthermore, limited availability of experienced managers and Board structures chaired by civil servants have reduced the prospects for public enterprises to operate on a sound commercial footing.

III. Outlook and Risks

9. **Outlook**. The growth outlook remains clouded. The weak global recovery would not increase remittances and investment income substantially. Given the difficult fiscal situation, government spending needs to be cut and no big construction projects are in the pipeline. Moreover, private sector credit is constrained due to high nonperforming loans. Thus, growth is projected to be zero or even turn negative in 2011 and remain low at below 2 percent over the medium term (Table 5). Given projected global food and fuel prices, inflation is expected to remain low over the medium term. The current account is projected to improve in line with fiscal tightening and higher investment income.

Tuvalu: Medium-term Scenario, 2008-2015

	2008	2009	2010	2011	2012	2013	2014	2015
	(Annual percent change)							
Output and prices								
Real GDP	7.0	-1.7	0.2	0.0	0.6	1.1	1.6	1.7
Consumer prices (period average)	10.5	-0.3	-1.9	1.2	1.6	2.0	2.2	2.2
	(In percent of GDP)							
Public finance								
Total revenue and grants	77.4	89.8	69.0	71.9	69.2	69.4	69.6	69.7
Total expenditure	82.7	93.5	97.7	82.8	81.7	81.0	80.8	80.6
Overall balance	-5.3	-3.7	-28.7	-10.9	-12.6	-11.6	-11.2	-10.9
Balance of payments								
Current account balance (incl. grants)	-10.2	-5.2	-24.1	6.3	-3.4	1.0	3.3	5.1
Current account balance (excl. grants)	-50.6	-49.3	-54.9	-37.6	-33.2	-28.0	-24.7	-22.0

[4] These are the Development Bank of Tuvalu, Tuvalu Electricity Corporation, Tuvalu Telecommunications Corporation, National Fishing Company of Tuvalu, Vaiaku Lagi Hotel, Philatelic Bureau, and Tuvalu Marine Training Institute.

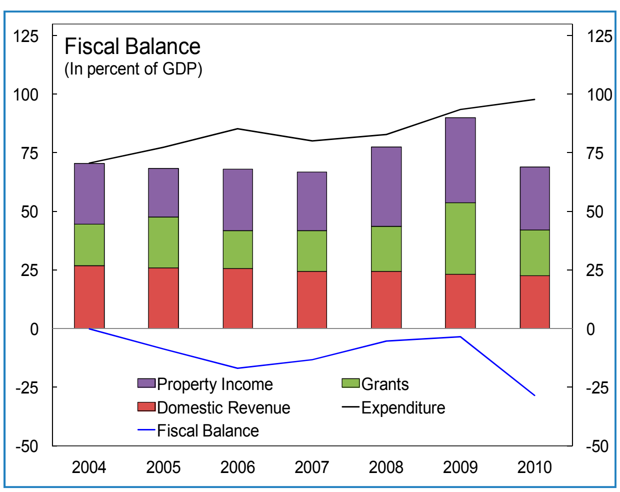
10. **Risks.** On the domestic front, the fund available for budget financing could be depleted in 2011 without fiscal adjustment, which may force a big, sudden cut in government spending and a sharp decline in growth. On the external front, the main risk is that a weaker external environment would spill into Tuvalu through investment income and remittances channels. Moreover, Tuvalu is vulnerable to natural disasters and climate change will be a major challenge in light of rising sea levels.[5]

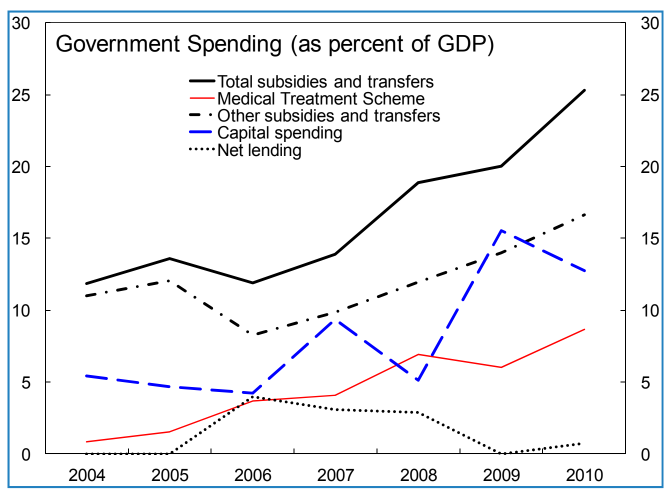
11. **Authorities' views.** The authorities shared the mission's assessment of the economy and growth prospects. They indicated that they are aware of the difficult fiscal situation, which was presented to community leaders at a conference on the Millennium Development Goals in November 2010.

IV. Policy Discussions

A. Fiscal Policy

12. **Developments.** The large spending increases in the last few years have resulted in a sharp increase in the fiscal deficit in 2010, as offshore revenue and grants fell to earlier levels. The large deficit has led to a rapid decline in the fund (CIF) available for budget financing. Total spending relative to GDP has increased by 20 percentage points since 2005, mainly due to sharp increases in subsidies, transfers and capital spending. Subsidies and transfers to households and public enterprises have risen to 25 percent of GDP in 2010, an increase of more than 10 percentage points of GDP over the last three years.



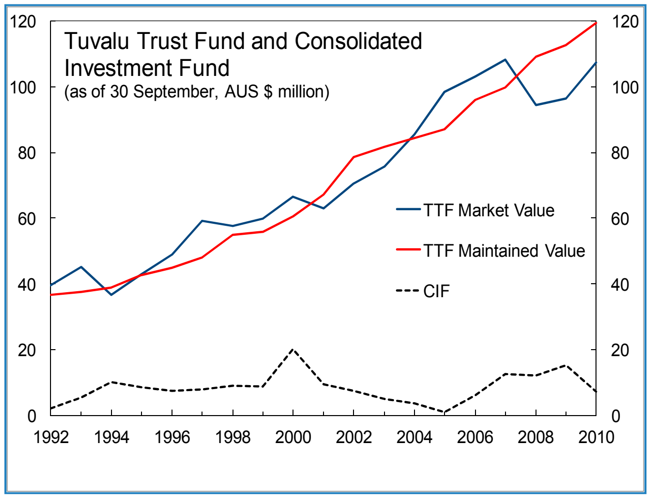


[5] Tuvalu is rated as extremely vulnerable on the region's Environmental Vulnerability Index (EVI), developed by the South Pacific Applied GeoScience Commission and the United Nations Environment Program.

13. **2011 Budget.** Staff advised the government to take immediate action to cut the current high level of spending, which is unsustainable. At the current pace of spending and assuming delays in receiving grants from the ADB and European Commission (EC), the CIF will be depleted in mid-2011 and a cumulative financing gap of about 40 percent of GDP will arise in 2011–12 since no distributions from the TTF to the CIF are likely in the next few years (text table).[6] Thus, the mission proposed that the 2011 budget deficit be contained to about 11 percent of GDP, mainly through a cut in capital spending, which jumped sharply in recent years because of fiscal stimulus in response to the global downturn. Moreover, the government should aim to bring down other spending by freezing wages, reducing travel costs, and cutting transfers and subsidies, in particular to the medical treatment scheme on which the government has failed to control spending. As the recent PFTAC TA mission recommended, the government also needs to take immediate action to increase tax compliance, particularly for the consumption tax, which was introduced in mid-2009 as part of the tax reforms. Many taxpayers did not submit returns for the consumption tax since they are unfamiliar with this tax.

Medium-Term Fiscal Outlook: No Adjustment Scenario
(In percent of GDP)

	2009	2010	2011	2012
Total revenue and grants	89.8	69.0	70.5	67.6
Current revenue	59.4	49.3	52.7	53.7
Taxes	16.1	15.3	15.3	15.3
Nontax	43.3	34.0	37.4	38.4
Grants	30.4	19.7	17.8	13.9
Total expenditure	93.5	97.7	97.7	97.7
Current expenditure	78.0	84.3	84.3	84.3
Capital expenditure and net lending	15.5	13.5	13.5	13.5
Overall balance	-3.7	-28.7	-27.3	-30.1
TTF distribution to CIF	0.0	0.0	0.0	0.0
CIF balance	45.0	20.7	0.0	0.0
SDR holdings	0.0	5.5	0.0	0.0
Financing gap	…	…	8.2	32.0



14. **Longer-term adjustments.** Staff stressed that further adjustments would be required over the medium term to ensure fiscal sustainability. The government has not tapped the TTF since its inception in 1987, which is key to fiscal discipline and maintaining the real value of the TTF over the long term to provide an ongoing source of financing. Tax administration needs to be strengthened to increase domestic revenue to earlier levels. The government also should aim to bring down total spending further to more sustainable levels (about the 2005–

[6] In years when the market value of the TTF exceeds its targeted value (which is linked to the Australian CPI), the surplus is distributed into the Consolidated Investment Fund (CIF) and is available for budgetary spending. As of September 2010, the TTF's market value was $A107 million compared with the targeted value of $A119 million. Since 2008, the TTF's market value has been below its targeted value.

08 level) and come up with a longer-term plan to rebuild the CIF to its targeted balance (16 percent of the TTF's maintained value). Implementing sound fiscal policy would also be necessary to build fiscal space to respond to natural disasters and the impact of climate change.

Medium-Term Fiscal Outlook: Adjustment Scenario
(In percent of GDP)

	2005-08 average	2009	2010	2011	2012	2013	2014	2015
Total revenue and grants	70.1	89.8	69.0	71.9	69.2	69.4	69.6	69.7
Current revenue	51.5	59.4	49.3	54.2	55.3	55.9	56.6	57.2
Taxes	17.9	16.1	15.3	16.8	16.9	17.0	17.3	17.4
Nontax	33.6	43.3	34.0	37.4	38.4	38.9	39.3	39.8
Grants	18.6	30.4	19.7	17.8	13.9	13.5	13.0	12.5
Total expenditure	81.3	93.5	97.7	82.8	81.7	81.0	80.8	80.6
Current expenditure	73.0	78.0	84.3	79.6	78.6	77.4	76.3	75.3
Wages	31.3	31.2	32.0	32.5	32.5	32.5	32.5	32.5
Goods and services	22.1	22.1	21.5	19.2	19.2	19.2	19.2	19.2
Subsidies and transfers	14.6	20.0	25.3	22.9	21.9	20.9	19.9	18.9
Capital expenditure and net lending	5.8	15.5	13.5	3.2	3.1	3.6	4.5	5.3
Overall balance	-11.2	-3.7	-28.7	-10.9	-12.6	-11.6	-11.2	-10.9
Total available funds (end of period)	24.5	45.0	26.2	19.9	5.1	9.8	15.2	20.6
CIF balance	24.5	45.0	20.7	14.5	0.0	4.1	8.8	14.1
SDR allocation	0	0	5.5	5.5	5.1	5.8	6.3	6.4
TTF distribution to CIF	21.9	0	0	0	0	18.3	18.6	18.4
EC grant	3.1	0	0	6.1	0	0	0	0
ADB grant	0	4.3	0	5.7	0	0	0	0

15. **Risks.** Staff noted that a weaker global recovery would require additional fiscal adjustments. The proposed medium-term adjustment scenario assumes that the TTF's market value would increase by an annual real growth rate of 5½ percent, which is somewhat below the average real rate of return of 6¼ percent over the last decade. About 60 percent of the TTF are invested in growth assets, including equities, and the remainder in fixed income instruments and others.[7] A weaker global recovery would increase risks that return could be lower than the assumed 5½ percent. For example, at an annual real rate of return of 3½ percent, the assumed adjustment scenario would result in a financing gap of about 11 percent of GDP ($A4½ million) during 2013–15, which would require additional adjustments without donor assistance. Thus staff urged the authorities to save windfall revenue and grants to be prepared for these risks.

Risks to the Assumed Adjustment Scenario

TTF real rate of return (In percent)	Financing gap in 2013-15 (In percent of GDP)
4.25	0.0
4.0	3.4
3.5	11.4
3.0	19.5

[7] The International Agreement on the TTF has provided a system of governance that includes a Board, an investment committee, and an advisory committee in which donor representatives are participating. Moreover, the fund is managed by professional fund managers currently based in Australia, and monitoring of fund performance is carried out by another consulting firm.

16. **Public financial management.** Staff advised that fiscal management be strengthened urgently. In the absence of its own currency and monetary policy, sound fiscal policy is key to maintaining macroeconomic stability. However, fiscal management has not been prudent in recent years, as windfall revenue from the TTF and fishing licenses has tended to be immediately spent on major public construction projects and subsidies and transfers. The mission recommended saving windfall revenue, given the volatility of key revenue items, and using a medium-term budget framework to highlight the longer-term impact of the current fiscal stance and new spending initiatives. Moreover, the authorities need to improve budget reporting and monitoring and strengthen economic and policy analysis capacity. Staff also advised that the US$10 million debt (about 30 percent of GDP) relating to joint ventures with foreign fishing companies be clarified soon and that the process of providing government guarantees be strengthened.

17. **Relations with public enterprises.** Staff noted that the government needs to regularize its financial relations with public enterprises. The government has substantial amounts of arrears to public enterprises, including utility bills amounting to almost 1 percent of GDP, and public enterprises have not paid their taxes on time. The mission urged the government and public enterprises to resolve these problems soon and honor their financial obligations to each other.

18. **Authorities' views.** The authorities agreed on the need for fiscal consolidation and stated that the new government will soon establish a Revenue and Expenditure Review Committee to be chaired by the Minister of Finance to consider possible avenues to widen the revenue base and to cut high levels of spending, including on the medical treatment scheme. They indicated that they would consider the mission's proposed fiscal adjustment scenario and that the 2011 budget would be only the first step in the required adjustments. However, they emphasized the importance of donor assistance to help them steer through the difficult path ahead and asked for technical assistance on tax audit. On climate change, the authorities felt that donors have made many pledges of financial and technical support, but have not delivered them. On the US$10 million debt related to joint ventures with foreign fishing companies, the authorities believe that no government guarantee was extended to this debt, but they will check all the related documents and inform staff accordingly.

B. Financial Sector

19. **Lending standards.** Banks have taken measures to address high nonperforming loans. The NBT remains profitable, mainly due to high foreign exchange income, but the Development Bank continues to incur losses. Starting in early 2010, the two banks and the Provident Fund started sharing borrowers' information and tightening their lending standards, including lowering the maximum debt service to income ratio from 50 to 40 percent for all personal loans, which the mission supported. Staff also encouraged the banks to make further efforts to recover nonperforming loans. Banks' interest rates should be market determined so

the mission urged the government to withdraw the direction to lower NBT lending rates by 1 percentage point.

20. **Bank supervision.** The mission welcomed passage of a Banking Act in August 2010. Amendments to the Act have been submitted to Parliament in December to be fully in line with the Basel Core Principles, including enhancement of the Bank Commissioner's independence.[8] However, no progress has been made yet in putting in place supervisory and prudential requirements such as minimum capital and loan loss provisioning. Continued progress in strengthening the banking sector and credit culture is critical for sustained growth in the private sector.

21. **Authorities' views.** The authorities noted that, given their lack of experience in bank supervision and regulation, it would take time to implement the new Act and they need technical assistance. Moreover, they need to develop a proper framework for appointing the Bank Commissioner, whose job would be only part time given the size of the banking sector in Tuvalu. They would check whether the previous government indeed directed the NBT to lower lending rates as claimed and rescind the direction if it was in fact given.

C. Structural Reform

22. **Public enterprise reform.** The mission supported the comprehensive public enterprise reform program underway with ADB assistance to improve the performance and profitability of public enterprises. A Public Enterprise (Performance and Accountability) Act was passed in 2010, and a Public Enterprise Reform Monitoring Unit (PERMU) responsible for public enterprise compliance with the Act was established. Moreover, the government is now required to compensate public enterprises for non-profitable services—community service obligations (CSOs)—which they are directed by the government to provide. Several public enterprises as well as business activities undertaken by line ministries are being considered for mergers, private sector participation, and possible corporatization. The ongoing reforms could reduce burdens on the budget down the road and help attract foreign direct investment.

23. **Job creation.** Staff noted that education and vocational training need to be strengthened to enable Tuvaluans to take advantage of overseas job opportunities. Given Tuvalu's limited land area, poor soil, and geographic isolation, it is difficult to create large private-sector employment opportunities domestically. Thus the mission encouraged the authorities to help Tuvaluans to better utilize the temporary labor migration scheme available in New Zealand and to explore opportunities to participate in a similar Australian scheme. Moreover, demand for Tuvaluan seafarers on the international maritime employment market

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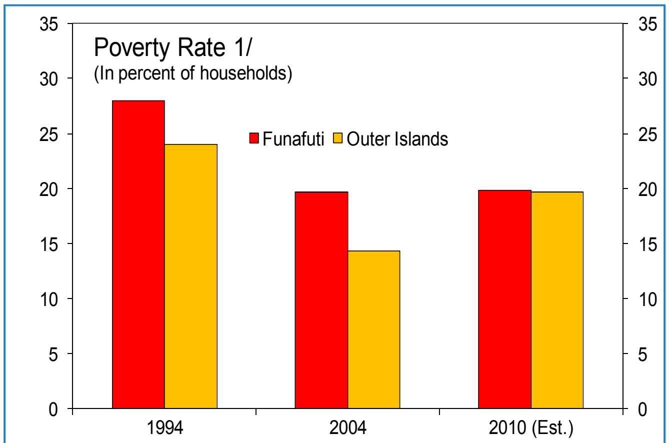
[8] This measure is one of the conditions for the ADB's second tranche grant disbursement to which EC grants are linked.

is declining, due to more competition from other countries.[9] According to studies by the World Bank and other donors, adequate training needs to be provided for seafarers and temporary seasonal workers to maintain these job opportunities for Tuvaluans.

24. **Poverty** has risen in the last few years. Although extreme poverty is rare in Tuvalu because of traditional social support networks and subsistence agriculture and fishing, the 2010 household income and expenditure survey indicates that the population living in poverty, particularly in outer islands, has increased sharply to about 20 percent of households from 14 percent in 2004. Given limited job opportunities, people in outer islands are facing greater hardship than in the capital city, as a result of the declining number of seafarers employed. This development indicates the importance of improving the quality of education and vocational training to reduce poverty in Tuvalu.



Source: Tuvalu Trust Fund Advisory Committee.
1/ Poverty line based on basic needs.

25. **Authorities' views.** The authorities stated that the new government is committed to enforcing and implementing the ongoing public enterprise reform. They noted that to address poverty issues and enhance the competitiveness of Tuvaluans for job opportunities internationally, the government is focusing more on strengthening vocational training. The project to upgrade the Tuvalu Maritime Training Institute (TMTI) had been badly managed. Repairs to the TMTI facilities are underway, but the authorities stated that they need donors' financial and technical support.

D. Other

26. **External stability**. Staff noted that the use of the Australian dollar as its currency is appropriate given the size of the economy and limited capacity for independent monetary and exchange rate policies. The real effective exchange rate has appreciated by 8 percent over the last year. However, exports are minimal at about 1–2 percent of GDP and the country depends highly on imports given almost no domestic production base except subsistence farming and fishing. The country's geographic remoteness and limited air services also constrain tourism with just over 300 visitors each year.[10] The current account deficit

[9] Remittances from the seafarers are now only 6 percent of GDP, a sharp decline from about 10 percent of GDP in recent years.

[10] There is presently air service only from Suva, Fiji to Funafuti with a 40-seat plane twice a week

(excluding grants) is very high but is projected to decline with fiscal adjustment, which is key to maintaining external stability.

27. **Article XIV/VIII**. At the time of joining the Fund, Tuvalu availed itself of the transitory provisions of Article XIV, Section 2. While the exchange control regulations are quite restrictive and prescribe approval requirements from the NBT or the Finance Minister for most payments or transfers, in practice, no approval is required and payments and transfers for current international transactions are administered liberally.[11] Staff recommended that the regulations be updated in line with current practice so that Tuvalu can accept the obligations of Article VIII, Sections 2, 3 and 4.

28. **Statistics**. Staff stressed that data shortcomings, particularly in the national accounts and balance of payments, hamper surveillance. The mission urged the authorities to provide more staff to the Statistics Division to start compiling the data necessary for surveillance and their own policy analysis and formulation. Moreover, attention needs to be paid to improving source data for macroeconomic statistics. Many of the underlying data have inconsistencies and errors, resulting in poor quality of the national accounts and balance of payments statistics.

29. **Authorities' views**. The authorities indicated that they will request TA from PFTAC to update or repeal the exchange control regulations and improve statistics. They are looking for additional staff for the Statistics Division but it is not easy to find good candidates. Continued training of their staff by PFTAC would also be critical.

V. Staff Appraisal

30. **Despite its geographic remoteness, Tuvalu has not been immune to the global financial crisis.** Even with higher government spending, the economy is expected to have almost no growth in 2010 owing to lower offshore earnings. Growth is projected to be zero or even turn negative in 2011, led by lower government spending, and remain low over the medium term. Given projected global food and fuel prices, inflation is expected to remain low. The outlook is subject to risks related to a delay in fiscal adjustment and the pace of the global recovery.

31. **The government needs to take immediate action to cut spending.** In response to the global crisis, the government continued to increase spending to support the economy, resulting in a large increase in the fiscal deficit and a rapid decline in the fund (CIF) available for budget financing in 2010. At the current pace of spending, the CIF will be depleted in mid-2011. A front-loaded adjustment would be needed and the 2011 budget deficit should be

[11] Staff is currently conducting a comprehensive review of the exchange system to assess jurisdictional implications.

contained to about 11 percent of GDP, mainly through a cut in capital spending, which jumped sharply in recent years. The government also should bring down other spending by freezing wages, reducing travel costs, and cutting social transfers and subsidies, particularly the unsustainable medical treatment scheme.

32. **Further adjustments would be required over the medium term to ensure fiscal sustainability.** Tax administration needs to be strengthened to increase domestic revenue to earlier levels, and government spending needs to be contained further. A weaker global recovery would require additional fiscal adjustments without donor assistance. The government should come up with a longer-term plan to rebuild the CIF to its targeted balance. Implementing sound fiscal policy would also be necessary to build fiscal space to respond to natural disasters and the impact of climate change.

33. **Fiscal management should be strengthened urgently.** In the absence of its own currency and monetary policy, sound fiscal policy is key to maintaining macroeconomic stability. However, fiscal management has not been prudent in recent years, as windfall revenue has tended to be immediately spent. Windfall revenue needs to be saved, given the volatility of key revenue items, and a medium-term budget framework should be used to highlight the longer-term impact of the current fiscal stance and new spending initiatives. Moreover, budget reporting and monitoring need to be improved and economic and policy analysis capacity should be strengthened. The process of providing government guarantees also should be strengthened.

34. **Public enterprise reform should press ahead.** Very low tariff structures, government arrears, and structural inefficiencies are the major impediments to sound balance sheets. Passage of a Public Enterprise Act and related reforms underway with ADB assistance are welcome. Several public enterprises are being considered for mergers, private sector participation, and possible corporatization. The government and public enterprises also need to regularize their relations by honoring their financial obligations to each other.

35. **Continued progress in strengthening the banking sector and credit culture is critical for sustained growth in the private sector.** Banks have started addressing high nonperforming loans by sharing borrowers' information and tightening lending standards. But further efforts would be needed to recover bad loans. Passage of a Banking Act is welcome, but no progress has been made yet in putting in place supervisory and prudential requirements.

36. **The use of the Australian dollar as its currency is appropriate given the size of the economy and limited capacity for independent monetary and exchange rate policies.** Exports are minimal and the country depends highly on imports given almost no domestic production base except subsistence farming and fishing. Fiscal adjustment will be key to maintaining external stability.

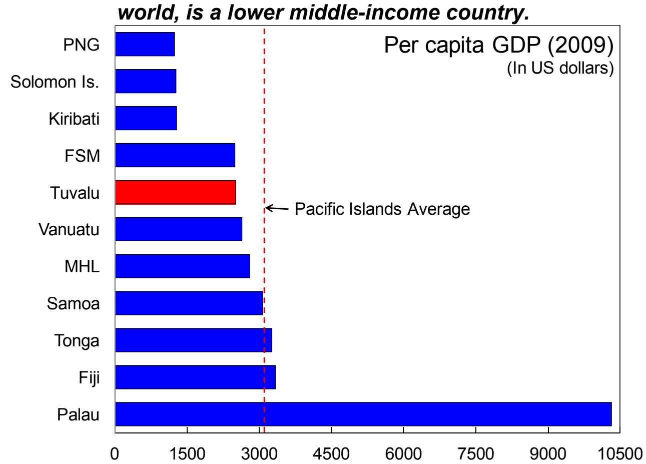
37. **Education and vocational training need to be strengthened.** Given Tuvalu's limited land area, poor soil, and geographic isolation, it is difficult to create large private-sector employment opportunities domestically. Thus, Tuvaluans need to better utilize overseas job opportunities, including seafarer employment and the temporary labor migration scheme in New Zealand. Education and vocational training need to be strengthened to enhance the competitiveness of Tuvaluans for these important sources of foreign exchange earnings and to reduce poverty, which has risen in the last few years.

38. **Data shortcomings, particularly in the national accounts and balance of payments, hamper surveillance.** More staff needs to be provided to start compiling the data necessary for surveillance and the authorities' own policy analysis and formulation.

39. **Staff recommends that the next Article IV consultation take place on a 24-month cycle.**

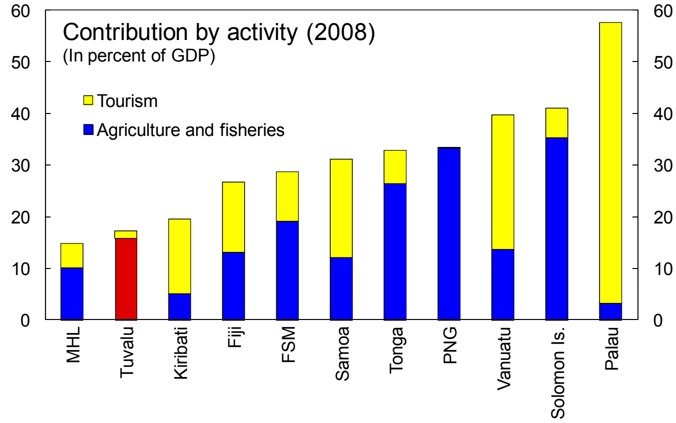
Figure 1. Tuvalu: Basic Economic and Institutional Features 1/

Tuvalu, one of the smallest and most remote countries in the world, is a lower middle-income country.



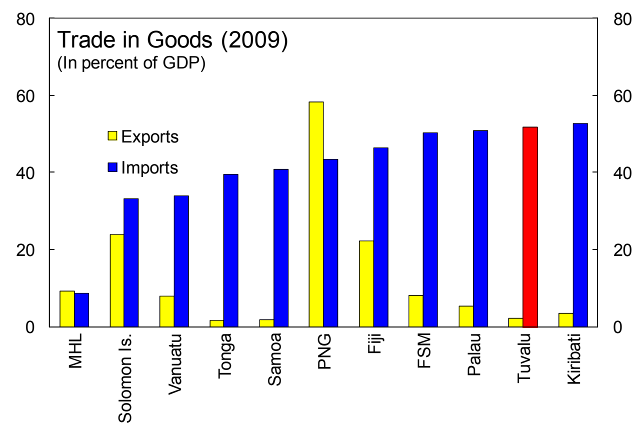
Sources: APDLISC, Tuvalu authorities and IMF staff estimates.

Subsistence agriculture and fishing are core activities, with tourism less important than elsewhere in the region.



Sources: WB WDI, APDLISC, Tuvalu authorities and IMF staff estimates.

Exports are negligible, while import dependency is high…



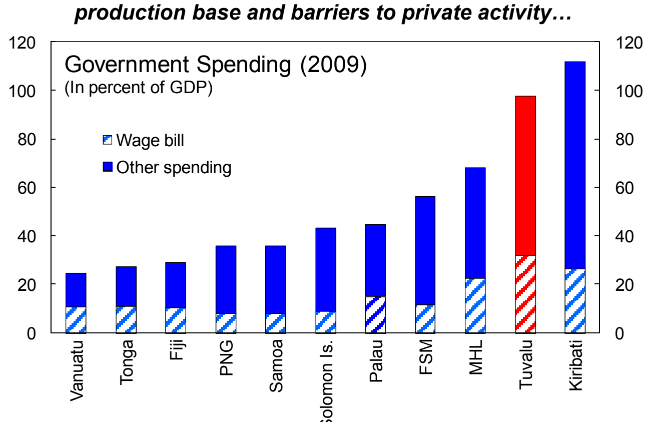
Sources: Tuvalu authorities, International Trade Center, and IMF staff estimates.

… as is reliance on offshore income—notably remittances, fishing licenses and ODA.

	Remittances	Fishing Licenses	ODA per capita
	Lest year available		2008
	(In percent of GDP)		(U.S. dollars)
Micronesia	16.9	5.9	871
Palau	4.4	0.5	2,089
Marshall Is.	1.5	1.3	976
Kiribati	8.0	16.7	266
Fiji	3.5	0.0	51
Tonga	25.6	0.0	256
Samoa	23.2	0.0	217
Papua New Guinea	16.2	0.2	48
Vanuatu	1.1	0.2	381
Solomon Is.	3.2	2.0	433
Tuvalu	**6.4**	**18.7**	**1,498**

Sources: WB, ADB, UNDP, APDLISC and IMF staff estimates.

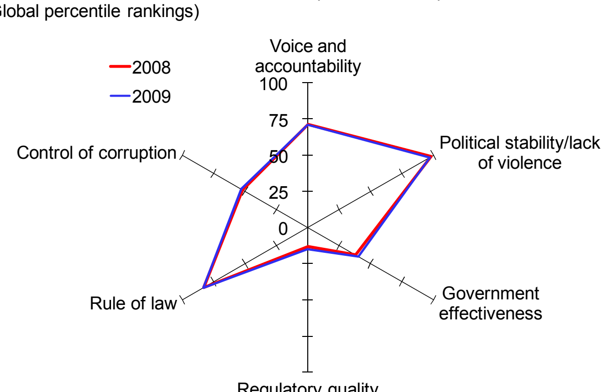
The public sector dominates the economy due to the narrow production base and barriers to private activity…



Sources: APDLISC, Tuvalu authorities and IMF staff estimates.

…and while Tuvalu overperforms on some governance indicators, government effectiveness and regulation are weak.

Tuvalu: Governance Indicators (2008-2009)
(Global percentile rankings)



Source: World Bank.

1/ Data for Tuvalu are for 2010.

Figure 2. Tuvalu: Recent Economic Developments in the Regional Context

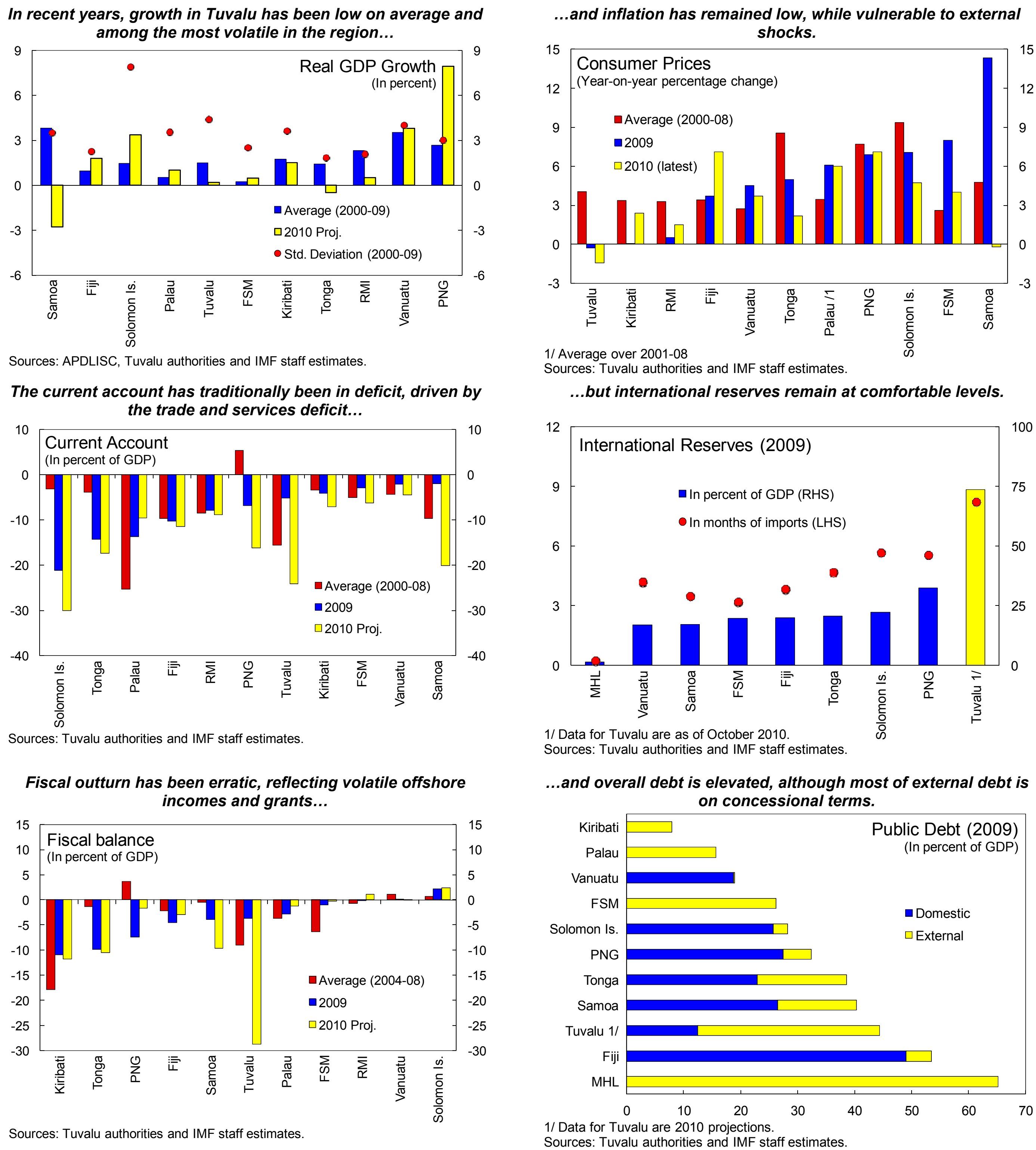


Table 1. Tuvalu: Selected Social and Economic Indicators, 2006–2011

I. Social and Demographic Indicators

GDP (2009):		Poverty rate (2010)	24.8
U.S. dollars (millions)	27.1	Life expectancy at birth (years, 2008)	64.0
Per capita	2,447	Total fertility rate (births per woman, 2008)	3.2
		Infant mortality rate (per 1,000 live births, 200	30
Population:		Births attended by skilled personnel (percent,	98
Total (thousands, 2009)	11.1	Adult literacy rate (2002)	99.0
Urban population (percent of total, 2008)	49.0	Unemployment rate (2004)	16.3

II. Economic Indicators 1/

	2006	2007	2008	2009	2010 Est.	2011 Proj.
			(Percent change)			
Real sector						
Real GDP growth	3.3	4.8	7.0	-1.7	0.2	0.0
Consumer prices (period average)	3.8	2.2	10.5	-0.3	-1.9	1.2
			(In percent of total)			
Structure of economy						
Agriculture	21.2	21.7	21.2	22.4	23.5	…
Manufacturing and construction	7.4	9.0	12.9	11.6	9.7	…
Services	71.4	69.3	65.9	66.0	66.8	…
			(In percent of GDP)			
Government finance 2/						
Revenue and grants	68.1	66.7	77.4	89.8	69.0	71.9
Current Revenue	51.7	49.4	58.2	59.4	49.3	54.2
Grants	16.4	17.4	19.2	30.4	19.7	17.8
Expenditure and net lending	85.2	80.1	82.7	93.5	97.7	82.8
Current expenditure	77.0	67.7	74.7	78.0	84.3	79.6
Capital Expenditure and net lending	8.1	12.4	8.0	15.5	13.5	3.2
Overall balance	-17.1	-13.4	-5.3	-3.7	-28.7	-10.9
			(Percent change, unless otherwise indicated)			
Money and credit						
Deposits 3/	21.2	-10.5	21.7	-9.5	7.4	…
Credit to non-government 3/	-2.1	4.0	14.0	-9.6	-2.0	…
Lending interest rate 4/	10.5	10.5	10.5	10.5	9.5	…
			(In millions of Australian dollars, unless otherwise indicated)			
Balance of payments						
Current account balance	-0.5	-0.6	-3.7	-1.8	-8.4	2.2
(In percent of GDP)	-1.5	-1.9	-10.2	-5.2	-24.1	6.3
Trade balance	-12.3	-13.9	-16.7	-16.0	-17.3	-14.5
Exports	0.6	0.5	0.6	0.6	0.7	0.8
Imports	-12.8	-14.4	-17.4	-16.6	-18.0	-15.3
Services balance	-19.3	-16.2	-22.0	-19.6	-16.1	-14.8
Income balance	21.0	20.0	22.0	19.7	15.5	17.3
Current transfers (net)	10.1	9.5	13.0	14.1	9.5	14.2
Gross official reserves 5/	17.4	20.3	30.7	30.3	25.6	23.5
(In months of imports of goods and services)	7.7	7.8	10.3	10.0	8.2	8.5
Debt indicators						
Total government debt (including guarantees)	20.3	19.7	21.7	15.6	15.1	12.3
(In percent of GDP)	64.9	59.0	60.2	44.9	43.6	35.1
Of which: External	13.9	13.6	16.8	12.3	10.8	9.9
(In percent of GDP)	44.7	40.7	46.7	35.3	31.0	28.1
NPV of external debt	…	…	…	10.2	8.6	8.2
(In percent of GDP)	…	…	…	29.4	24.7	23.2
External debt service	0.5	0.5	0.6	0.8	1.6	0.8
(In percent of exports of goods and services)	14.1	16.1	17.2	22.8	39.4	17.9
Exchange rates						
Australian dollars per U.S. dollar						
Period average 6/	1.3	1.2	1.2	1.3	1.1	…
End-period 6/	1.3	1.1	1.5	1.1	1.0	…
Nominal effective exchange rate (2005=100) 6/	99.8	105.8	101.5	95.4	105.9	…
Real effective exchange rate (2005=100) 6/	101.1	106.6	107.4	100.6	108.4	…
Nominal GDP	31.2	33.5	36.0	34.8	34.8	35.2
Nominal GNI	52.2	53.5	58.0	54.5	50.3	52.5

Sources: Tuvalu authorities, PFTAC, Asian Development Bank, UNDP, CIA World Factbook, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.
2/ Data for 2011 are IMF staff proposals.
3/ Data for 2010 are as of September.
4/ Rates for personal and business loans.
5/ Defined as sum of foreign assets of the National Bank of Tuvalu, the Consolidated Investment Fund, and SDR holdings. Excludes the Tuvalu Trust Fund. Data for 2010 are as of October.
6/ Data for 2010 are as of October.

Table 2. Tuvalu: Central Government Budget, 2006-11

	2006	2007	2008	2009	2010 Budget	2010 Est.	2011 1/
	(In millions of Australian dollars)						
Total revenue and grants	21.2	22.3	27.8	31.3	24.9	24.0	25.3
Current revenue	16.1	16.5	20.9	20.7	18.0	17.2	19.1
Taxes	5.1	6.2	6.0	5.6	6.4	5.3	5.9
Nontax revenue	11.0	10.3	14.9	15.1	11.5	11.8	13.2
Capital revenue and grants	5.1	5.8	6.9	10.6	7.0	6.8	6.3
Total expenditure	26.6	26.8	29.7	32.6	32.6	34.0	29.1
Current expenditure	24.0	22.7	26.8	27.1	28.8	29.3	28.0
Wages and salaries	10.0	9.9	10.5	10.9	11.9	11.1	11.5
Purchase of goods and services	8.0	6.6	7.5	7.7	7.0	7.5	6.8
Subsidies and transfers 2/	3.7	4.7	6.8	7.0	7.8	8.8	8.0
Capital expenditure and net lending	2.5	4.2	2.9	5.4	3.8	4.7	1.1
Capital expenditure	1.3	3.1	1.8	5.4	3.8	4.4	1.1
Net lending	1.2	1.0	1.0	0.0	0.0	0.3	0.0
Overall balance	-5.3	-4.5	-1.9	-1.3	-7.7	-10.0	-3.8
Statistical discrepancy	-4.0	-0.3	2.4	0.0	0.0	0.0	0.0
Financing	1.4	4.2	4.3	1.3	7.7	10.0	3.8
Foreign (net) 3/	0.0	0.0	-0.4	-0.3	-0.3	-1.5	-0.4
Domestic (net)	1.4	4.2	4.7	1.6	8.0	11.5	0.1
Donor support 4/	…	…	…	…	…	…	4.1
	(In percent of GDP)						
Total revenue and grants	68.1	66.7	77.4	89.8	71.7	69.0	71.9
Current revenue	51.7	49.4	58.2	59.4	51.7	49.3	54.2
Taxes	16.5	18.7	16.8	16.1	18.5	15.3	16.8
Direct	7.9	9.6	7.6	7.9	7.4	8.7	9.1
Indirect	8.6	9.0	9.2	8.2	11.1	6.6	7.7
Nontax revenue	35.2	30.7	41.4	43.3	33.2	34.0	37.4
Property income	26.2	25.1	33.8	36.3	24.1	27.0	28.3
Fishing license fees	16.8	13.1	23.4	26.2	16.1	18.7	16.1
Interest and dividends	0.2	5.1	4.2	2.9	1.8	2.4	4.2
.tv revenue	9.3	6.8	6.2	7.1	6.3	5.9	8.1
Other income	9.0	5.7	7.6	7.0	9.1	7.1	9.1
Capital revenue and grants	16.4	17.4	19.2	30.4	20.0	19.7	17.8
Total expenditure	85.2	80.1	82.7	93.5	93.8	97.7	82.8
Current expenditure	77.0	67.7	74.7	78.0	82.9	84.3	79.6
Wages and salaries	32.0	29.7	29.2	31.2	34.1	32.0	32.5
Purchase of goods and services	25.6	19.7	20.9	22.1	20.2	21.5	19.2
Subsidies and transfers 2/	11.9	13.9	18.9	20.0	22.5	25.3	22.9
Capital expenditure and net lending	8.1	12.4	8.0	15.5	10.9	13.5	3.2
Capital expenditure	4.2	9.4	5.1	15.5	10.9	12.7	3.2
Net lending	4.0	3.1	2.9	0.0	0.0	0.7	0.0
Overall balance	-17.1	-13.4	-5.3	-3.7	-22.1	-28.7	-10.9
Financing	4.4	12.6	11.9	3.7	22.1	28.7	10.9
Foreign (net)	0.0	0.0	-1.1	-0.9	-0.9	-4.3	-1.2
Domestic (net)	4.4	12.6	13.1	4.7	23.0	33.0	0.4
NBT	-9.1	1.1	-6.4	-1.1	11.0	7.1	-5.7
Consolidated Investment Fund (CIF)	13.5	11.5	19.5	5.7	12.1	25.9	17.7
Donor support 4/	…	…	…	…	…	…	11.7
Memorandum items:							
Overall balance (authorities' definition) 5/	-4.8	-1.5	6.8	9.2	-8.4	-15.0	3.1
Total government debt (incld. guarantees)	64.9	59.0	60.2	44.9	…	43.6	35.1
Tuvalu Trust Fund (TTF) balance (market value) 6/							
(In millions of A$)	103.0	108.2	94.5	96.3	…	107.3	116.5
(In percent of GDP)	330.0	323.4	262.8	276.9	…	308.8	330.9
CIF balance (millions of A$)	6.2	10.0	16.1	15.7	…	7.2	5.1
(In percent of GDP)	19.9	29.8	44.7	45.0	…	20.7	14.5
Nominal GDP (millions of A$)	31.2	33.5	36.0	34.8	34.8	34.8	35.2

Sources: Tuvalu authorities and IMF staff estimates.

1/ IMF staff proposal.
2/ Includes medical treatment scheme and scholarships.
3/ The 2010 outturn includes the payment of government-guaranteed debt of A$1.2 million for Air Fiji.
4/ Possible grants from the ADB and EC.
5/ Includes 4 percent of the maintained value of TTF as revenue.
6/ As of end-September.

Table 3. Tuvalu: Assets and Liabilities of the Banking Sector, 2006-10
(In millions of Australian dollars)

	2006	2007	2008	2009	2010		
					March	June	Sept
				National Bank of Tuvalu			
Assets	34.7	32.7	36.8	36.6	36.5	37.4	38.4
Bank reserves	9.8	10.6	13.2	14.3	13.4	15.4	15.6
Cash	1.1	1.0	0.9	0.9	1.4	1.1	1.4
Deposits	8.6	9.7	12.3	13.4	12.0	14.3	14.2
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on government	5.0	4.9	3.6	1.7	1.7	2.0	1.4
Loans and advances 1/	14.7	14.0	15.1	14.3	13.5	13.0	13.9
Of which: nonperforming loans	…	…	…	6.2	6.1	6.1	6.0
Claims on other banks	2.5	0.6	2.1	1.1	2.6	1.9	1.7
Fixed assets	0.5	0.4	0.4	0.5	0.3	0.3	0.4
Other assets	2.1	2.1	2.3	4.7	5.1	4.8	5.3
Liabilities	34.7	32.7	36.9	36.6	36.5	37.4	38.4
Government deposits 2/	4.4	4.3	3.4	2.6	2.0	1.7	2.0
Other deposits	18.8	16.2	19.8	18.7	19.3	20.0	20.1
Demand deposits	4.9	2.7	6.4	5.3	5.6	5.5	5.9
Time and savings deposits	12.4	12.1	12.2	13.2	13.6	14.4	14.1
Other deposits	1.4	1.5	1.3	0.2	0.1	0.1	0.1
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities to other banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.5	0.4	0.8	0.1	0.2	0.2	0.2
Capital	10.9	11.7	13.0	15.2	15.0	15.5	16.1
Paid-up capital	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Retained earnings	3.4	4.1	5.1	5.4	6.7	6.7	6.7
Provision for credit impairment	6.7	6.9	7.4	7.5	7.6	7.6	7.6
Other	0.3	0.2	0.0	1.8	0.2	0.7	1.3
				Development Bank of Tuvalu			
Assets							
Bank reserves							
Cash	0.1	0.2	0.3	0.6	0.7	0.5	0.4
Deposits	1.1	0.6	0.4	0.4	0.4	0.4	0.4
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans and advances 1/	1.4	2.8	4.1	3.0	3.0	3.1	3.1
Claims on other banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fixed assets	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities							
Government deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other deposits							
Demand deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Time and savings deposits	0.2	0.8	0.9	1.0	1.0	1.0	0.7
Other deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities to other banks 3/	1.4	1.4	2.3	1.0	1.0	0.9	0.9
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital							
Paid-up capital	2.6	2.9	3.2	3.5	3.5	3.5	3.7
Retained earnings	-1.7	-1.8	-2.6	-1.4	-1.4	-1.4	-1.4
Provision for credit impairment	0.1	0.4	1.0	1.1	1.1	1.1	1.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: National Bank of Tuvalu and Development Bank of Tuvalu.
1/ Gross loans and advances, mostly to the private sector.
2/ Includes deposits of public enterprises.
3/ Loans from the European Investment Bank.

Table 4. Tuvalu: Balance of Payments, 2006-15
(In millions of Australian dollars, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Projections				
Trade balance	-12.3	-13.9	-16.7	-16.0	-17.3	-14.5	-14.6	-14.7	-14.9	-15.0
Exports, f.o.b.	0.6	0.5	0.6	0.6	0.7	0.8	0.8	0.8	0.8	0.8
Imports, f.o.b.	-12.8	-14.4	-17.4	-16.6	-18.0	-15.3	-15.4	-15.5	-15.7	-15.9
Services (net)	-19.3	-16.2	-22.0	-19.6	-16.1	-14.8	-14.8	-14.9	-15.0	-15.2
Receipts	2.7	2.4	3.0	3.0	3.4	3.5	3.7	4.0	4.2	4.5
Payments	-22.0	-18.6	-24.9	-22.6	-19.5	-18.3	-18.5	-18.8	-19.3	-19.7
Transportation	-4.1	-4.4	-5.6	-5.3	-6.2	-5.6	-5.7	-5.7	-5.8	-5.9
Travel	-6.1	-7.1	-8.7	-8.8	-8.9	-8.3	-8.3	-8.4	-8.7	-8.9
Other 1/	-11.8	-7.0	-10.6	-8.3	-4.3	-4.4	-4.5	-4.6	-4.8	-5.0
Income (net)	21.0	20.0	22.0	19.7	15.5	17.3	18.6	20.3	21.5	22.5
Receipts	22.0	21.0	22.9	20.6	16.5	18.2	19.6	21.3	22.5	23.5
Compensation of employees	3.1	3.6	4.2	3.6	2.2	3.2	3.3	3.6	3.9	4.1
Investment income	10.2	10.2	7.1	4.6	5.4	6.3	7.1	8.1	8.6	8.9
Other property income	8.7	7.2	11.6	12.4	8.8	8.8	9.2	9.6	10.0	10.5
Payments	-1.0	-1.0	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Compensation of employees	-0.3	-0.2	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Investment income	-0.7	-0.8	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Current transfers	10.1	9.5	13.0	14.1	9.5	14.2	9.6	9.6	9.7	9.8
Private	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6
Inflows	1.0	1.1	1.0	1.0	1.0	1.1	1.1	1.1	1.2	1.2
Outflows	-1.6	-1.7	-1.8	-1.7	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Official	10.7	10.1	13.7	14.8	10.2	14.9	10.2	10.3	10.3	10.3
Inflows	11.1	10.8	14.6	15.3	10.7	15.4	10.7	10.8	10.8	10.8
Outflows 2/	-0.4	-0.7	-0.8	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Current account balance										
including official grants	-0.5	-0.6	-3.7	-1.8	-8.4	2.2	-1.2	0.4	1.3	2.0
excluding official grants	-11.6	-11.4	-18.2	-17.1	-19.1	-13.2	-12.0	-10.4	-9.5	-8.8
Capital and financial accounts	10.8	2.0	10.1	-0.7	0.5	-4.3	-4.0	1.5	0.9	0.3
Credits	10.8	6.4	8.9	4.4	3.6	3.6	3.6	3.6	3.6	3.6
Debits	0.0	-4.4	1.2	-5.1	-3.1	-7.9	-7.6	-2.1	-2.7	-3.3
Errors and omissions	1.2	1.5	3.9	1.1	3.2	0.0	0.0	0.0	0.0	0.0
Overall balance	11.5	2.8	10.3	-1.4	-4.7	-2.1	-5.2	1.8	2.2	2.3
Financing	-11.5	-2.8	-10.3	1.4	4.7	2.1	5.2	-1.8	-2.2	-2.3
Change in official reserves (increase -)	-11.5	-2.8	-10.3	0.4	4.7	2.1	5.2	-1.8	-2.2	-2.3
Exceptional financing 3/	0.0	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Current account balance (percent of GDP)										
including official grants	-1.5	-1.9	-10.2	-5.2	-24.1	6.3	-3.4	1.0	3.3	5.1
excluding official grants	-37.0	-34.2	-50.6	-49.3	-54.9	-37.6	-33.2	-28.0	-24.7	-22.0
Gross official reserves	17.4	20.3	30.7	30.3	25.6	23.5	18.3	20.2	22.3	24.7
(in months of imports of goods and services)	7.7	7.8	10.3	10.0	8.2	8.5	6.5	7.1	7.7	8.4
External public debt 4/	13.9	13.6	16.8	12.3	10.8	9.9	9.3	8.6	8.0	7.3
(in percent of GDP)	44.7	40.7	46.7	35.3	31.0	28.1	25.9	23.1	20.6	18.3
External debt service	0.5	0.5	0.6	0.8	1.6	0.8	0.8	0.9	0.9	0.8
(in percent of exports of goods and services)	14.1	16.1	17.2	22.8	39.4	17.9	18.3	18.2	16.9	15.6
NPV of external debt (percent of GDP) 4/	…	…	…	29.4	24.7	23.2	21.5	19.3	17.4	15.5

Sources: Tuvalu authorities, PFTAC, and IMF staff estimates.
1/ Includes construction services related to donor-funded projects.
2/ Includes government's overseas contributions.
3/ In 2009, part of the EIB loan to the Development Bank of Tuvalu (500,000 Euro) was converted to a grant.
4/ Projections for 2011-15 are based on outstanding debt as of 2010, assuming no new borrowings.

Table 5. Tuvalu: Medium-Term Scenario, 2007–2015 1/

	Average 2001-2009 2/	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Projections				
					(Annual percent change)					
Output and prices										
Real GDP	1.6	4.8	7.0	-1.7	0.2	0.0	0.6	1.1	1.6	1.7
Consumer prices (period average)	3.6	2.2	10.5	-0.3	-1.9	1.2	1.6	2.0	2.2	2.2
					(In percent of GDP)					
Central government finance										
Total revenue and grants 3/	73.5	66.7	77.4	89.8	69.0	71.9	69.2	69.4	69.6	69.7
Total revenue	53.0	49.4	58.2	59.4	49.3	54.2	55.3	55.9	56.6	57.2
Grants	20.5	17.4	19.2	30.4	19.7	17.8	13.9	13.5	13.0	12.5
Total expenditure and net lending	81.6	80.1	82.7	93.5	97.7	82.8	81.7	81.0	80.8	80.6
Current expenditure	72.5	67.7	74.7	78.0	84.3	79.6	78.6	77.4	76.3	75.3
Capital expenditure and net lending	9.1	12.4	8.0	15.5	13.5	3.2	3.1	3.6	4.5	5.3
Overall balance	-8.1	-13.4	-5.3	-3.7	-28.7	-10.9	-12.6	-11.6	-11.2	-10.9
TTF Market Value 4/	304.5	323.4	262.8	276.9	308.8	330.9	351.0	369.4	367.0	363.7
(Annual percent change)	9.2	12.7	-5.2	2.0	11.4	8.5	8.5	8.5	8.5	8.5
CIF Market Value	25.9	29.8	44.7	45.0	20.7	14.5	0.0	4.1	8.8	14.1
			(In millions of Australian dollars, unless otherwise indicated)							
Balance of payments										
Exports, f.o.b.	0.5	0.5	0.6	0.6	0.7	0.8	0.8	0.8	0.8	0.8
Imports, f.o.b.	-16.0	-14.4	-17.4	-16.6	-18.0	-15.3	-15.4	-15.5	-15.7	-15.9
Services and investment income (net)	2.0	3.8	0.1	0.1	-0.6	2.5	3.9	5.5	6.5	7.3
Current transfers (net)	9.6	9.5	13.0	14.1	9.5	14.2	9.6	9.6	9.7	9.8
Current account balance (including official transfers)	-4.0	-0.6	-3.7	-1.8	-8.4	2.2	-1.2	0.4	1.3	2.0
(in percent of GDP)	-14.4	-1.9	-10.2	-5.2	-24.1	6.3	-3.4	1.0	3.3	5.1
Current account balance (excl. offficial transfers)	-14.1	-11.4	-18.2	-17.1	-19.1	-13.2	-12.0	-10.4	-9.5	-8.8
(in percent of GDP)	-46.8	-34.2	-50.6	-49.3	-54.9	-37.6	-33.2	-28.0	-24.7	-22.0
Gross international reserves										
In millions of Australian dollars	18.5	20.3	30.7	30.3	25.6	23.5	18.3	20.2	22.3	24.7
In months of imports of goods and services	6.8	7.8	10.3	10.0	8.2	8.5	6.5	7.1	7.7	8.4
External public debt										
In millions of Aus $	14.2	13.6	16.8	12.3	10.8	9.9	9.3	8.6	8.0	7.3
In percent of GDP	41.8	40.7	46.7	35.3	31.0	28.1	25.9	23.1	20.6	18.3
Debt service ratio										
In millions of Aus $	0.8	0.5	0.6	0.8	1.6	0.8	0.8	0.9	0.9	0.8
In percent of exports of goods and services	19.1	16.1	17.2	22.8	39.4	17.9	18.3	18.2	16.9	15.6
Memorandum items:										
Commodity price indexes (2005 = 100)										
Food 5/	132.9	155.0	191.2	163.2	174.3	172.0	168.2	166.9	165.6	164.9
Fuel 5/	181.0	245.3	343.6	216.9	264.4	272.6	283.5	290.7	294.3	298.2
Nominal GDP (millions of Aus $)	30.7	33.5	36.0	34.8	34.8	35.2	36.0	37.1	38.5	40.0

Sources: Tuvalu authorities, PFTAC, Asian Development Bank, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.
2/ Data for government finances are averages of 2004-2009.
3/ Excludes extra-budgetary grants and matching capital expenditure.
4/ As of end-September. Assumed an annual real growth rate of 5½ percent for 2011-15.
5/ IMF GAS assumptions.

Table 6. Tuvalu: Social Indicators

Millennium Development Goals	Baseline		Latest data	
1 Eradicate extreme poverty and hunger 1/	(2015 target = halve 1990 $1/day poverty and malnutrition)			
Population below $1 per day (in percent)	17.0	(1994)	…	
Population below national poverty line (in percent)	17.2	(1994)	26.3	(2010)
Poverty gap at $1 per day (in percent)	13.0	(1994)	…	
Percentage share of income or consumption held by poorest 20 percent	7.0	(1994)	6.2	(2010)
Prevalence of child malnutrition (in percent of children under 5)	0.0	(1997)	…	
Population below minimum level of dietary energy consumption (in percent)	...		4.1	(2010)
2 Achieve universal primary education 2/	(2015 target = net enrollment to 100)			
Net primary enrollment ratio (in percent of relevant age group)	98.0	(1992)	98.1	(2007)
Percentage of cohort reaching grade 5 (in percent)	72.7	(2000)	91.2	(2004)
Youth literacy rate (in percent of ages 15–24)	95.0	(1991)	98.6	(2007)
3 Promote gender equality 3/	(2015 target = education rate to 100)			
Ratio of girls to boys in primary education (in percent)	1.02	(1999)	0.96	(2009)
Ratio of young literate females to males (in percent of ages 15–24)	0.96	(1991)	1.0	(2007)
Share of women employed in the nonagricultural sector (in percent)	38.0	(1991)	36.0	(2007)
Proportion of seats held by women in national parliament (in percent)	7.7	(1990)	0.0	(2010)
4 Reduce child mortality 4/	(2015 target = reduce 1990 under 5 motality by two thirds)			
Under 5 mortality rate (per 1,000 live births)	53.0	(1990)	24.6	(2009)
Infant mortality rate (per 1,000 live births)	42.0	(1990)	14.8	(2009)
Immunization, measles (in percent of children under 12 months)	95.0	(1990)	90.0	(2008)
5 Improved maternal health 5/	(2015 target = reduce 1990 maternal mortality by three fourths)			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	434.8	(1990)	418.4	(2003)
Births attended by skilled health staff (in percent of total)	95.0	(1990)	97.9	(2007)
6 Combat HIV/AIDS, malaria, and other diseases 6/	(2015 target = halt, and begin to reverse, AIDS, etc.)			
Prevalence of HIV, female (in percent of ages 15–24)	0.0	(1990)	…	
Contraceptive prevalence rate (in percent of women ages 15–49)	39.0	(1990)	30.5	(2007)
Number of children orphaned by HIV/AIDS	0.0	(1990)	…	
Incidence of tuberculosis (per 100,000 people)	297.0	(1990)	162.0	(2009)
Tuberculosis cases detected and successfully treated under DOTS (in percent)	…		100.0	(2007)
7 Ensure environmental sustainability 7/	(2015 target = various, see notes)			
Forest area (in percent of total land area)	33.3	(1990)	33.3	(2005)
Nationally protected areas (in percent of total land area)	0.0	(1990)	0.2	(2009)
GDP per unit of energy use (PPP$ per kg. oil equivalent)	0.2	(1993)	0.2	(1999)
CO2 emissions (metric tons per capita)	0.2	(1993)	0.2	(1999)
Use of solid fuels (in percent of households)	70.0	(1991)	25.0	(2007)
Access to an improved water source (in percent of population)	90.0	(1990)	97.0	(2008)
Access to improved sanitation (in percent of population)	80.0	(1990)	84.0	(2008)
Access to secure tenure (in percent of population)	…		…	
8 Develop a global partnership for development 8/	(2015 target = various, see notes)			
Youth unemployment rate (in percent of total labor force ages 15–24)	3.0	(1991)	24.0	(2002)
Telephone lines (per 100 people)	1.4	(1990)	17.2	(2009)
Cellular subscriptions (per 100 people)	4.8	(2000)	20.1	(2009)
Internet user (per 100 people)	4.9	(1995)	43.3	(2009)

		Same Region / Income group	
Other indicators	Tuvalu	East Asia and Pacific	Lower-Middle Income
Population (millions)	0.0111	1,931	3,702
Urban (percent of toal)	49.0	44.1	41.3
GNI per capita (in U.S. dollars)	4,386	2,515	2,015
Adult literacy rate (in percent of people ages 15 and over)	99.0	92.8	82.6
Life expectancy at birth (in years)	64.0	72.0	68.0
Total fertility rate (births per woman)	3.2	1.9	2.5

Sources: Tuvalu authorities, Asian Development Bank, UNDP, and World Bank.

1/ Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

2/ Goal 2 targets: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

3/ Goal 3 targets: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

4/ Goal 4 targets: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

5/ Goal 5 targets: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

6/ Goal 6 targets: Halt by 2015, and begin to reverse, the spread of HIV/AIDS. Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases.

7/ Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

8/ Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

INTERNATIONAL MONETARY FUND

TUVALU

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2010 Consultation with Tuvalu

(In Consultation with Other Departments)

January 12, 2011

Contents Page

ANNEX I. TUVALU: FUND RELATIONS

(As of November 30, 2010)

I. Membership Status: Joined June 24, 2010; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	1.80	100.00
Reserve Tranche Position	0.00	0.00

III. SDR Department:	SDR Million	% Allocation
Net Cumulative Allocation	1.69	100.00
Holdings	1.69	100.00

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Payments to Fund: None

VII. Exchange Rate Arrangement:

Tuvalu's legal tender is the Australian dollar. There is no central monetary institution. Tuvalu avails itself of transitional arrangements under Section 2 of Article XIV and has not yet accepted the obligations under Article VIII, Sections 2, 3, and 4. The legal framework for the exchange and trade system is the Exchange Control Law of 1981 and the Exchange Control Regulations of 1983, as amended. Staff is currently conducting a comprehensive review of the exchange system to assess jurisdictional implications. While the Exchange Control Regulations are quite restrictive and prescribe approval requirements from the National Bank of Tuvalu (NBT) or the Minister of Finance for most payments or transfers, in practice, no approval is required and transactions are administered liberally.

The NBT is the only bank in Tuvalu handling foreign exchange transactions. The NBT buys and sells foreign exchange at rates determined daily by the NBT's board on the basis of rates quoted in the international markets plus specific spreads dependent on the specific foreign currency.

VIII. Article IV Consultation:

The first Article IV consultation discussions took place during November 11–23, 2010.

IX. Technical Assistance:

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

X. Resident Representative:

A new Resident Representative office, covering Pacific islands and based in Fiji, was established in September 2010.

ANNEX II. TUVALU: WORLD BANK-IMF COLLABORATION

The Bank and Fund country teams, led by Mr. Byung K. Jang (Fund mission chief for Tuvalu) and Mr. Piers Merrick (country officer, EACNQ), have maintained a close working relationship since Tuvalu's decision to pursue membership of the Bretton Woods institutions in 2009. The Bank team joined the membership mission as well as the first Article IV consultation mission. Teams from the Asian Development Bank (ADB), AusAID, and NZAID also overlapped with the Article IV mission.

The teams agree that Tuvalu's main macroeconomic challenge is to cut government spending to avoid looming fiscal problems and ensure fiscal sustainability over the longer term. Based on this shared assessment, the teams identified the following structural reform areas as macro-critical in view of their central role in achieving fiscal consolidation and sustained growth:

i. **Strengthening public financial management.** In the absence of its own currency and monetary policy, sound fiscal policy is key to maintaining macroeconomic stability. However, fiscal management has not been prudent in recent years, as windfall revenue from the Tuvalu Trust Fund and fishing licenses has tended to be immediately spent on major public construction projects, subsidies, and transfers. Windfall revenue needs to be saved, given the volatility of key revenue items, and a medium-term budget framework should be used to highlight the longer-term impact of current fiscal stance and new spending initiatives. Moreover, budget reporting and monitoring need to be improved and economic and policy analysis capacity should be strengthened.

ii. **Reforming public enterprises.** The ADB is undertaking a comprehensive public enterprise reform program to improve the current weak performance and profitability of public enterprises. Several public enterprises as well as business activities undertaken by line ministries are being considered for mergers, private sector participation, and possible corporatization. The ongoing reforms could reduce burdens on the budget down the road and help attract foreign direct investment.

iii. **Exploring opportunities for poverty reduction, job creation, and private sector development.** Tuvalu's geographic isolation, small size, and poor land quality have made it extremely challenging to generate domestic private sector employment. Demand for Tuvaluan seafarers on the international maritime employment market is declining, due to more competition from other countries, and existing labor migration schemes have not been well utilized. Adequate education and training need to be provided for Tuvaluans to better utilize these overseas job opportunities and to reduce the rising poverty.

The teams expect to sustain the close cooperation going forward. Attachment 1 details the specific activities implemented and planned by the two teams over the period July 2010—October 2011. It was agreed that details of further collaboration would be determined at the technical level as the scope of engagement is further defined.

Attachment 1
Tuvalu: Bank and Fund Implemented/Planned Activities in Macro-Critical Areas
July 2010—October 2011

	Products	**Expected/Actual Delivery Date**
World Bank Work Program	• Joint participation in Article IV Mission	November 2010
	• Poverty data gathering	November 2010
	• Preliminary consultations with government on priorities for the prospective WB program	November 2010
	• Preliminary consultations with development partners on opportunities for collaboration and coordination	November 2010
	• Debt sustainability analysis to decide IDA eligibility (jointly with the IMF)	2011
IMF Work Program	• PFTAC: balance of payments TA mission	July 2010
	• PFTAC: national account TA mission	October 2010
	• Article IV mission	November 2010
	• Staff visit	October 2011

ANNEX III. TUVALU: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

The Asian Development Bank (ADB) assistance to Tuvalu aims to contribute to improving the quality of Tuvalu's human resource capital by ensuring the provision of basic education and primary health through the implementation of its national plan, *Te Kakeega II.* Given the lack of resources, successive governments have focused on the education and health of its people as the foundation for future opportunities. The Country Partnership Strategy (CPS) 2008–2012 therefore focuses on ensuring a credible budget that will allow increased allocations of scarce financial resources to government priority areas: primary education and preventative health care. This will be achieved through targeting improved public expenditure and financial management.

A set of five Performance Benchmark Indicators has been developed to track achievement of the stated social sector outcomes, through a focus on fiscal prudence. These benchmarks also consolidate assistance programs for ADB, AusAID, and NZAID to support the prioritized and sustainable implementation of *Te Kakeega II*.

To improve aid effectiveness, the government, ADB, AusAID, and NZAID signed the Development Partners Declaration (DPD) in 2009. The declaration will not only facilitate closer harmonization for improved aid effectiveness, but also ensure that implementation of specific projects do not undermine the general priority direction as agreed in the government performance benchmark indicators. The DPD remains open to other development partners.

ADB has approved 2 loans and 1 grant totaling $11.06 million from the Asian Development Fund (ADF) and 21 technical assistance (TA) totaling $5.91 million to Tuvalu since it joined ADB in 1993. In recent years, ADB operational strategy has focused on improving governance and economic management, as well as providing skills development to enhance employment opportunities. Improvement of services on the outer islands, where poor and vulnerable groups are concentrated, has also been undertaken, partly through the sustainable financing mechanisms through the establishment of the Falekaupule Trust Fund.

Active projects include a grant and a TA project. The grant which was approved in 2008 focuses on: (i) development of a strengthened governance framework for the oversight of public enterprises in Tuvalu, (ii) improved capacity for oversight on the part of the government, (iii) the capacity to respond positively to such oversight on the part of public corporations, (iv) strengthened capacity to manage debt, and (v) a reduction in government debt to the National Bank of Tuvalu (NBT). The TA directly supports the achievement of the program grant through improving government capacity and commitment to fiscal management; and addressing issues which are contributing to public enterprise non-

[1] Prepared by ADB staff.

profitability. Tuvalu also benefits from a number of ADB's regional TA to the Pacific in areas including audit and technical and vocational education.

Tuvalu: Loan, Grant, and Technical Assistance Approvals, 2005–2009

	2005	2006	2007	2008	2009
Loan approvals					
Number	0	0	0	0	0
Amount (in millions of U.S. dollar)	0	0	0	0	0
Grant approvals					
Number	0	0	0	1	0
Amount (in millions of U.S. dollar)	0	0	0	3.24	0
TA approvals					
Number	0	1	0	2	0
Amount (in millions of U.S. dollar)	0	0.3	0	1.13	0

ANNEX IV. TUVALU: RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE (PFTAC)[1]

The Centre's assistance to Tuvalu since 2006 has included 8 advisory missions. Tuvalu also sent eleven officials to regional seminars and workshops.

Tax administration and policy

In 2007 and 2008, PFTAC supported the ADB which took responsibility for implementing the tax policy reforms recommended by PFTAC.

A PFTAC mission visited Tuvalu in August 2010 to conduct a post implementation review of the Tuvalu Consumption Tax and changes to the personal and business income tax changes implemented in 2009. Compliance with all tax obligations in Tuvalu is poor, enforcement is limited, and skills within the tax office are low. Government departments are also noncompliant. A debt and return collection guide was developed and a cabinet note prepared for the new cabinet seeking endorsement of stricter enforcement actions.

PFTAC will liaise with the ADB to provide longer-term assistance to Tuvalu to improve compliance levels and skills within the tax office. Much of the compliance improvement is dependent on political support.

The proposed regional IT support strategy for countries with the Revenue Management Software (RMS) will also benefit Tuvalu if it signs the service contract for ongoing maintenance of its new computer system.

A Tuvalu representative has attended Pacific Islands Tax Administrators Association (PITAA) in Cook Islands, Papua New Guinea, and Vanuatu and the head of the tax office undertook an attachment to Fiji Islands Revenue & Customs Authority (FIRCA) sponsored by PFTAC.

Financial sector regulation and supervision

At the request of the ADB, a mission was conducted from July 2–7, 2008 concurrently with the ADB.

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[1] Prepared by PFTAC staff. PFTAC, which is based in Suva, Fiji, is a multi-donor technical assistance institution, financed by the IMF, ADB, AusAID, NZAID, Japan, and Korea, with the IMF as executing agency. The Centre's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

These were to: (i) assess the operating condition and performance of the National Bank of Tuvalu along with the adequacy of its lending and liquidity policies and (ii) follow-up on the status of legislation to implement a legal framework for the licensing and on-going supervision and regulation of banks.

During 2009–10, in response to a request from the ADB, assistance has been provided to Tuvalu in reviewing and providing comments/feedback on proposed legislation to supervise and regulate banking institutions to assure compliance with Basel core principles and best practices. In response to this assistance, the Tuvalu authorities have forwarded to PFTAC revised legislation incorporating many of the recommendations previously proposed by PFTAC. A final review of the revised legislation, however, is pending.

Economic and financial statistics

A 2006 mission assessed data needs and prepared a work plan for increasing the range of existing data to be incorporated into the national accounts and balance of payments estimates. Subsequently, some work was begun on updating the estimates by a Central Statistics Division staff member while on study leave in Fiji.

During 2009 two missions assisted the authorities to improve methodology and update the balance of payments and national accounts statistics to the 2008 year. Improvements included benchmarking the nominal national accounts estimates using recent Household Income and Expenditure Survey data, rebasing the constant price estimates, estimation of gross national disposable income, and moving the balance of payments to the latest international standard. A staff member participated in a regional national accounts seminar in Fiji in 2009. Two missions in 2010 assisted the authorities to make further data and methodology improvements and to update the balance of payments and national accounts statistics to 2009.

ANNEX V. TUVALU—STATISTICAL ISSUES

As of December 29, 2010

I. Assessment of Data Adequacy for Surveillance

General: Data have shortcomings that hamper surveillance. Shortcomings are most serious in the national accounts and balance of payments. The Pacific Financial Technical Assistance Centre (PFTAC) has provided technical assistance to the Central Statistics Division (CSD) of the Ministry of Finance to help start compiling those statistics for surveillance and the authorities' own policy analysis and formulation. More staff needs to be provided to the CSD urgently.

National accounts: With PFTAC assistance in 2009 and 2010, the compilation methodology for the national accounts was improved. However, little progress had been made on previous missions' recommendations, largely due to a lack of capacity. Attention needs to be paid to improving source data for national accounts.

Price statistics: The consumer price index (CPI) is the only price index compiled in Tuvalu. The CSD produces a quarterly CPI, which is timely and of reasonable quality. The CPI weights are expected to be revised in 2011, based on the 2010 Household Income and Expenditure Survey.

Government finance statistics: The MOF compiles the central government data for budget analysis and control. However, the classifications of some accounts, particularly on capital spending, need to be improved to be in line with international standards.

Monetary and financial statistics: Tuvalu uses the Australian dollar as its legal tender and does not have a central bank. Monetary and financial statistics are currently not produced in Tuvalu. The National Bank of Tuvalu and the Development Bank of Tuvalu provided the Article IV mission with their balance sheets and income statements, which were used to produce the monetary data on the two banks.

Balance of payments: Balance of payments statistics have been compiled by visiting PFTAC experts. A balance of payments statistics mission took place in Tuvalu during June 29–July 8, 2010. The mission assisted the authorities in developing a balance of payments compilation system to enable CSD staff to compile the balance of payments data. The mission noted that many of the underlying data have inconsistencies and errors, resulting in poor quality of the balance of payments statistics. In addition, the mission noted that the CSD needs better trained staff to produce quality balance of payments statistics.

II. Data Standards and Quality

Not a General Data Dissemination System participant.	No data ROSC are available.

III. Reporting to STA

No data are currently reported to STA for publication.

Tuvalu: Table of Common Indicators Required for Surveillance
(As of December 29, 2010)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates[1]	12/29/10	12/29/10	D	NA	NA
International reserve assets and reserve liabilities of the monetary authorities[2]	10/2010	11/2010	M	I	NA
Reserve/base money	NA	NA	NA	NA	NA
Broad money	NA	NA	NA	NA	NA
Central bank balance sheet	NA	NA	NA	NA	NA
Consolidated balance sheet of the banking system	09/2010	11/2010	M	I	NA
Interest rates	10/2010	11/2010	M	I	NA
Consumer price index	11/2010	12/2010	Q	Q	Q
Revenue, expenditure, balance and composition of financing[3]—general government[4]	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing[3]—central government	2009	11/2010	A	A	A
Stocks of central government and central government-guaranteed debt[5]	2009	11/2010	A	A	A
External current account balance	2009	11/2010	A	A	NA
Exports and imports of goods and services	2009	11/2010	A	A	NA
GDP/GNP	2009	11/2010	A	A	NA
Gross external debt	2009	11/2010	A	A	A
International investment position[6]	2009	11/2010	A	A	NA

[1] Tuvalu uses the Australian dollar as its legal tender.

[2] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means. Tuvalu does not have a monetary authority. Foreign assets of National Bank of Tuvalu and the Consolidated Investment Fund constitute the official reserves of Tuvalu.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/16
FOR IMMEDIATE RELEASE
February 2, 2011

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with Tuvalu

On January 28, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the 2011 Article IV consultation with Tuvalu.[1]

Background

Despite its geographic remoteness, Tuvalu has not been immune to the global financial crisis. Even with higher government spending, the economy is expected to have almost no growth in 2010 after contracting by about 2 percent in 2009. Major construction projects to build a wharf and a power station have been completed, and seafarer employment—Tuvalu's main foreign exchange earning source for the private sector—is weak. Annual inflation has been negative since mid-2009 (-1¾ percent in November 2010) due to lower global food prices and the strong Australian dollar.

In response to the global crisis, the government continued to support the economy by increasing spending. The large spending increases in the last few years have resulted in a sharp increase in the fiscal deficit from 4 percent of GDP in 2009 to almost 30 percent of GDP in 2010, as domestic revenue, offshore income, and grants fell. The large deficit has led to a

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

rapid decline in the fund available for budget financing to about 20 percent of GDP from 45 percent in 2009. Total spending relative to GDP has increased by 20 percentage points since 2005, mainly due to sharp increases in subsidies, transfers and capital spending.

The current account deficit is estimated to increase sharply to almost 25 percent of GDP in 2010 due to low income and grants. Tuvalu exports little and depends heavily on imports. Gross official reserves have declined substantially in 2010, but still remain high at about 8 months of imports of goods and services. External public debt is at over 30 percent of GDP, but mostly on concessional terms, resulting in low debt servicing obligations. However, total public debt remains high by regional standards at about 44 percent of GDP.

The financial sector is underdeveloped and lending constrained, following rapid credit growth in the early 2000s. Nonperforming loans are high at around 40 percent of total loans. Banks have started addressing high nonperforming loans by sharing borrowers' information and tightening lending standards, including lowering the maximum debt service to income ratio from 50 to 40 percent for all personal loans. Interest rates on lending have changed little in recent years, reflecting limited competition in the financial system.

The growth outlook remains clouded. Growth is projected to be zero or even turn negative in 2011, led by lower government spending, and remain low over the medium term. The outlook is subject to risks related to a delay in fiscal adjustment and the pace of the global recovery. Moreover, Tuvalu is vulnerable to natural disasters and climate change will be a major challenge in light of rising sea levels.

Executive Board Assessment

Executive Directors welcomed the opportunity to discuss this first Article IV consultation with Tuvalu. Directors recognized that Tuvalu faces tremendous challenges because of its remote location, limited land area, lack of resources, serious capacity constraints and the potential impact of climate change. The uncertain global recovery is adding to the country's vulnerabilities. In light of the difficult near and medium-term prospects of the economy, Directors emphasized the need for resolute fiscal adjustment and structural reforms. Noting the limited domestic job opportunities, they agreed that the authorities should promote overseas employment opportunities, which would generate income and help reduce poverty.

Directors urged the authorities to cut spending, given that the Consolidated Investment Fund (CIF) available for budget financing will be depleted soon at the current pace of spending. They called for a front-loaded adjustment mainly through cuts in capital spending, and subsidies and transfers, which increased rapidly in recent years. Freezing wages and reducing travel costs will also be important.

Directors agreed that to ensure fiscal sustainability, it will also be necessary to increase domestic revenue, particularly by boosting efforts to increase tax compliance. At the same time, saving any windfall revenue from offshore earnings into the CIF and formulating a medium-term budget framework will strengthen fiscal management.

Directors agreed that use of the Australian dollar as Tuvalu's currency is appropriate. They underscored however that fiscal adjustment will be key to maintaining external stability.

Directors commended the authorities for their structural reform efforts. They welcomed the ongoing public enterprise reform and looked forward to further progress in regularization of government's financial relations with the public enterprises. Directors stressed that continued improvements in the banking sector and credit culture will help support private-sector development. Noting the steps being taken to address the high level of nonperforming loans, they urged the authorities to accelerate progress on putting in place the supervisory and prudential requirements. Improving the country's statistical capacity will be critical for policy analysis and formulation.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Tuvalu: Selected Social and Economic Indicators, 2006–2011

I. Social and Demographic Indicators

GDP (2009):		Poverty rate (2010)	24.8
U.S. dollars (millions)	27.1	Life expectancy at birth (years, 2008)	64.0
Per capita	2,447	Total fertility rate (births per woman, 2008)	3.2
		Infant mortality rate (per 1,000 live births, 200	30
Population:		Births attended by skilled personnel (percent,	98
Total (thousands, 2009)	11.1	Adult literacy rate (2002)	99.0
Urban population (percent of total, 2008)	49.0	Unemployment rate (2004)	16.3

II. Economic Indicators 1/

	2006	2007	2008	2009	2010 Est.	2011 Proj.
			(Percent change)			
Real sector						
Real GDP growth	3.3	4.8	7.0	-1.7	0.2	0.0
Consumer prices (period average)	3.8	2.2	10.5	-0.3	-1.9	1.2
			(In percent of total)			
Structure of economy						
Agriculture	21.2	21.7	21.2	22.4	23.5	…
Manufacturing and construction	7.4	9.0	12.9	11.6	9.7	…
Services	71.4	69.3	65.9	66.0	66.8	…
			(In percent of GDP)			
Government finance 2/						
Revenue and grants	68.1	66.7	77.4	89.8	69.0	71.9
Current Revenue	51.7	49.4	58.2	59.4	49.3	54.2
Grants	16.4	17.4	19.2	30.4	19.7	17.8
Expenditure and net lending	85.2	80.1	82.7	93.5	97.7	82.8
Current expenditure	77.0	67.7	74.7	78.0	84.3	79.6
Capital Expenditure and net lending	8.1	12.4	8.0	15.5	13.5	3.2
Overall balance	-17.1	-13.4	-5.3	-3.7	-28.7	-10.9
			(Percent change, unless otherwise indicated)			
Money and credit						
Deposits 3/	21.2	-10.5	21.7	-9.5	7.4	…
Credit to non-government 3/	-2.1	4.0	14.0	-9.6	-2.0	…
Lending interest rate 4/	10.5	10.5	10.5	10.5	9.5	…
			(In millions of Australian dollars, unless otherwise indicated)			
Balance of payments						
Current account balance	-0.5	-0.6	-3.7	-1.8	-8.4	2.2
(In percent of GDP)	-1.5	-1.9	-10.2	-5.2	-24.1	6.3
Trade balance	-12.3	-13.9	-16.7	-16.0	-17.3	-14.5
Exports	0.6	0.5	0.6	0.6	0.7	0.8
Imports	-12.8	-14.4	-17.4	-16.6	-18.0	-15.3
Services balance	-19.3	-16.2	-22.0	-19.6	-16.1	-14.8
Income balance	21.0	20.0	22.0	19.7	15.5	17.3
Current transfers (net)	10.1	9.5	13.0	14.1	9.5	14.2
Gross official reserves 5/	17.4	20.3	30.7	30.3	25.6	23.5
(In months of imports of goods and services)	7.7	7.8	10.3	10.0	8.2	8.5
Debt indicators						
Total government debt (including guarantees)	20.3	19.7	21.7	15.6	15.1	12.3
(In percent of GDP)	64.9	59.0	60.2	44.9	43.6	35.1
Of which: External	13.9	13.6	16.8	12.3	10.8	9.9
(In percent of GDP)	44.7	40.7	46.7	35.3	31.0	28.1
NPV of external debt	…	…	…	10.2	8.6	8.2
(In percent of GDP)	…	…	…	29.4	24.7	23.2
External debt service	0.5	0.5	0.6	0.8	1.6	0.8
(In percent of exports of goods and services)	14.1	16.1	17.2	22.8	39.4	17.9
Exchange rates						
Australian dollars per U.S. dollar						
Period average 6/	1.3	1.2	1.2	1.3	1.1	…
End-period 6/	1.3	1.1	1.5	1.1	1.0	…
Nominal effective exchange rate (2005=100) 6/	99.8	105.8	101.5	95.4	105.9	…
Real effective exchange rate (2005=100) 6/	101.1	106.6	107.4	100.6	108.4	…
Nominal GDP	31.2	33.5	36.0	34.8	34.8	35.2
Nominal GNI	52.2	53.5	58.0	54.5	50.3	52.5

Sources: Tuvalu authorities, PFTAC, Asian Development Bank, UNDP, CIA World Factbook, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.
2/ Data for 2011 are IMF staff proposals.
3/ Data for 2010 are as of September.
4/ Rates for personal and business loans.
5/ Defined as sum of foreign assets of the National Bank of Tuvalu, the Consolidated Investment Fund, and SDR holdings. Excludes the Tuvalu Trust Fund. Data for 2010 are as of October.
6/ Data for 2010 are as of October.

Statement by Mr. Christopher Legg, Executive Director for Tuvalu
January 28, 2011

Background

Our Tuvaluan authorities greatly appreciated Staff's comprehensive and objective analysis of Tuvalu's macroeconomic issues. The joint presence of the World Bank, the ADB, and other development partners was also greatly appreciated, allowing for a joint constructive exchange of views with their development partners on how to assist Tuvalu in moving forward with its development issues. Our Tuvaluan authorities underscore the benefits of becoming a member of the Fund and World Bank, with the most obvious being access to technical assistance and policy advice to help address the country's development challenges, and not least, the potential to trigger financial assistance.

Though Tuvalu is one of the smallest and most remote countries in the world, its economic performance is still highly susceptible to developments in the global economic and financial arena. Its offshore earnings are subject to overseas asset price fluctuations and exchange rate movements. The return on the Tuvalu Trust Fund (TTF) has been below its targeted value in recent years, resulting in no distribution to the Consolidated Investment Fund (CIF). The strengthening of the Australian dollar has also affected Tuvalu's offshore earnings from its dot.tv domain and fishing licenses, which are largely denominated in the USD. The increased competitiveness in the global labor market has seen the decline in the overseas employment of Tuvalu nationals, affecting remittances. The public sector dominates Tuvalu's economy, which in turn is largely dependent on offshore earnings to deliver its services. In addition, Tuvalu's lack of economies of scale, because of its remoteness, and high costs of doing business, all constrain development, whilst the climate change looms as a major fiscal, social, and indeed existential challenge.

The significant near-term challenge for Tuvalu is to ensure immediate fiscal discipline in the face of declining revenues. Over the medium term, Tuvalu will need to strengthen its fiscal management to create fiscal space for countercyclical measures and to mitigate against the volatility of offshore earnings.

Fiscal Policy

The volatility of offshore earnings and the relative dominance of the public sector in the economy add significantly to the challenge of fiscal management, particularly in light of the growing demands for better social services and public infrastructure.

Notwithstanding this, the authorities agree with Staff recommendation that fiscal management needs to be strengthened immediately, and remedial actions need to be taken to address the weakening fiscal position. Whilst there has been a recent change in government, our Tuvaluan authorities wish to reassure the Board that the new government ,recently appointed on December 24, has taken on board Staff recommendations and are committed to fiscal discipline. Being in office for just over a month, the government is still finalizing its plans for fiscal consolidation.

As an initial step towards fiscal consolidation, a Revenue and Expenditure Review Committee is being established, that will consider avenues to widen the revenue base and to cut high levels of spending, including the Tuvalu Medical Treatment Scheme (TMTS). The authorities' ultimate aim for the TMTS is a gradual reduction of costs. They aim to do this through a review of the selection criteria for overseas medical referrals with a view to tighten further such criteria. In addition, they plan to consult with external providers of medical services, who are able to make regular visits and perform the required medical treatment in Tuvalu. This will have potential economies of scale benefits, bringing the medical treatment to Tuvalu that can benefit many, rather than only a few, from the overseas medical referral scheme. Over the long term, the authorities aim to seek assistance in improving and upgrading their domestic medical services. The authorities are also reviewing capital spending with a view to prioritize and scale back capital spending, given that most of the major infrastructure needs have been addressed in recent years. The authorities have also taken measures to freeze further hiring, with a view to better assess the size of the civil service.

The volatility in earnings also underscores the need to build up savings as a buffer against future macroeconomic risks. In this context, the CIF (distributable income from the TTF) has given Tuvalu a certain degree of financial security, underpinning the budget in recent years. However, the authorities concur with Staff that more will need to be done to rebuild the CIF to its targeted balance. To this effect, the Tuvaluan authorities acknowledge that fiscal consolidation is key to rebuilding fiscal space, and, whenever possible, saving windfall earnings. Understanding the need for fiscal adjustment over the medium term, our Tuvaluan authorities are seeking assistance in the formulation of a simple and credible medium-term budget framework. The authorities will also continue to seek direct financial support from their developments partners, which they consider to be a crucial buffer to the CIF, especially in times where the global and domestic economic environment is weak.

As with their predecessors, the new government also emphasizes the importance of donor assistance in supporting Tuvalu through the difficult and challenging times ahead. They are currently seeking assistance in various areas, including strengthening tax administration.

Financial Sector

The banking sector is underdeveloped with only two banks currently serving the country. The two banks have taken measures to tighten lending standards to mitigate further increases in non-performing loans. However, the authorities concur with Staff that further progress in strengthening the banking sector and credit culture will be critical for sustained growth in the private sector. The authorities have requested technical assistance in this area.

The authorities are committed to accelerating the implementation and approval of the Amendments to the Banking Act. They aim to have it endorsed and passed by Parliament at its next sitting in early 2011.

In respect of bank interest rates, the newly appointed Minister of Finance has issued instructions to the National Bank of Tuvalu (NBT) to suspend any directions given to lower bank lending rates.

Structural Policy and Growth

The authorities agree with Staff's assessment that most of the public enterprises face challenging financial circumstances. The Tuvaluan authorities are looking into options, such as mergers, private sector participation, as well as corporatization of public enterprises and business activities. However, our authorities want to highlight the constraints faced by the domestic private sector regarding capital and financing requirements that hinder full participation in capital-intensive ventures. In addition, limited availability of skilled managers hinders the effective and efficient operation of public enterprises on a more commercial basis. An additional challenge is the lack of required skills and capacity to monitor and operate corporatization models that depend on arms length governance.

A comprehensive public enterprise reform program is currently underway with the assistance of the ADB. One of its objectives' aims is to regularize government's financial relations with its public enterprises. The authorities plan to discuss further with the ADB whether the assistance can be extended to include a review of the US10 million debt related to joint ventures with foreign fishing companies.

The authorities view their human resources as a potential source of economic growth. However, they are also well aware that it is currently underdeveloped and not marketed adequately. In addition, the high-travel costs from Tuvalu to external labor markets reduce the attractiveness of hiring Tuvaluans. Nevertheless, the authorities plan to invest in technical and vocational education and training aimed at establishing a niche in the overseas labor market through the provision of high-quality services and the provision of more practical skills aimed at gaps in domestic services. They are working closely with recognized training institutions and development partners in this area. To address the fall off in revenue from seafaring, the authorities are also looking into the scope to upgrade maritime qualifications with the WB, indicating their interest in cultivating the potential of the Tuvalu Maritime Training Institution (TMTI).

Data and Staffing

The authorities acknowledge the need to strive to continuously meet the standards required by the Fund in terms of data quality and availability. Overall, the authorities understand the value of quality data to assist in their policy analysis and formulation. However, they highlight chronic shortages in the availability of qualified staff, which underscores the importance of allocating scarce human resources most effectively. Currently their efforts are being concentrated on getting the 2010 Household Income and Expenditure Survey (HIES) completed. In addition, the components of the BOP data are sourced from different arms of the government, which also require training and the upgrading of their capacity to maintain and submit quality data on a timely basis. The authorities consider sustained efforts to improve the quality of statistics staff to be vital and have requested PFTAC assistance in this regard. They also see merit in continuing assistance to update data to the minimum standard required for policy analysis until such time that the domestic statistics staff are able to fully take on this role.

Conclusion

This was Tuvalu’s first Article IV mission since becoming a member of the IMF, and our Tuvaluan authorities greatly appreciated the constructive policy dialogue with the Fund Staff during the mission and in the process of finalizing the report. They would like to put on record their appreciation of the contributions from the mission chief and his team. The authorities look forward to working very closely with the Fund as they work towards more sustainable growth.