



Tuvalu

**MINISTERIAL ORDER ON FISCAL RISKS
REPORTING**

LN 5 of 2023



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MADE UNDER SECTION 5 OF THE PUBLIC FINANCE ACT

1 Citation

This Directive may be cited as the Fiscal Risks Report.

2 Fiscal Risks Report

(1) Entity Responsible

- (a) The MOF will set up a Fiscal Risks Technical Working Group (FRTWG), which will oversee fiscal risks management for the Government of Tuvalu. The main activities/tasks of the FRTWG will include the following:
- (i) Identification, analysis, and quantification of fiscal risks that can jeopardize the achievement of the fiscal targets established in the government annual and medium-term budgets. It includes the identification of sources of fiscal risks for the budgetary system.
 - (ii) Coordination of government agencies, line ministries and other entities in which the main fiscal risks are generated. Because several fiscal risks are generated outside the MOF and sometimes managed by other entities, the coordination role is critical, especially in designing a methodology for identification and reporting on fiscal risks.
 - (iii) Preparation of annual Fiscal Risk Report (FRR) as a stand-alone document, which will consolidate all identified fiscal risks.

- (iv) Publication of the FRR on the MOF website.
- (b) FRTWG will be formed by representatives from the following Departments.
 - (i) Ministry of Finance Headquarter, which will chair the committee.
 - (ii) Planning, Budget, and Aid Coordination Department, will play secretariat role and focus on analyzing macro, debt related risks and other contingent liabilities.
 - (iii) Climate Change Department, focusing on climate change and natural disasters fiscal risks.
 - (iv) Public Enterprise Reporting and Monitoring Unit, focusing on SOEs: Tuvalu Electricity Corporation, National Bank of Tuvalu, Development Bank of Tuvalu, Tuvalu Post Limited.
 - (v) Revenue and Customs Department, focusing on domestic and customs tax revenues.
 - (vi) Treasury Department will focus on general contingent liabilities in the budget.
 - (vii) Fisheries Department, focusing on fishing licenses.
 - (viii) Ministry of Education Headquarter, focusing on other SOE: TMTI.
 - (ix) Ministry of Fisheries and Trade Headquarter, focusing on other SOE: NAFICOT.
 - (x) Ministry of Justice, Communication and Foreign Affairs Headquarter focusing on other SOEs: Tuvalu Telecom Corporation and Tuvalu Broadcasting Corporation.

(2) Main Sources of Fiscal Risks in Tuvalu

Considering the fiscal risks definition analyzed before, a few potential fiscal risks will need to be analyzed, quantified, and included in the FRR:

- (a) Macroeconomic fiscal risks:
 - (i) These are fiscal risks related to macroeconomic variables, including GDP growth, inflation, and exchange rate volatility.

- (ii) While there are several techniques to analyze the impact of different macro variables assumptions on the fiscal stance, one possibility is to apply different scenarios or shocks (baseline, optimist, pessimist) for the macro assumptions on the fiscal aggregates (revenues, expenditures, fiscal balance, and public debt) and analyze potential deviations.
 - (iii) *Fiscal risks on the public debt portfolio* depend also on macro variables. There is a risk of higher debt servicing costs because of development in market prices, for example, higher interest rate, inflation, and exchange rate. Changes in these macro variables imply a risk of higher redemptions and interest payments. Main indicators of interest rate risk are the following:
 - (1) Fixed/Floating ratio shows the floating rate debt as a percentage of total debt. In the case of Tuvalu, the analysis should stress that interest rates are fixed and external loans are contracted on concessional terms.
 - (iv) Main indicators of exposure to *foreign exchange rate risk* are:
 - (1) External Debt/Total Debt, which captures the exposure of the debt portfolio and the government debt stock to a depreciation/devaluation in the external value of the domestic currency.
 - (2) Currency Composition, of the government debt portfolio.
 - (v) Another indicator is the *Shape of Public Debt Redemption Profile*, perhaps the simplest risk indicator and very easy to calculate but extremely powerful in showing the exposure to refinancing risk. This indicator (a chart/graph) highlights specific points in time of exposure such as risks associated with realization of capital gains/losses.
- (b) Specific risks or Contingent Liabilities
- (i) *Fiscal risks arising from SOEs*. Persistent needs of capital injection and transfers from the budget to some of the SOEs may indicate an important source of fiscal risks. Financial risks will also be analyzed for the financial SOEs.
 - (1) Analyzing the information available in terms of budget formulation and budget execution (actuals) during the past 5-7 years may provide useful information about potential risks.
 - (2) Variables to look at include the following: capital injections need, transfers (subsidies), payment tax delays

to the government, guarantees, actual payments of dividends vs expected dividends, profitability, liquidity, solvency, debt structure, SOEs' Board performance and management efficiency.

- (3) As part of the incremental approach to prepare the FRR, the government start quantifying and reporting on two SOEs: (i) Tuvalu Electricity Corporation and (ii) Tuvalu Telecom Corporation.
- (c) *Climate change and natural disasters:* Tuvalu's geographical, geological and socioeconomic conditions make the islands extremely vulnerable to the adverse effects of climate change and natural disasters. It is a significant source of fiscal risks and certainly will become critical in medium- and long term for public policy and the public finances. The government has already set up a framework to manage risk arriving from natural disasters. Main sources are cyclones, reduced rainfall, water shortages, and king tides.
- The Climate Change Department is the focal point for climate change and natural disasters policies and activities in the country.
- (d) *Regarding natural disasters reporting,* best practices stipulates that a FRR should include the following:
- (i) Discussion of the country's exposure to climate change (rising sea level and the resulting inundation) and main natural disasters affecting the country.
 - (ii) The direct fiscal impact of climate change and natural disasters in recent years.
 - (iii) Allowance for climate change and natural disaster-related costs in the budget (Reserves, Funds, etc.).
 - (iv) A summary of the government's climate change and disaster risk management strategy, including catastrophe risk insurance.
- (e) *Regarding managing fiscal risks,* the MOF and the FRTWG, should focus their contributions on the *financial aspects* of the public policies, especially the following:
- (i) MOF and FRTWG must enhance procedures to be permanently in a "state of preparedness", that is, if a natural disaster event occurs, the available financial strategies must be ready to be deployed and the rapid implementation of the measures initiated.
 - (ii) Financial strategies include: (i) Contingent Reserves and/or Allowances for natural disaster expenditures

- allocated in the budget; and (ii) Catastrophe risk insurance available (such as World Bank Catastrophe Deferred Drawdown Options (CAT-DDOs), ADB Contingent Disaster Financing (CDF), others).
- (iii) Other Contingent Liabilities, such as the current financial budget transfers to elderly people in the country. In the long run, it may be considered or transformed in a pension scheme.
- (f) Incremental Approach for preparing the Fiscal Risk Report
- (i) MOF should adopt an incremental approach to start preparing the FRR:
- (1) The first step is to begin identifying and quantifying a reduced number of fiscal risks and prepare a first annual FRR. The current Public Debt Bulletin can be enhanced by including risk indicators analysis. This debt portfolio risk indicator will generate inputs for the preparation of the FRR. Furthermore, the MOF could also analyze risks arising from two of the SOEs (energy and communication sectors). The FRR will be published on the MOF website.
- (i) To accomplish this first step, the MOF will set up the FRTWG with members from the Departments in which fiscal risks are generated.
- (ii) A Ministerial Order will be issued to guide the work and tasks of the FRTWG. The Committee should meet formally at least once a month. The Ministerial Order will be published.
- (2) In the second step, a second annual FRR will be prepared including the risks related to the debt portfolio and all SOEs, which might present potential fiscal risks.
- (3) In the third year, the annual FRR will also include macro risks.
- (4) In the fourth year, the annual FRR will also include climate change and natural disasters.
- (5) A FRR calendar is provided on Section E shows the steps and timeline.

3 Publishing the Fiscal Risk Report

- (1) The FRR shall be published no later than four months after the approval of the Government National Budget.
 - (a) The report shall ideally cover the three fiscal prior years.

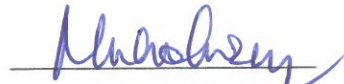
Made under my hand this 26th day of April, 2023.



HON. SEVE PAENIU

Minister of Finance

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