# GOVERNMENT OF TUVALU

# TUVALU FISCAL RISK REPORT

# 2024

# Contents

## ACRONYMS

| | |
|---|---|
| ADB | Asian Development Bank |
| AUD | Australian Dollar |
| CIF | Consolidated Investment Fund |
| CSO | Community Service Obligation |
| EIB | Europe Investment Bank |
| FRR | Fiscal Risk Report |
| GDP | Gross Domestic Product |
| ICDF | International Cooperation Development Fund |
| IMF | International Monetary Fund |
| SDR | Special Drawing Rights |
| SOE | State-Owned Enterprise |
| TDF | Tuvalu Development Fund |
| TEC | Tuvalu Electricity Corporation |
| TSF | Tuvalu Survival Fund |
| TTC | Tuvalu Telecom Corporation |
| TTF | Tuvalu Trust Fund |
| TWG | Technical Working Group |
| USD | US Dollars |

## Introduction

The Ministry of Finance and Economic Development has released the inaugural annual Fiscal Risk Report (FRR) for 2024 on behalf of the Government of Tuvalu. This report aims to align with international standards and to fulfill the requirement for a comprehensive National Budget as outlined in the Financial Instructions. To ensure the smooth preparation and coordination of this independent document, a Technical Working Group (TWG) was established under the Ministerial Order on Fiscal Risks Reporting (LN 5 of 2023) issued by the Minister for Finance in April, 2023.

This annual report outlines risks with a fiscal impact stemming from various sources and the Government's mitigation measures to reduce these impacts. Fiscal risks are possible deviations from fiscal outcomes expected at the time of budget formulation.[1] The realization of these risks creates additional burden on the government finances and difficulties in planning and budget execution, and increases public debt and refinancing difficulties. Thus, identifying, analyzing and mitigating these risks are important for effective fiscal planning.

In general, this report encompasses the Government's fiscal outcomes for 2021 to 2023 and two selected State-Owned Enterprises. The report broadens the scope of evaluated risks that are disclosed in the National Budget Framework.

The coverage is in line with the incremental approach of the 2023 Ministerial Order. This is the first publication and it will be published annually in April every year to ensure mitigation measures are accounted for in the Budget to the extent possible and given the availability of fiscal space

[1] https://www.worldbank.org/en/programs/debt-toolkit/fiscal-risk

# 1. Macroeconomic Risks

The IMF's global economic forecast in January 2024[2] projected a slight acceleration in growth at 3.1 percent in 2024 and 3.2 percent in 2025. This upward trend is on account of greater than expected resilience in the United States and several large emerging market and developing economies, as well as fiscal support in China. Global inflation witnessed a significant drop from 6.9 percent in 2023 to 5.8 percent in 2024 and further down to 4.4 percent in 2025.

The fluctuations in commodity prices can significantly affect economic growth, considering the reliance of countries on trade. Moreover, a continued increase in oil prices can result in substantial expenses for processed goods, impede trade viability, and diminish capital investments. These risks introduce uncertainties into government fiscal projections.

## 1.1 Macroeconomic Performance

The Tuvalu economy estimated a modest growth recovery of 3.9% in 2023 and projected a low growth trajectory going into the medium term.[3] Major impediments to domestic growth have driven largely by price hike on food items and energy. It is an imported inflation that has led to the current high cost of living which prompted the new government to craft immediate fiscal responses.

Lingering geopolitical tensions continue to create economic headwinds and elevate the uncertainties on major local project investments. Inflated costs of shipping and construction materials risk placing additional cost variation on major donor-funded projects. Tuvalu is an import dependent country and as a result became vulnerable to these shocks.

On the pre-COVID period, the average growth rate of 3.1% was registered between 2016 and 2018 prior to a significant rebound in 2019 with a growth rate of 13.8 percent. This was driven primarily by extensive construction projects undertaken for the Pacific Forum Secretariat Summit. However, the economy was negatively impacted in the emergence of the COVID-19 pandemic in 2020, resulted in a contraction of 4.3 percent on the back of border closure and disruption of major infrastructure implementation. Despite some recovery, economic activities have not fully returned

[2] IMF World Economic Outlook Update (January,2024). Available at World Economic Outlook Update, January 2024: Moderating Inflation and Steady Growth Open Path to Soft Landing (imf.org)
[3] IMF Article IV 2023 Report

to pre-pandemic levels, with growth reached at 1.8 percent in 2021 and further declined to 0.7 percent in 2022.

The sharp increase in domestic commodity prices during the period of 2020-2022 led to an annual average inflation rate peaked at 12.2 percent in 2022, before it fell down slightly to 7.2 percent in 2023.

*Table 1:Fiscal Budget Performance from 2021 to 2023 (Budget vs Actuals) - (Data Source – MoF 2021 -2023 National Budget)*

| Fiscal Budget Balance (2021-2023) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Year | NGDP | Budget | Actual | Deviation (Actual - Budget) | Budget to NGDP | Actual to NGDP | Deviation as % of NGDP |
| 2021 | 80.1 | 0.0 | (0.3) | 0.3 | 0.0% | -0.3% | 0.3% |
| 2022 | 85.2 | (8.6) | (12.0) | 3.3 | -10.1% | -14.0% | 3.9% |
| 2023 | 93.7 | (8.1) | 5.1 | (13.2) | -8.6% | 5.5% | -14.1% |

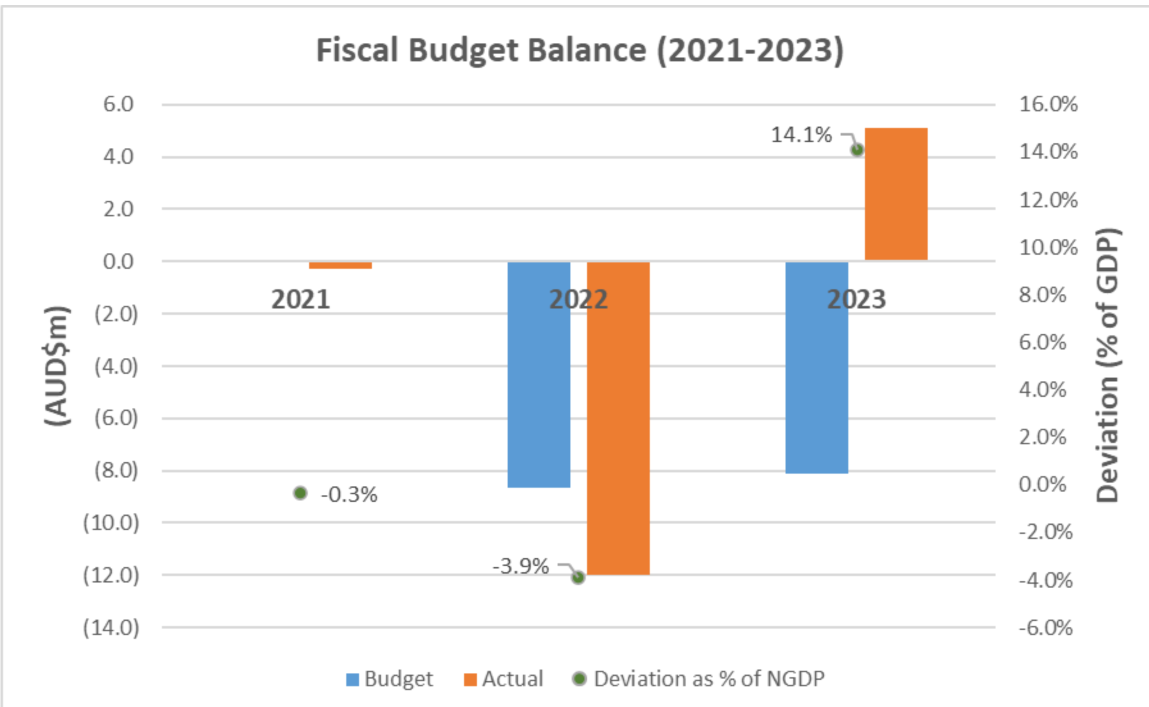



*Figure 1: Fiscal Budget Balance Performance. (Data Source – MoF 2021 -2023 National Budget)*

In 2021, the government initially committed to a balanced budget as indicated in Table 1. However, the actual budget outcomes revealed a slight deviation of 0.3%. This deviation was primarily attributed to a decline in revenue collection, rigid recurrent expenditures on goods and services, and reallocation of fundings to support proactive containment measures against COVID-19 outbreak. Anticipated with economic fallout of COVID, the government maintained the budget expenditure level to avoid a significant impact on service delivery despite revenue loss. The actual outcome dipped even further to 14.0 which was a slight deviation from the budget by 3.9%.

In 2023, the government secured a significant level of revenue through fishing license and budget support which enabled the maintenance of major expenditure programs. It was initially budgeted at -8.6% but the actual outcome was 5.5% which delivered a large deviation of 14.1%.

Optimistic revenue projections had distorted the budget outcomes for both 2021 and 2022, as shown in Table 2. The revenue forecasted for 2021 displayed a significant disparity from the actual collection by 14%. It went further off by 16% in 2022. Nonetheless, in 2023, the government was able to surpass its estimated revenue, due to augmented budget support from development partners, enhanced tax collections, and increased fishing revenues.

*Table 2: 2021-2023 Revenue Forecast vs Actuals*

| | **2021** | **2022** | **2023** |
|---|---|---|---|
| ***Forecast*** | 108,101,500 | 93,581,340 | 86,868,110 |
| ***Actual*** | 93,383,606 | 78,685,002 | 110,558,074 |
| ***Deviation*** | **- 14,717,894** | **- 14,896,338** | **23,871,964** |
| ***Deviation (%)*** | ***-14%*** | ***-16%*** | ***28%*** |

Fishing license contributed a significant portion of revenues in 2021 to 2023 with an average of 40 percent of the total revenue. However, the ratio of fishing license to GDP had been declined. It accounted for 49.2 percent in 2021, 45.6 percent in 2022 and it was estimated at 38.6 percent in 2023. On average, fishing revenues as a share of GDP for the three consecutive years stood at 44.5 percent. These revenues are highly susceptible to volatility due to ongoing climate change threats and exposure to foreign exchange risks.

## 1.2 Sensitivity Analysis

The fiscal accounts can be impacted by various macroeconomic factors such as inflation, exchange rates, and commodity prices. Inflationary pressures on domestic goods can negatively affect government planned expenditure. For example, when prices of goods and services rise, the government has to either make additional budgetary provisions or reallocation from other programs

Additionally, the government's major sources of revenue such fishing license, commercial contracts and budget support made up 83% of total revenue and are denominated in USD which expose them to fluctuations based on exchange rates and climate conditions. The table provided below demonstrates the sensitivity of significant fiscal estimates to inflation and exchange rates based on the Medium-Term Fiscal Framework (MTFF) 2023.

*Table 3: Sensitivity Analysis to Macroeconomic Shocks*

| | **2023 Estimates (In AUD million)** | | |
|---|---|---|---|
| **Sensitivity Scenarios** | **Revenue** | **Expenditure** | **Budget Balance** |
| Increase Inflation by 1% | 0.125[4] | 1.018[5] | - 0. 893 |
| Effect of 10% Exchange Rate Depreciation | 8.0 | 3.2 | 4.8 |
| Effect of 10% Exchange Rate Appreciation | -8.0 | 1.6 | -6.4 |

*Table 4: Sensitivity Analysis to Macroeconomic Shocks based on MTFF 2023*

The government's fiscal stance is susceptible to the impact of inflationary forces on commodity prices. A 1 percent surge in the prices of goods would result in a corresponding rise of AUD0.125 million in revenue and AUD1.018 million in expenditures, ultimately adding to a fiscal shortfall by AUD0.893 million.

A depreciation in the AUD to USD exchange rate erodes the buying power of the domestic currency against the foreign currency. When the AUD depreciates by 10 percentage points, it leads to an increase in domestic revenue collection by AUD 8 million. However, payment or transfer made abroad such as import, interest payment, international contributions become expensive which would add to the total expenditure by 3.2 million. This results in an additional fiscal collection that could finance new programs. In a situation where exchange rate appreciates by 10%, revenue originated abroad would plunge by 8 million and payment abroad would increase by 1.6 million.

Often, the government faces dilemmas of fiscal impacts from domestic revenue shortfall and expenditure overruns leaving behind a trail of large fiscal deficits. In 2021 the government budgeted for AUD108.1 million in total revenue and AUD114.0 million total expenditures. However, the government realized a total revenue of AUD93.4 million backs by the increased budget support and fishing license. For 2023, the government received more revenues than

[4] Taxation Revenues (MTFF 2023) – Source by MoF
[5] Recurrent Expenditures (MTFF 2023) – Source by MoF

anticipated and accumulated spending above the budget level. Table 4 below presents fiscal budget and actuals from 2021 to 2023.

*Table 5: Fiscal Budget vs Actuals (2021-2023)*

| All figures in $A million | 2021 | | 2022 | | 2023 Estimates | |
|---|---|---|---|---|---|---|
| | **Budget** | **Actual** | **Budget** | **Actual** | **Budget** | **Actual** |
| Total Domestic Revenue (A) | 74 | 58 | 75 | 64 | 62 | 70 |
| General Budget Support (B) | 35 | 24 | 19 | 15 | 24 | 40 |
| **Grand Total Revenue (C=A+B)** | 108 | 82 | 94 | 79 | 87 | 111 |
| Total Recurrent & One-Off Expenditure (D) | 84 | 75 | 91 | 82 | 84 | 95 |
| Capital Expenditures ( E) | 22 | 17 | 8 | 5 | 8 | 5 |
| Statutory Expenditures (F) | 2 | 2 | 3 | 4 | 3 | 3 |
| **Grand Total Expenditure (G=D+E+F)** | 108 | 94 | 102 | 91 | 95 | 105 |
| | 0 | 0 | 0 | 0 | 0 | 0 |
| **Domestic Budget Balance (H=A-G)** | (35) | (36) | (28) | (27) | (33) | (35) |
| **Fiscal Budget Balance (I=C-G)** | 0 | (11) | (9) | (12) | (8) | 5 |

## 2. Public Debt Portfolio

The government possesses a limited stock of external public debt from two lenders, with ADB being the primary lender and ICDF Taiwan being the subsequent lender. As of end-2023, the total public debt amounted to AUD4.29[6] million, a decrease from AUD5.07 million in 2022. The loans from ICDF and ADB are set to mature in the next 5 to 14 years, respectively.

Furthermore, the government does not provide any explicit guarantees for the loans of its State-Owned Enterprises (SOEs). The last time government settled the remaining balance of a loan incurred by public entities from the European Investment Bank (EIB) was in 2018. Yet, the domestic debt of public entities can create significant fiscal risks.

At the end of 2023, the total public debt stood approximately 5.8% of the GDP, indicating a decrease of 2.3 percentage point from the 8.1% percent recorded in 2022. All debts are fixed rate debt and there is no exposure to interest rate risk. To ensure medium-term fiscal sustainability, the government had maintained a fiscal anchor of limiting nominal debt to GDP. The assessed period of 2021-2023 (Table 5) reveals that the public debt as a percentage of nominal GDP remained below the benchmark of 30% of GDP. The debt portfolio has an Average Time to Maturity of 5.4 years.

[6] Extracted from the 2024 National Budget

Debt servicing refers to the process in which the government repays its loans to the lender in the original currencies they were denominated in, such as SDR and USD. Tuvalu, however, pegs its currency to the Australian dollar, which exposes it to foreign exchange risks and variations in interest and principal payments of its loan in domestic currency. If the Australian dollar devalues against the foreign denominated currencies, debt is likely to increase as well as the interest and principal payments.

*Table 6: Tuvalu's Public, Publicly Guaranteed and SOE Debt (Total debt figures extracted from the 2024 National Budget)*

| Total Public Debt, 2021-2023 (AUD million) | | | |
|---|---|---|---|
| **Lender** | **2021** | **2022** | **2023** |
| ADB | 3.51 | 3.04 | 2.6 |
| ICDF (ROC Taiwan) | 2.36 | 2.03 | 1.69 |
| ***General Government Debt*** | ***5.87*** | ***5.07*** | ***4.29*** |
| **SOE Borrower** | | | |
| Tuvalu Electric Corporation | *1.10*[7] | *1.10* | *1.10* |
| Tuvalu Telecom Corporation | *1.60*[8] | *0.76* | *0.07*[9] |
| ***Total SOE Debt*** | ***2.20*** | ***1.86*** | ***1.17*** |
| ***TOTAL PUBLIC DEBT***[10] | ***8.07*** | ***6.93*** | ***5.46*** |
| ***NOMINAL GDP***[11] | *80.1* | *85.2* | *93.8* |
| **Share of Nominal GDP** | | | |
| ***Public Debt*** | *10.1%* | *8.1%* | *5.8%* |

[7] TEC was unable to provide debt amount for the purpose of this analysis. However, presented figures were extracted from the IMF Staff Report for the 2023 Article IV Consultation – Debt Sustainability Analysis (page 6, June 23, 2023) . Available at [Tuvalu: 2023 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Tuvalu (imf.org)]

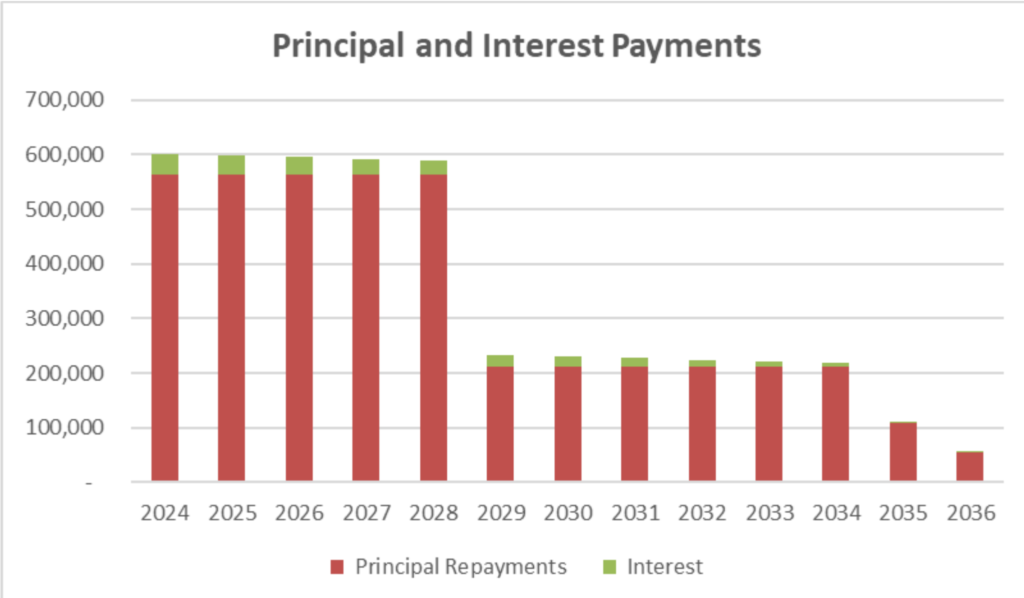
[8] IMF Staff Report for the 2023 Article IV Consultation – Debt Sustainability Analysis (page 6, June 23, 2023) . Available at [Tuvalu: 2023 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Tuvalu (imf.org)]

[9] TTC debt figures for 2022 and 2023 were taken as given from unaudited financial reports.

[10] Only TTC and TEC cover in this report and the remaining SOEs will include in the next report.

[11] IMF Article IV 2023 Report. Available at [Tuvalu: 2023 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Tuvalu (imf.org)]

*Figure 2:Principal and Interest Payment*




Similar to the sensitivity analysis above, a 10 percent depreciation in the domestic currency (AUD) is expected to increase the debt stock by AUD0.37 million, with the principal payment raised by AUD56,460and the interest payment increased by AUD3,748. These exchange rates fluctuations can exert additional pressures on the budget fiscal balance.

*Table 7: Sensitivity Analysis for Debt ~ Depreciation of AUD to USD by 10%*

| **Sensitivity Analysis of Exchange Rates** | **Base Scenario** | **Depreciation of AUD by 10%** | **Difference** |
|---|---|---|---|
| *Debt Stock (By end of 2024)* | 3,696,079 | 4,065,686 | 369,607 |
| *Principal Payment (2024)* | 564,603 | 56,460 | 56,460 |
| *Interest Payments (2024)* | 37,487 | 41,235 | 3,748 |

*Table 8: Sensitivity Analysis for Debt ~ Depreciation of AUD to USD by 10%*

## 3. Risks Arising from State-Owned Enterprises

State-Owned Enterprises (SOEs) are provided with yearly capital injections from the government to guarantee the effective provision of vital public services. Despite being overseen independently by board members and the management; government interventions may be implemented if needed.

There is a total of six[12] entities that fall under the jurisdiction of the Public Enterprises Performance and Accountability Act of 2009. Of these, two are financial corporations - the National Bank of

[12] IMF Article IV 2021 Report. Available at [Tuvalu: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Tuvalu (imf.org)]

Tuvalu (NBT) and Development Bank of Tuvalu (DBT), while the other four are non-financial corporations which include Tuvalu Post Limited (TPL), Tuvalu Electric Corporation (TEC), Tuvalu Telecom Corporation (TTC), and Tuvalu Broadcasting Corporation (TVBC). The assessment in this report primarily focuses on TTC and TEC, with plans to eventually incorporate other State-Owned Enterprises in upcoming reports.

The underperformance of SOEs poses a significant fiscal risk to the government. The quick ratio of TEC falling below 1 indicates that their short-term debts outweigh their liquid assets. Similarly, TEC profitability determined by EBITDA Margin ratio from 2020 (0.04) to 2022 (-0.17) and low returns on assets implies poor growth due to the inefficient management of revenues and costs. Consequently, the government finds itself in a precarious position, with an increased probability of providing additional financial aid to ensure the smooth functioning of state-owned enterprises.

Furthermore, the solvency ratio is a key indicator of state-owned enterprises' capacity to fulfill their long-term financial obligations, providing insight into their financial stability. The TEC debt to equity ratio has surged from 1.54 in 2020 to 4.38 in 2022, whereas TTC experienced a slight drop to 2.15 in 2022 from 2.53 in 2021. In essence, in 2022, for every dollar of equity, TEC and TTC hold $4.38 and $2.15 in debt respectively. Higher debt to equity ratios implies that state-owned enterprises heavily depend on borrowing to sustain their operations, thereby heightening their need for government financial assistance to ensure operational continuity, thus posing substantial risks to the government should these enterprises default on their debts.

*Table 9: State Owned Enterprise Liquidity, Solvency and Profitability Ratio*[13]

| Types | Ratios | TEC | | | TTC | |
|---|---|---|---|---|---|---|
| | | 2020 | 2021 | 2022 | 2022 | 2023 |
| Liquidity | Current | 1.33 | 1.37 | 1.21 | 2.81 | 3.65 |
| | Quick | 0.73 | 0.77 | 0.62 | 2.72 | 3.57 |
| | | | | | | |
| Solvency | Debt to Equity | 1.54 | 1.88 | 4.38 | 2.53 | 2.15 |
| | | | | | | |
| Profitability | EBITDA Margin | 0.04 | -0.10 | -0.17 | 0.31 | 0.42 |
| | Return on Assets | 0.01 | -0.08 | -0.13 | 0.12 | 0.12 |

[13] Data provided in this table were extracted from unaudited SOEs financial reports.

## 4. Climate Change and Natural Disasters

Tuvalu's susceptibility to climate-induced disasters and extreme weather events, such as cyclones, coastal flooding, storm surge, and drought, is high due to its geographical and physical characteristics, as well as sea level rise. These factors make the nation highly vulnerable. The escalating frequency of natural disasters not only results in significant financial burdens for recovery efforts but also strains the fiscal balance, depleting reserves and potentially necessitating increased government borrowing. For instance, the impacts of Cyclone Pam in 2015 amounted to an estimated cost of 30 percent of the country's GDP.[14] Similarly, the recovery and vulnerability reduction plan devised by the government for Tropical Cyclone Tino in 2020 anticipated a total recovery cost of approximately AUD103.09 million (155 percent of GDP).

*Table 10: TC Tino Recovery and Vulnerability Reduction Plan (2020-2023) Planned Costs*

| Tropical Cyclone Tino Recovery and Vulnerability Reduction Plan (2020 - 2023) | | |
|---|---|---|
| **Priority Areas** | **Estimated Cost** | **Immediate Priorities Description** |
| Food Security | 4,130,079.20 | Establish, maintaine and enhance food security for the people |
| Coastal Protection | 38,648,000.00 | Strategies for coastal protections and immediate actions to undertake to lessen severe disaster impacts |
| WASH | 4,845,597.00 | Strengthen water security and ensure people access to primary health care services during and after cyclone |
| Infrastructure | 50,633,070.50 | Ensure the people of Tuvalu access to communication services and build resilient building structures to withstand storm surges |
| Strategies for Implementation | 4,046,864.00 | Acquisition of emergency response kits and provide capacity building programs to disaster response team for smooth operation during disaster period |
| Disaster Response to date | 788,252.43 | |
| **GRAND TOTAL** | **103,091,863.13** | |

## 5. Managing Fiscal Risks

### *a. Mitigation measures for macroeconomic shocks and debt portfolio*

The government has undertaken a number of mitigation measures geared towards minimizing the impacts of macroeconomic shocks described above to prevent public finance challenges. These include:

[14] IMF 2023 Article IV Consultation Report (Tuvalu)

i. A thorough review of rigid expenses including the medical treatment scheme, sharp increase in goods and services spending, recent increase in the wage bill, subsidies, and scholarship. Consequently, such fiscal policy actions will create fiscal space to deal with future shocks or new capital investment priorities.
ii. Improve compliance of large taxpayers through annual audits.
iii. Strict enforcement of public financial management for sustainability through gradual attempts to reduce fiscal deficits to remain below sustainable level (-10 percent of GDP) and other fiscal anchors in the table below.

*Table 11: Fiscal Targets extracted from 2024 National Budget*

| Description | Target |
|---|---|
| **Expenditure** | |
| Scholarship to Domestic Revenue | 5% |
| Staffing to Domestic Revenue | 40% |
| TOMRS to Domestic Revenue | 6% |
| Others (travel, G&S, fuel, …) | 49% |
| **Revenue** | |
| Tax Revenue to GDP | 20% |
| Fishing License to GDP | 50% |
| **Additional Fiscal Ratios** | |
| Capital Spending to GDP | 30% |
| Fiscal Balance to GDP | -10% |
| Recurrent Expenditure to GDP | 60% |
| Nominal Debt to Nominal GDP | 30% |

iv. Rigorous implementation of the Procurement Act to enhance effectiveness in public expenditure, thereby fostering cost-effectiveness.
v. Increase the size of fiscal buffers from saving cyclical revenues to finance future budget deficits and avoid risks on increasing current debt levels.
vi. Adherence to no new (including non-concessional) external borrowing to eliminate refinancing risk and reduce exchange rate risk.

*Table 12: Financial Reserves 2021 - 2023 (Extracted from the 2024 Half Year National Budget)*

| Financial Reserves | 2021 | 2022 | 2023 (Sept) |
|---|---|---|---|
| Consolidated Investment Fund | 36,954,420 | 37,578,479 | 39,250,659 |
| Tuvalu Survival Fund | 9,208,489 | 9,156,390 | 9,125,872 |
| Tuvalu Development Fund | 17,495,800 | 9,022,540 | 10,119,747 |
| **Total** | **63,658,709** | **55,757,409** | **58,496,278** |

***b. Mitigating measures for SOEs***

As specify under the Public Enterprises Performance and Accountability Act the requirements to provide monitoring, the following measures are implemented to curb fiscal risks from SOEs which include:

i. promoting and strengthening SOEs accountability through regulating the development of a Corporate Plan,
ii. submission of timely quarterly financial reports and regular audit for financial performance improvements,
iii. enforce monitoring requirements by the Public Enterprise Reform Monitoring Unit,
iv. reviewing the structure of electricity tariffs to cover production cost,
v. adopting and implementing rules-based system for Community Service Obligations to help minimize risks from contingent liabilities.

***c. Mitigation strategies for climate change-related fiscal risks***

The government has consistently made a commitment to safeguard the future of Tuvalu by ensuring its resilience to climate change. Several initiatives have been implemented to achieve this goal, including:

i. Strengthening climate finance access through becoming an accredited entity for the adaptation fund, accessing green climate funds for coastal protection, and establishing the Tuvalu Survival Fund *(AUD9.13 million, 14 percent of GDP)* to address climate and environmental impacts.
ii. Ensure that the final Building Code Act will be in place and be enforced to reduce cyclone impacts on private and public properties in the future.
iii. Several adaptation measures are also being implemented including accelerating access for renewable energy for electricity generation, promoting the use of energy efficient appliances through the Energy Efficient Act 2016, access to safe maritime facilities, support waste management and promoting the use of biogas for energy.
iv. Increasing climate resilience of coastal areas and settlements, improving household water capacity and conservation techniques and strengthening community disaster preparedness and response.