ADB

Country Partnership Strategy

Document Stage: Draft for Consultation
February 2008

TUVALU
2008-2012

CURRENCY EQUIVALENTS
(as of 29 September 2007)

Currency Unit	–	Australian Dollar (A$)
A$1.00	=	$0.8732
$1.00	=	A$1.145213_

ABBREVIATIONS

ADB	–	Asian Development Bank
AusAID	–	Australian Agency for International Development
CIF	–	Consolidated Investment Fund
DPA	–	Development Partners Agreement
FTF	–	Falekaupule Trust Fund
GDP	–	gross domestic product
The Government	–	Government of Tuvalu
HIV	–	human immunodeficiency virus
IOU	–	i owe you
MDG	–	Millenium Development Goals
NBT	–	National Bank of Tuvalu
NZAID	–	New Zealand International Aid and Development Agency
PBA	–	performancebBased allocation
PE	–	public enterprises
TA	–	technical assistance
TMB	–	target minimum balance
TMTI	–	Tuvalu Maritime Training Institute
TTF	–	Tuvalu Trust Fund
TTFAC	–	Tuvalu Trust Fund Advisory Committee
UNDP	–	United Nations Development Programme

WEIGHTS AND MEASURES

square kilometers	–	Km^2

GLOSSARY

Falekaupule	–	Local island council
Te Kakeega II	–	National Strategies for Sustainable Development 2005-2015

NOTE

(i) The fiscal year (FY) of the Government of Tuvalu and its agencies ends on 31 December.

Vice President	C. Lawrence Greenwood, Jr., Operations 2
Director General	P. Erquiaga, Director General, Pacific Department (PARD)
Regional Director	S. Jarvenpaa, South Pacific Subregional Office, PARD
Team leader	T. Gloerfelt-Tarp, Principal Portfolio Management Specialist, PARD
Team members	A. Huang, Country Economist, PARD V. Narayan, Assistant Project Analyst, PARD T. Seniloli, Assistant Project Analyst, PARD C. Sugden, Country Economist, PARD A. M. Witheford, Governance Specialist, PARD

CONTENTS

EXECUTIVE SUMMARY

Development Context

Tuvalu has performed moderately well on economic and social indicators compared with many of its Pacific neighbors. Real GDP per capita is estimated to have grown at an average annual rate of 2% between 1995 and 2005, mainly in the public sector. The rule of law is upheld, access to basic services is generally good, and serious poverty is not a major problem. Tuvalu has made progress on some of the Millennium Development Goal targets, including universal access to primary education. On the other hand, an increase in non-communicable diseases, declining proficiency in English, and low pass rates in exams are causes for concern. In addition, Tuvalu has seen a shift from preventive towards curative health care, a trend that can impact negatively the outer island populations that are less well off.

The development challenge is also accentuated by the lack of human capital. Because of the relatively small population base and the limited opportunities available in the country, some talents are attracted by the better opportunities available in Australia, New Zealand, Fiji Islands and other places. In addition, a large number of young scholarship recipients often failed to achieve satisfactory grades in overseas studies.

The Tuvalu economy grew at a real rate of 7.3% per annum (p.a.) from 1996 to 2002, and 6.1% per capita (2002 is the latest year of measurement). More than half of the growth was recorded by an expansion in public construction and public business activities—notably transport, communication, and finance sectors—with most of the remaining growth recorded by an expansion in the civil service. By 2002, public construction and business activities were contributing 39% of GDP and ministries were contributing a further 30% of GDP. Large aid flows secured by Tuvalu have played an important role in the large public sector, but also in the volatility of the economy. In Tuvalu’s micro-sized economy, commencement of even a single capital project financed by grants can result in a year of high economic and employment growth, but the stimulus can quickly dissipate.

The Government’s national development strategy, *Te Kakeega II*, includes many areas targeting improvement in life for all, but is not prioritized. The primary challenge for the Government is to correct the fiscal imbalance and produce a credible budget with allocations towards the priority sectors.

A set of 5 Performance Benchmark Indicators has been formulated by the Government, ADB, AusAID and NZAID to track achievement of the stated social sector outcomes, through a focus on improved financial management. These benchmarks also consolidate the assistance programs for ADB, AusAID, and NZAID to support the prioritized and sustainable implementation of *Te Kakeega II*.

Government Development Strategy

Eight strategic areas are identified in *Te Kakeega II*: (i) good governance; (ii) macroeconomic growth and stability; (iii) social development (health, welfare, youth, gender, housing, and poverty alleviation); (iv) outer Island and Falekaupule development; (v) employment and private sector development; (vi) human resource development; (vii) natural resources (agriculture, fisheries, tourism, and environmental management); and (viii) infrastructure and support services. The expected results of implementation of the national plan are more employment opportunities, higher economic growth, better health care, better education, better basic infrastructure, and continued social stability.

Asian Development Bank (ADB) Development Strategy

The geographical isolation, the small size of the country as well as its population, the extremely limited resource endowment, the high debt vulnerability, the deteriorating CPA score in the governance cluster coupled with a fourth quintile place using the low-income countries under stress (LICUS) index, are all characteristics similar to a weakly performing country (WPC). A such, special consideration for engagement is warranted and this Country Partnership Strategy (CPS) emphasizes the intent of the Paris Declaration through a much strengthened partnership with other development partners in full agreement by the Government and alignment with *Te Kakeega II*.

Tuvalu's progress has been hindered by shortcomings in producing credible and prioritized budgets. There are several reasons for the poor budgets: (i) weak budgeting skills across ministries, (ii) limited recording or monitoring of expenditure arrears, (iii) poor accounting of donor-funded activities into Treasury's general ledger, (iv) capacity constraints in ministries preparing sector plans with financial forecasts, and (v) legacies of past bad policy decisions. The successive governments have rightly focused on education and health as the foundation for future opportunities by the country's sole asset, its human capital. ADB has aligned its assistance with *Te Kakeega II* and will also directly support the assistance provided by AusAID and NZAID through a focus on improved public expenditure and financial management. The CPS will encompass a long-term cluster-TA for capacity development to the Ministry of Finance, Economic Planning, and a Program Grant with the main policy focus on prudent financial management with an introduction of private sector management contract of a public enterprise. The intended outcome of the CPS is a credible budget that will assist to increase allocation of scarce resources towards the Government's priority areas: primary education and preventive health care. The proposed Program Grant will also facilitate better mobilization of domestic savings for private sector development and result in improved financial services in the outer islands.

Priority Sectors and Themes	**Sector** Financial Sector **Theme** Public Finance and Economic Management
Financing Envelope	Total ADF allocation is US$5.1 million.
Partnership Arrangements	A draft Development Partners Agreement is being finalized and builds on the Paris Declaration with an objective to improve aid effectiveness. ADB, AusAID, and NZAID are expected to sign the Agreement early 2008 with Tuvalu's other development partners expected to sign later in the year. Close coordination with the European Union, the Government of Japan and Taipei,China, and UNDP has ensured that no overlap in development assistance exists.
Risks and Mitigating Actions	There is a risk that the will of the country authorities to manage recurrent fiscal expenditures in accordance with existing revenues may be affected by political considerations. In particular, there might be a risk to implementation of improved budget management, if Tuvalu does not see incentives in greater fiscal prudence, but continues to receive aid, when facing fiscal challenges on the account of less than optimal policies. The political will and buy-in by all the country authorities will require close management and monitoring by Tuvalu and its development partners.

I. DEVELOPMENT CONTEXT: CURRENT TRENDS, ISSUES AND CONSTRAINTS

1. Tuvalu's development constraints can be summarized as: (i) an extremely limited natural resource base, (ii) widely scattered and sparsely populated islands remote from major markets, (ii) a lack of economies of scale and high transaction cost, (iv) a social and cultural system that can resist change and support unrealistic expectations of government, (vii) cultural constraints on trade in land, and (ix) the capacity constraints that come with a small population.

2. The physical constraints present the most severe challenge to development. Tuvalu has a total land area of 26 square kilometers (km^2) covering nine coral atolls and reef islands spread across more than 900,000 km^2 of Pacific Ocean. Land resources are of poor quality, with the highest point of land only a few meters above sea level. Tuvalu is rated as extremely vulnerable on the Environmental Vulnerability Index[7] and its low-lying atolls face cyclones and the prospect of marine inundation in the event of rapid rising sea-levels.

3. Of the total population of approximately 11,000 persons, more than half live on the capital island of Fongafale in the Funafuti atoll, which has an area of only 2.8 km^2. The closest regional centre is the Fiji Islands, which is 1,100 kilometers to the south of Fongafale. The small size and isolation lead to a high cost environment for most business activities. Productivity is impaired by capacity constraints that arise from difficulties faced in generating appropriate competencies and performance and in retaining highly skilled individuals.

4. The development challenge is also accentuated by the lack of human capital. Because of the relatively small population base and the limited opportunities available in the country, some talents are attracted by the better opportunities available in Australia, New Zealand, Fiji Islands and other places. In addition, a large number of young scholarship recipients often failed to achieve satisfactory grades in overseas studies.

5. The expenditure of the Government of Tuvalu (the Government) is very high in Tuvalu– the ratio of expenditure to gross domestic product (GDP) ranged from 150% to 220% from 1999 to 2003 and is likely to have remained above 125% in recent years because a large portion of expenditures is spent on imports. Hence government expenditure is the main driver of economic activity. A private sector-led economy is yet to emerge, and given the inherent constraints in such a small country the private sector may never achieve lead status in the economy.

6. Tuvalu's strong communities provide a social capital that is reflected in relatively good rankings on many international measures of governance. Yet hardship and gender inequity are ongoing issues. Cultural constraints impinge on trade in land to the detriment of economic activity and efforts to help the landless, who are among Tuvalu's most vulnerable people. There is also some apprehension towards the pressures for performance that come with modern markets and modern systems of managing public resources, and also towards foreign investors. Community expectations of secure jobs appear to be behind a public service that is unnecessarily large and soaks up the funds needed for essential goods and services and capital expenditure. A widespread community acceptance of extensive government involvement in business also suppresses sustained economic growth because the large public sector crowds out the private sector.

[7] South Pacific Applied Geoscience Commission and the United Nations Environment Programme, Environmental Vulnerability Index (www.vulnerabilityindex.net).

7. Tuvalu's development challenges are magnified in the outer islands. Outer island residents have poorer access to quality services and fewer opportunities for paid employment. There is dependence for cash on remittances from seafarers and Funafuti-based public servants. Lack of transport is a serious constraint to service delivery and income generation. Funafuti dominates job opportunities in the public sector while subsistence is the main economy in the outer islands. The result is a skewed income distribution–average gross weekly income of a Funafuti household is 3.4 times that of an outer island household.

8. Despite its severe development constraints, relative to its neighbors, Tuvalu has performed moderately well against key economic and social indicators. (Appendix 1, Table A1.1; Table A1.2). Income growth has been relatively high since the mid-1990s, the rule of law is upheld, access to basic services is generally good and extreme poverty is not present. Tuvalu scores relatively well on many of the Millennium Development Goal (MDG) targets, including universal access to primary education. (Appendix 1, Table A1.3). However, there is a dearth of MDG data in Tuvalu and most are outdated. Of concern are the declining data on poverty, percentage of women in employment, no female representation in Parliament, and infant mortality rate. The record of malaria death should probably be attributed to the seafarers as malaria is not endemic in Tuvalu. On all other MDG data available Tuvalu has made progress.

9. For these reasons Tuvalu ranked close to average in the Asian Development Bank's (ADB) 2007 Country Performance Assessment (Appendix 2), which assesses a developing member country's policy and institutional framework for promoting poverty reduction, sustainable growth, and effective use of concessional assistance.

A. Political Environment

10. Tuvalu has a relative political stability at regional standards, but this stability has been at the expense of a tendency to inertia in government decision-making. The 2006 general election brought with it major changes. Several long-term members of the previous Government were not reelected, suggesting that the people of Tuvalu wanted changes. Seven new members of Parliament were elected, of whom the majority is former civil servants. After some initial positioning and deal making a new Government was formed. The new Government faced major challenges with regard to the financial situation of the country. Long overdue bills, numerous "I owe you" bills, and a generally depleted Treasury forced the Cabinet to drastically rein in expenditures and at the same time insist on increased performance measures for the civil service.

11. Tuvalu does not elect politicians through a political party system, but instead members of Parliament are elected based on their individual merits. The Government consists of the Cabinet members plus the Speaker and the remaining parliamentarians normally form the opposition. With governments typically holding a one seat majority, an immediate turn-around in policies is unlikely. Instead even reform-minded governments are likely to adopt a precautionary approach with emphasis on issues that can deliver positive impact and solicit support in the wider population. However, in October 2007 two ministries were separated from the traditional configuration and are now headed by new ministers. These positions were filled by members of the "opposition". The Government now enjoys a comfortable majority.

B. Macroeconomic Management Issues

1. Socioeconomic Issues

12. While Tuvalu has performed comparatively well in providing access to basic services, there are increasing concerns over the quality of these services. This is well demonstrated in the education sector—despite higher overall expenditure and better student teacher ratios, basic numeracy and literacy rates are declining and pass rates of secondary students sitting external exams have dropped. In relation to health performance, incidences of non-communicable diseases have increased significantly and now constitute a major public health threat. There is a worrying rise in the number of sexually transmitted infections and the incidence of HIV per head of population is also increasing. There has also been a marked shift from preventive health care toward curative health care, which has negatively affected most people from the outer islands. The main hospital in Funafuti often has to send patients abroad for treatment due to lack of medicine and functioning equipment and this scheme is extremely expensive.

13. Tuvalu's traditional, cultural-based social safety net means that there is little obvious poverty in the narrow sense. However, the traditional social structure and associated safety nets are coming under strain as external influences affect attitudes, education broadens horizons and aspirations are raised. The continuing migration to Funafuti (and overseas) from the outer islands is depopulating the outer islands and increasing the dependency ratios among those remaining. This means that there are fewer working age people in relation to the very old and very young. There are fewer people to do the construction and house maintenance, gardening and fishing, and to take care of the elderly. At the same time the increasing population on Funafuti is generating social tensions and land disputes. The relatively small share of the population that are landless thus tend to face a very low standard of basic service. Increasing hardship and poverty of opportunity is therefore being experienced both in the outer islands, where employment opportunities and incomes are very limited, and on Funafuti because of population pressure.

14. The gradual weakening in traditional systems that is occurring has been described as a “poverty of social spirit” as people become less inclined to help others. The steady monetization of the economy is one of the sources of strain on traditional customs and practices. Traditional cultural and family exchanges are increasingly involving money in addition to the traditional crops, handicrafts and such similar gifts. There is also growing concern that traditional skills are being lost as the younger generation are reluctant to engage in the hard work of a traditional subsistence lifestyle. Thus despite the strong traditional society there are signs that social safety nets are beginning to weaken. This means that sometimes the most disadvantaged are not always being cared for as well as they might have been in the past. Even those with good jobs in Funafuti can be under financial pressure from relatives who are staying with them, or who expect support from their better-off family members.[8]

2. Economic Growth

15. Despite the development constraints, important achievements in the economic sphere have included (i) a long-standing remittances from seafarers employed on international vessels, (ii) good revenue collections from offshore fishing operations in Tuvalu’s large sea area, and (iii)

[8] In 2002 17% of outer island households received remittances only from other family within the country. A further 11% received remittances both from outside and within Tuvalu.

large financial returns from the international marketing of Tuvalu's phone numbers and dot.tv domain name. A rising level of external revenue and grants has supported relatively good income growth, by regional standards, and progress in the transition to a service oriented economy—agriculture, forestry and fishing now provide less than 20% of GDP and approximately 40% of employment. Large offshore financial assets have been accumulated—holdings in two offshore trust funds are approximately five times GDP—and substantial savings have been invested offshore by the national superannuation scheme. However, Tuvalu does not have international competitive sectors and both seafarer remittance and trust fund earnings are subject to demand for such labors and international market developments.

16. The Tuvalu economy grew at a real rate of 7.3% per annum (p.a.) from 1996 to 2002, and 6.1% per capita (2002 is the latest year of measurement). More than half of the growth was recorded by an expansion in public construction and public business activities—notably transport, communication, and finance sectors—with most of the remaining growth recorded by an expansion in the civil service. By 2002, public construction and business activities were contributing 39% of GDP and ministries were contributing a further 30% of GDP. Large aid flows secured by Tuvalu have played an important role in the large public sector, but also in the volatility of the economy. In Tuvalu's micro-sized economy, commencement of even a single capital project financed by grants can result in a year of high economic and employment growth, but the stimulus can quickly dissipate.

17. The 2007 review of the Tuvalu Trust Fund (TTF)[9] stated that in March 2007 TTF was in a good financial position, with fund market value at A$102.6 million, or 7.0% above the maintained value 95.9 million, which is indexed to Australian inflation rate. The existence of the TTF has (i) created a financial asset for current and future generations with a maintained value currently at around A$106 million (about 3 times the size of Tuvalu's estimated 2007 GDP); (ii) provided around 12% of total recurrent budget revenue for FY2007 and funding for around 10% of total recurrent budget expenditure for the same fiscal year; (iii) strengthened positive external perceptions of Tuvalu's finances through the broadly successful operation of the TTF and its governance structure; and (iv) contributed (in recent years) around 8% of Tuvalu's Gross National Income. Although TTF provides needed recurrent budgetary support, it also produces complacency in the Government budget planning and creates certain level of moral hazard, particularly in years of good financial performance. Most importantly, the income is highly volatile, despite the existence of a TTF buffer account.[10]

18. Such a level of complacency is highlighted during the years of unexpected windfall revenues from favorable external conditions. Over the late 1990s and to 2002, such windfalls provided financial strength and allowed the Government to implement a large development program. The more recent experiences, however, demonstrate the risks inherent in such an approach to economic management. Over 2003 to 2005, the combination of low offshore income and high recurrent cost from these large capital projects, (and rising overall public expenditure and an imprudent level of lending by the financial institutions) pressured underlying budget balance and largely exhausted the country's financial buffers. Over a three year period the economy moved from buoyant conditions to an at risk state.

---

[9] Tuvalu Trust Fund Advisory Committee's (TTFAC) First Half -Year Report for 2007 to the Government of Tuvalu and the Board of the Tuvalu Trust Fund (TTF).

[10] The buffer account is Consolidated Investment Account (CIF), and the target minimum balance is 16% of TTF maintained value. CIF accumulates excess reserves during the good years for unforeseen budget support during the years of poor TTF financial performance.

19. In conclusion, Tuvalu's economy is highly volatile, and even the trust fund earnings can suddenly dissipate during market downturn. Also due to the ultra-small size of the domestic economy, any large capital projects could put pressure on the subsequent recurrent expenditure on, e.g., maintenance and operations. The fluctuations of the offshore earnings in early 2000s typified such a case. The Government and the Development Partners of Tuvalu agree that more needs to be done to build buffers against volatility, including the development of the private sector. Innovative policies and a willingness to embrace economic and structural reforms is needed to achieve economic and employment growth and to ensure outer islands are able to receive a reasonable share of the benefits of development.

3. Private Sector Development

20. The Government's almost total control of all service deliveries through its 10 statutory corporations[11] and a variety of other activities including stevedoring, travel agency, fish supplies and repair shops, amount to a direct crowding out of the private sector. As most of these activities are also loss making it also indirectly hamper the private sector development as fiscal deficits absorb the country's capital and public sector pay-rates and work-effort set benchmarks the private sector cannot afford to match. Some public enterprises/activities could lend themselves to private sector management contracts or privatization in order to improve efficiency. However, it is difficult to formulate a clear roadmap for private sector development given: the small size of the country; the general lack of commercial experience within the population, almost no foreign direct investment; and the risk of creating private sector monopolies as many sectors are so small that competitive pressures will be difficult to generate. In addition, Tuvalu in general is by tradition an egalitarian society, a history that carries with it restrictions on the emergence of a profit-seeking private sector.

21. However, there are several reasons why a private sector lead economy is unlikely in the near or even medium future. With a few notable exceptions the good restaurants and retailers are run by people of non-Tuvaluan decent. The lending institutions have over the years provided considerable credits for private sector lead initiatives, but with a very high rate of defaults. The private sectors in Tuvalu cites the special difficulties in doing business, especially the high risk and high transport costs, and consistently lobby for loans with interest rates way below the market rate. The combination of lack of business skills and experience, relatively few opportunities, and constrained access to capital has not been conducive for a rapid growing private sector.

4. The Fiscal Management

22. Over 2000 to 2002, there was a surge in external revenue from fish licenses and the international marketing of dot.tv. Grants as well as revenue from TTF were also relatively high over that period. Revenue from these sources then declined over 2003 to 2005, averaging Australian dollar (A$) 9 million p.a. compared to the annual average of A$35 million over the previous three years. Expenditure had grown quickly as offshore revenue had risen. While much of the additional expenditure was allocated to once-off items, some of the expanding expenditure items were recurrent in nature and proved difficult to reduce as the revenue position

[11] Development Bank of Tuvalu, National Bank of Tuvalu, National Fisheries Corporation, Tuvalu Electricity Corporation, Tuvalu Media Corporation, Tuvalu Telecommunications Corporation, Tuvalu Maritime Training Institute, Tuvalu Philatelic Bureau, Vaiaku Lagi Hotel, and Tuvalu National Provident Fund.

weakened. This resulted in considerable fiscal pressure. As a ratio to GDP, the budget deficit reached the order of 35% in 2003 and of 20% and 7% of GDP in 2004 and 2005, respectively.[12]

23. The large deficits quickly drew down the Government's liquid financial reserves. In net terms liquid financial reserves stood at 59% of GDP at the end of 2002, but they were exhausted by the end of 2005. The downturn in revenue resulted in very tight expenditure restraints and the compression of expenditure on capital, maintenance and goods and services. Financial relief was provided over 2006 by the TTF distribution from the improved earnings, attributed to the strengthening in the Australian capital market. The budget surplus was approximately 30% of GDP in 2006, and a surplus of 16% of GDP is budgeted for 2007. While the reliability of the fiscal outturn forecasts is made highly uncertain by the volatility in key revenue items.

24. The gross value of public debt was estimated as A$24 million as of the end of 2005. Taking into account the Government's cash holdings, the net debt was estimated as 72% of GDP, or of the order of 45% of GDP in net present value terms. Such debt levels were substantially above desirable levels. The improvement in returns from TTF meant that by the end of 2006 gross debt stood at A$21 million (approximately 65% of GDP), net debt stood at A$10 million (35%) and the net present value of net debt was approximately A$3 million (11%). Moreover, an additional inflow in early 2007 meant that as of April the Government's cash assets were larger than the net present value of gross debt.

25. Main debts that add to significant fiscal pressure include (2007 estimates by TTFAC) A$1.3 million owed to Tuvalu Telecommunications Corporation (TTC), A$5.0 million owed to the outer islands agency suspense account (OIASA), and A$1.3 million on the guarantees to the failed National Fishing Corporation of Tuvalu (NAFICOT) loan. In 2006, the debt to GDP level surpassed the threshold of 60%. As a result, there is a serious need for the Government to reduce the debt level during the years of beneficial TTF contributions, particularly paying off the abovementioned nonperforming debts. Due to the high volatility of dependency of the Tuvalu economy, Government should leverage the use of grant financing to stabilize its fiscal stance.

26. Furthermore, although the overall fiscal situation has recovered temporarily due to the improving TTF performance, this trend can be transitional and fiscal pressure remains. Staff costs now account for 40% of on-budget expenditure, well up on the 24% share of 1996. In 1994, public sector reform program became a core component of the then national plan and a civil service downsizing was proposed. By 2005, the number of established posts had grown by 37%, above their 1994 level, while the population had only grown by less than 10%. Average rates of pay also increased substantially over the period. Despite restraint over recent years, staff costs have risen to such high levels that they are now an ongoing source of fiscal pressure and compression of non-staff expenditure.

27. The problem facing Tuvalu is that it has allowed the trend level of expenditure and net lending to rise above the trend level of revenue and grants. This gives rise to an underlying budget deficit. Financial buffers need to be built up in good years so they can be used in poor years. TTF is not a buffer against volatility and uncertainty—it is instead a saving mechanism designed to provide a permanent source of recurrent revenue. The financial buffers are given in the Government's holdings of liquid assets in the Consolidated Investment Fund and the cash

[12] Budget deficits were A$9.8 million, A$5.7 million, and A$2.0 million from 2003 to 2005 respectively, against estimated GDP at current prices of between A$28 million to A$30 million. Sources: Tuvalu Government 2007 Budget and TTFAC 2007 Half-Year Report.

deposits in bank accounts. Action is required on both the expenditure and revenue side of the budget to build these buffers, and some progress has been made in this respect. In addition, the Government has recently put fiscal benchmarks in place to help achieve a fiscal consolidation. These benchmarks are being monitored by the Government, by the TTF Advisory Committee and by the international development partners.

C. Improving Public Financial Management and Procurement, and Combating Corruption for Development Management

28. The Government has recognized improved governance as an important requirement, if Tuvalu is to address its development challenges. In particular, the need to maintain an affordable public sector is a pressing priority. The public sector is too large, crowding out the private sector in terms of both employment opportunities and wage rates, influencing income distribution and encouraging rent-seeking behavior. The new Government is serious in setting the economy and fiscal position right and improvement in its Public Expenditure and Financial Management has been accorded the highest priority.

29. An ADB governance assessment (2007) focuses on performance in public financial management, procurement and combating corruption and highlights the priority challenges. There is a need for reform and improvement across most key aspects of public financial management. Weak budgeting skills across ministries limit the administration's ability to prioritize, prepare realistic budgets and revise budgets in an environment of expenditure constraint. The government's oversight of fiscal risks from other public entities is poor. There is a need for improved internal controls and stronger monitoring and reporting across the board. Tuvalu will need external technical assistance and financial management training to strengthen its basic public financial management capacity, such that it can effectively manage the program budgeting approach introduced in 2004 and utilize a medium-term budget framework. ADB will continue to assist in improving economic and financial management in the public sector through development of public financial management capacity and enhancing transparency and accountability within ministries and state-owned enterprises.

30. The recent fiscal difficulties were made harder to manage by difficulties in tracking expenditure. Changes in the net cash position (which equals the fiscal balance) are not reported publicly and are obscured by the Government's use of multiple sources of cash. Gaining a clear interpretation of the Government's fiscal management is complicated by the presence of a range of estimates of expenditure and revenue and the budget balance. The Budget Papers themselves present more than one estimate of some of the key aggregates (e.g., recurrent expenditure, the wage and salary bill) and historical data presented in the Budget Papers differ significantly to that presented in the audited accounts. This situation appears to be a reflection of the use of multiple accounting systems to prepare the budget as well as a general weakness in the accounting systems.

31. Public sector record keeping has been in a poor state generally. Information on the debt position of the public sector and the value of investment and performance of the offshore assets are generally not disclosed to the public. The extent of government guarantees is difficult to determine even though the policy is for such guarantees to receive Parliament approval. The (now corrected) rundown in the Government's net cash holdings was poorly understood within and outside the Government despite its seriousness.

32. Accountability and transparency are impaired by the limited information available on government operations and mechanisms for civil society to engage in government decision-

making. The main source of information on government operations is the Budget Papers. These papers identify the activities of the main sections within each ministry, performance indicators, and expenditure by item and revenue. However, in the past there were inconsistencies within the Budget Papers and performance measures are often unrealistic. AusAID fielded a long-term adviser to MFEP from 2005-2007 to assist the individual ministries with their budget proposals and subsequent submission for Parliament approval. MFEP's capacity was strengthened considerably in consolidating the individual submissions for final budget preparation.

33. On procurement, while the Public Tenders Board Regulations 1979 provide a general legislative framework, there is a need to revise procurement rules and processes to ensure they provide adequate controls and uphold principles of competition and value for money.

34. While corruption is not a serious problem, Tuvalu’s small size, clan-based social structure and communal traditions could, if not managed, exacerbate this risk due to blurred notions of impartiality and independence. There is a need to develop a comprehensive anti-corruption strategy based on a commonly accepted definition of corruption. The weakness of parliamentary oversight demonstrates the need to develop an accountability framework, within which ministers and public officials are expected to function. This framework should clarify the relationship between formal government institutions and processes and traditional customs.

35. Tuvalu’s scores on governance criteria in the ADB 2007 Country Performance Assessment (CPA) are just below the average of other Pacific island countries, haven fallen slightly since 2005. The CPA ratings are in Appendix 2. In particular, Tuvalu’s performance declined in relation to the efficiency of revenue mobilization, reflecting concerns outlined above. Transparency, accountability and corruption in the public sector is also an issue, mainly due to weaknesses in the Executive’s accountability to oversight institutions and the unclear role played by traditional norms and customs.

36. The Government is serious in setting the economy and fiscal position right and improvement in its Public Expenditure and Financial Management has been accorded highest priority. The Governance Assessment is in Appendix 3.

D. Gender

37. The Constitution provides for gender equality in education. Correspondingly, there are no significant differences in female to male in the education system and females are generally perceived performing better than the males do. A literacy rate of 99% has been achieved for both boys and girls in primary and secondary education. However, there are social pressures that discourage women from obtaining education and training at post-secondary levels. Only a third of post-secondary scholarships are awarded to women. There is a widespread belief within the Tuvalu society that women studying or working abroad are likely to find their partners abroad and thus will not return.

38. Gender disparities exist in participation in the labor force, land tenure, and inheritance practices. Although formal policies and laws provide for gender equality, women in Tuvalu, in general, cannot inherit land and a spouse of a landowner would have far fewer rights to the husband’s family’s land. According to the “Beijing +10”, the Department of Women’s Affairs reports that the banking system offers equal financial services to all men and women. In 2005, the number of women who gained credits from the Development Bank of Tuvalu increased from 16 to 30 comparing to number of males from 31 to 41. However, the loan approval rate is still

lower for women at 37% compared to men at 63%, while the total loan value for men at 74% is also higher than that for women at 26%.

39. Significant gender disparities exist in political participation at the national level. Although 1 woman was elected to Parliament in the 1990s, none of the 15 parliamentary seats today is held by a woman. Tuvalu ratified the Convention on Elimination of all forms of Discrimination Against Women (CEDAW) in 1999, and is also signatory to the Beijing Platform for Action and the Pacific Platform for Action. In addition, there is the Department of Women’s Affairs within the Ministry of Health and the Tuvalu National Council of Women advocating strongly for equality and better influence in decision-making at all levels.

40. Tuvalu will participate in a regional ADB gender study under a technical assistance for Strengthening Pacific Economic Analysis and Policy Development that aims to identify effective methods for mainstreaming of gender equity and advocacy in policy setting.

E. Environment

41. Tuvalu has a limited natural resource base on widely scattered islands, which rarely exceed 3 m above mean sea level. The country is highly vulnerable to the adverse impact of climate change and extreme weather events. This, in combination with beach mining/aggregate collection, has already caused extensive coastal erosion which is the major problem causing land loss. Other problems associated with climate change in Tuvalu also include flooding, inundation, salinity intrusion, shortage of potable water, increased health risks due to increased vector breeding sites, negatively affected food crops that may cause concern to food security, and extreme temperature and evaporation are major problems for the agriculture and water sector. The frequency of extreme events are increasing and exacerbating climate risks that will cause further economic pressure. Congested living conditions in Funafuti, due to a combination of increasing population, poorly planned land use, and overburdened water, sewage and waste disposal systems have all contributed to a fragile coastal environment and significant waste management problems. If migration to Funafuti from the outer islands continues these problems are likely to become much worse.

42. Tuvalu’s status as a Least Developed Country and the risk of climate change faced by the country have been the driving force for the preparation of the Tuvalu’s National Adaptation Programme of Action (NAPA), recently published in May 2007. NAPA was decided during the United Nations Framework Convention on Climate Change (UNFCCC) conference. The NAPA’s objective include identify and promote priority activities that address urgent and immediate needs for adapting to the adverse impacts of climate change among communities on vulnerable islands of the country. Its objective is to reduce severity of adverse impacts of climate change. NAPA has selected priority adaptation measures in the following areas which are most urgent for Tuvalu, i.e. coastal, agriculture, water, human health, fisheries, and disaster management. The NAPA has been submitted to the UNFCCC for funding consideration. (Appendix 1, Table 1.4).

43. The most frequently cited environmental disaster to hit Tuvalu is the rising sea-levels that threaten the islands to submerge beneath the sea. Many footages of water flooding low-lying areas and even the airstrip have been shown worldwide on television. However, it should be noted that extreme high tides, known as King Tides, have been a phenomenon for centuries. The impact is unfortunately accentuated now with increased coastal erosion and many more structures therefore affected. There are few, if any, mitigating measures that can prevent the impact of rising sea-levels in an atoll country. A healthy marine environment is probably the

most efficient measure where natural coral growth will dampen the wave actions and also supply the natural accretion to an atoll. Several donors have targeted waste management issues, which has the greatest impact on the surrounding marine environment and hence coral growth. Detailed development partners/donors matrix is in Appendix 1, table 1.5.

F. Disaster Risk Management and Risk Reduction

44. Tuvalu is especially vulnerable to natural disasters such as cyclones because of its low lying atolls and islands. The cyclones have the capacity to decimate the fragile ecosystem and effectively destroy the subsistence economy. The critical issues in the area of Disaster Management and Risk Reduction for Tuvalu have been found to be (i) lack of community awareness of risks and hazards mitigation, (ii) no communication backup, and (iii) lack of clearly defined disaster risk management arrangements.

45. The three cyclones of the 1990s have prioritized Disaster Management and have resulted in the establishment of the National Disaster Management Office (NDMO), new building codes incorporating cyclone proofing and educational and awareness programs for the community. A number of projects have also been implemented: the Global Environment Facility (GEF) assisted with NAPA; Tuvalu Association of Non-government Organizations and the Foundation of the Peoples of the South Pacific International conducted the Disaster Preparedness; and Adventist Development and Relief Agency assisted with the Small Disaster Preparedness and Response projects. Tuvalu also has a National Disaster Plan from 1997.

46. Tuvalu is in addition assisted by the South Pacific Applied Geoscience Commission (SOPAC) who have various programs to address Disaster Management and Risk Reduction for the Pacific Region, including the provision of support, where appropriate, for Tuvalu's representation at international training programs, workshops and conferences, and the provision of post disaster technical or institutional support following the impact of disasters.

G. Regional Cooperation and Integration

47. The Government is active in several regional initiatives. The Forum Fisheries Agency assists through its DevFish program to promote greater economic returns from the fisheries resources, primarily with analyses and recommendations on the important purse seine fishery and which strategies to apply. Through SOPAC, Tuvalu receives assistance in water management and climate change adaptation relating to coastal processes and Funafuti is one of the sites measuring sea-level changes. South Pacific Regional Environment Programme is providing assistance in waste management, and the Secretariat of the Pacific Community has various programs within Agriculture, Gender, HIV, and the all-important activity on maritime issues that has enabled Tuvalu to continue to have its Maritime Training Institute accredited to the International Maritime Organisation. Tuvalu is also in the process of ratifying the Pacific Island Countries Trade Agreement (PICTA) which aims to create a regional free trade zone, and the Pacific Agreement on Closer Economic Relations (PACER), which aims to liberalize trade with Australia and New Zealand.

48. Tuvalu pursues many regional initiatives, including design of the Pacific Regional Initiative.[13] In addition, Tuvalu participates in the ADB funded regional technical assistance for Strengthening Poverty Analysis and Strategies in the Pacific; Strengthening Pro-Poor Policy in

---

[13] 2006. ADB. *Technical Assistance for Strengthening Governance and Financial Management in PDMCs*. Manila (TA6360-REG).

the Pacific (Pacific Islands Economic Report publication series); Improving Delivery of Infrastructure Services; Implementation of Pacific Education Strategy and Skills Development; Pilot Strengthening of Civil Society Participation in Development in the Pacific; Private Sector Development Initiative; Supporting Strengthened Regional Cooperation among PDMCs; and Results-Based Project Management, demonstrating efforts of Tuvalu to benefit from subregional and regional cooperation opportunities.[14]

II. THE GOVERNMENT'S DEVELOPMENT STRATEGY

A. Development Goals and Strategy

49. The goal of the National Strategies for Sustainable Development 2005-2015 *(Te Kakeega II)* is pointy formulated as: "*Recognize the importance of sustainable development—[that is] development without compromising the ability of future generations to meet their needs—and endorse the Vision of* " by 2015, guided by strong spiritual values enshrined in its motto—'*Tuvalu mo te Atua*'—we will have achieved a healthy, educated, peaceful and prosperous Tuvalu."

50. *Te Kakeega II* has 8 strategic areas of (i) Good Governance; (ii) Macroeconomic Growth and Stability; (iii) Social Development: Health, Welfare, Youth, Gender, Housing, and Poverty Alleviation; (iv) Outer Island and Falekaupule Development; (v) Employment and Private Sector Development; (vi) Human Resource Development; (vii) Natural Resources: Agriculture, Fisheries, Tourism, and Environmental Management; and, (viii) Infrastructure and Support Services. The expected outcomes are (i) more employment opportunities; (ii) higher economic growth; (iii) better health care; (iv) better education; (v) better basic infrastructure; and, (vi) continued social stability.

51. To achieve *Te Kakeega II* goals of *sustainable budgets* and their *effective use* of resources to achieve public policy priorities, the Government, together with ADB, the Australian Agency for International Development (AusAID) and the New Zealand International Aid and Development Agency (NZAID) formulated 5 Performance Benchmark Indicators aimed at ensuring (i) prudent recurrent fiscal expenditures, (ii) maintenance of fiscal reserves, (iii) prudent debt management, (iv) sufficient education, and (iv) health spending.

B. Resource Mobilization and Investment

52. Given Tuvalu's limited resource endowment TTF is generally accepted among development partners to be the most efficient means to work with other key donors to help Tuvalu ensure financial stability in the future and thereby manage its recurrent expenditure. AusAID will channel at least 50% of it's A$3 million yearly program allocation for Tuvalu through TTF. NZAID annual allocation is around NZ$2.2 million and contributes on average 15%-20% of its assistance to TTF. In 2006 NZ$325,000 was transferred, followed-up with a NZ$1 million in 2007 to mark TTF's 20 years anniversary.

---

[14] 2004. ADB. *Technical Assistance for Strengthening Poverty Analysis and Strategies in the Pacific* (TA6157-REG), 2005 ADB. *Technical Assistance for Strengthening Pro-Poor Policy in the Pacific* (TA6257-REG), 2005. ADB. *Technical Assistance for Implementation of Pacific Education Strategy: Skills Development* (TA6268-REG), 2006. ADB. *Technical Assistance for Pilot Strengthening of Civil Society Participation in Development in the Pacific* (TA6319-REG), 2006. ADB. *Technical Assistance for Private Sector Development Initiative* (TA6353-REG), 2007. ADB. *Technical Assistance for Supporting Strengthened Regional Cooperation among PDMCs* (TA6379-REG), 2007. ADB. *Technical Assistance for Results-Based Project Management* (TA6436-REG), Manila.

53. In a normal year, the Government has very little fiscal capacity to fund capital investment and relies almost exclusively on development partners' assistance. Windfall revenues from fishing licenses and TTF will occur again, but the key lesson learned is that at-best these provide a short term solution. There are clear intentions by the new Government that it will pursue management contracts, if not privatization, for certain services and also divestiture of government shareholdings where feasible. Except for the banking sector, foreign direct investment is, however, likely to remain low. It is difficult for foreigners to do business in Tuvalu, it is in general not popular with the population and costs of doing business are high.

54. The investment priorities for the new Government are the upgrade of the main wharf on Funafuti and a general upgrade—or rather increased safety—of the interisland shipping service. Communication and internet access with and for the outer islands is another high priority area. The Government of Japan has pledged assistance for the construction of the jetty and NZAID is assisting with the ship-to-shore project. Taipei,China is planning to field a mission to Tuvalu in 2007 to explore possibilities for Information and Communication Technology projects and an agreement for a joint purse-seine fishing operation between Tuvalu and Taipei,China has also been reached. However, maintenance and operational costs of these investments need to be carefully monitored to ensure that economic growth will not be compromised.

C. Role of External Assistance

55. External assistance for infrastructure is typically 20-40% of the on-budget expenditures. Major external assistance in recent years are (i) interisland vessel (A$12 million in 2002); (ii) new hospital on Funafuti (A$10 million over 2002-2003); (iii) new Government building (A$12 million over 2002-2004); and, (iv) power plant on Funafuti (A$11 million in 2006). The new wharf at Funafuti is around A$10 million in 2008, and upgrade of Vaiaku Lagi Hotel for A$3 million in 2008.

56. Taipei,China and the Government of Japan are by far the two main donors for capital investment projects. The European Union (EU), AusAID, and NZAID are also considerable donors. In comparison, ADB's assistance is limited. A comprehensive development coordination matrix is in Appendix 1, Table 1.5.

57. The Government has the financial and human capacity to begin implementation of many of the strategies of *Te Kakeega II*. At present, however, many externally funded activities tend to be considered on ad-hoc basis without a clear framework for defining impacts, outputs, and inputs and particularly the linkages to Government's activities and capacity to sustainably finance recurrent costs. While the current approach has the benefit of flexibility, it is not suited to a systematic and rationalized approach to implementing *Te Kakeega II.* A process of identification of savings for prioritized implementation of new initiatives under a multi-year budgeting framework, a best practice in public sector management, could be applied in Tuvalu. Under this approach to funding implementation of *Te Kakeega II* more could be achieved even under tight fiscal constraints. In addition, greater harmonization among the development partners offers further potential to correct the disjointedness between some grant-funded and recurrent budget activities that is, under current conditions, resulting in operating costs rising above the fiscal capacity to fund such costs.

58. Development partners need to recognize the important role they play in the prioritization of public expenditure and, hence, a systematic and prioritized implementation of *Te Kakeega II*. This is because the development partners support a large share of expenditure and send signals on public resources management that have considerable repercussions. Non-priority

capital investment can impose a significant opportunity cost by diverting resources from the country's most important needs to less important initiatives.

59. All Tuvalu's development partners have been engaged in the refinement of the Government's draft Development Partners Agreement (DPA), (Appendix 4), which is rooted in the Government's key benchmark indicators (Appendix 5) for prioritized development, namely a 5% non-salaried increase in the national budget for the primary education and preventive health care sectors. The DPA is expected to be signed first by ADB, AusAID and NZAID in early 2008 and is open for other development partner's signature at any time. The DPA should ensure that the Government's priorities are not compromised.

D. Asian Development Bank's Assessment of the Government's Development Strategy

60. *Te Kakeega II* sets out a range of public sector reform initiatives to pursue to the year 2015, including to (i) realign the role and size of the public service; (ii) identify departments that can be reorganized for commercialization; (iii) contract out senior public service posts; (iv) clarify the roles of ministers, secretaries, and heads of department to eliminate political interference; (v) strengthen performance appraisal process; and, (vi) review policy on public servants operating or owning private businesses. *Te Kakeega II* establishes a target deficit of not more than 2%–3% of GDP and an external debt of not more than 60% of GDP. These targets are likely to be achieved over the medium term, but require achievement of intermediary objectives given in the Benchmark Indicators. In addition, a broad range of initiatives are also formulated for Fiscal Management, Public Administration, and Public Enterprise Management.

61. Te Kakeega II establishes budget expenditure priorities for primary and secondary education, primary health care, and employment-oriented technical and vocational education. Currently these collectively account for only about 15% of expenditure––still low level resource allocation for the Government's priority activity. However, whether the Te Kakeega II objectives for the social sector outcomes can be reached will depend on achieving overall improvement of management of public finances and be an important indicator of the quality of public expenditure management and performance against the agreed Performance Indicators.

62. The *Te Kakeega II* strategies are generally sound and, if implemented, have the potential of bringing Tuvalu's public sector management to an international standard. The strength of *Te Kakeega II* is its highly participatory formulation with the largest public consultations undertaken since the country's separation from Kiribati in 1975. However, the reform agenda is highly ambitious, non-prioritized, and many of the intended decade-long implementation plans are too brief. Implementation of *Te Kakeega II* is also likely to be heavily constrained by political will and the limits on human capacity arising from Tuvalu's small population.

63. For *Te Kakeega II* to be advanced, the Government will need to decide which strategies are to be implemented first. The public sector management strategies are interrelated, and while this makes it difficult to determine which strategy item should be implemented first, choices are best guided by what is realistically achievable as well as by sequencing initiatives to ensure that they complement one another.

64. For example, achieving a sustainable fiscal position requires expenditure restraint. The overall fiscal imperative can probably be met by cutting expenditure on capital, maintenance, and other goods and services. But good expenditure restraint also requires restraint on the

number of public servants and the pay and travel bill of public servants and Members of Parliament. When the Government was advised during the 2006 Budget round of the large TTF distribution available, the first initiative was to increase pay rates by 3%–7%. This decision was made in preference to revisiting expenditure cuts made to essential items during the budget round.

65. Taking these considerations into account, it is suggested that the initial emphasis should be on reversing the trend of budget deficit. It is very difficult for the public service to function effectively if it is subject to expenditure cuts or if there are delays in providing agreed funding. It is easier to improve the quality of expenditure once fiscal discipline is achieved. In this respect, actions based on the existing systems for budget management should probably be pursued in preference to those requiring the adoption of new approaches.

III. ASIAN DEVELOPMENT BANK'S DEVELOPMENT EXPERIENCE

A. Development Impact of Past Assistance

66. Since joining ADB in 1993, Tuvalu has received 3 loans: 1 program loan 1693-TUV: Island Development Program for US$4 million and the ongoing loans 1921/2088-TUV: Maritime Training Project. The Island Development Program was designed to complement the Falekaupule (local council) Act 1997, for which the Falekaupule Trust Fund (FTF) was established in 1999 as a method for funding community-selected projects, while strengthening each island's capacity to steward its own development. The Government matched the individual island contributions dollar for dollar and ADB's loan was distributed proportionately. The combined contributions of the Government and the individual islands plus returns on investment have resulted in a current market value of around A$25 million. Determined and administered exclusively by the island councils, the first two distributions from FTF were implemented in conventional projects, principally on buildings and equipment for the island councils and on water and smaller farming projects. While FTF has been successful in building up its value and FTF has become a sustainable and a cost-effective way to fund outer island development in ways that are relevant to island communities, it still is experiencing some problems regarding the rules for contributing to the principle endowment and long delays in approving projects.

67. The Maritime Training Project will ensure continued accreditation of Tuvalu's seafarers by the International Maritime Organisation's (IMO) critical for them to continue employment on foreign vessels. The Project will also increase the number of graduated seafarers by 50%, thus facilitating greater contributions to the outer island communities through their remittances. The physical and technical upgrade of the Tuvalu Maritime Training Institute (TMTI) is timely as there is a worldwide oversupply of seafarers and only institutions with an IMO accreditation will be allowed to supply seafarers internationally.

68. In the same period, Tuvalu has received 19 TAs—5 PPTAs and 14 ADTAs—for a total of US$4.78 million. The low absorptive capacity often coupled with inappropriate staff skills and low productivity has reduced the impacts and outcomes of most TAs. Consultants, in general have implemented inputs rather than transferred technology, and while the outputs have been achieved, the skills transfer and capacity development were only of fleeting benefit. The ADTAs for financial management suffered from a lack of thorough assessments at the formulation stage as to the reasons for the performance gaps in the institutions targeted by such assistance. There has also been a tendency to propose and implement new systems, generally appropriate for much larger countries, rather than efforts to improve and integrate existing systems, more proportionate for a country with a total population the size of a small village in a larger country.

B. Portfolio Performance and Status

69. Lack of dedicated counterparts, often due to a plethora of other and similar assistance programs by other development partners, but also due to frequent staff turn-over, and/or overseas training, has made it difficult to achieve intended impacts and outcomes from ADTAs. The Government has often been impatient to rectify a particular shortcoming, and have had limited appreciation of the meaning of capacity development, and other development partners have simultaneously been approached for the same assistance. This often necessitated change in scope after approval of a particular TA to avoid overlap, but has also further eroded the targeted capacity development.

70. With only one program loan completed and one investment loan, plus its supplementary loan, under implementation, it is probably a too small sample to draw extensive lessons from. Nevertheless, these loans have demonstrated common characteristics that should be accounted for in future loan processing. These include: (i) limited understanding within the Government on the terms and conditions a multilateral institution like ADB work with; (ii) only a scant interest in the actual processing of the loans and hence limited understanding of covenants and other conditions in place for program loan or investment loans; (iii) limited appreciation regarding the concept of counterpart funding; and, (iv) incomprehension of the benefits of following ADB's *Guidelines on Procurement* or *Guidelines on Use of Consultants*.

71. Despite participation in ADB's Project Implementation Seminars understanding of normal disbursement procedures by government staff is very low. The ongoing loan and its supplementary loan are suffering long delays in implementation. A lack of appreciation for the only economic growth endowment Tuvalu has—its overseas employment as seafarers—and political brinkmanship by the past Government, coupled with major problems in understanding the commercial realities in the outside world, have all contributed to the delayed implementation. An inexperienced skills base, low absorptive capacity, and low productivity are all elements to consider in the future. Judging from the problems with implementation and repeated delays encountered with the current infrastructure investment loan(s), future projects should probably be program loans—from which a better experience exists—or direct contribution to either TTF or FTF. (Portfolio Indicators are in Appendix 1, Tables 1.6; 1.7; 1.8; 1.9.)

C. Weakly Performing State Characteristics

72. The geographical isolation, the small size of the country and the population, the extremely limited resource endowment, the high debt vulnerability, the deteriorating CPA score in the governance cluster, coupled with a place in the fourth quintile using the low-income countries under stress (LICUS) index are all characteristics shared with identified weakly performing countries (WPC). A such, special consideration for engagement is warranted and this CPS emphasizes the intent of the Paris Declaration through a much strengthened partnership with other development partners in full agreement by the Government and alignment with *Te Kakeega II*. The CPS is conforming to 8 of the 12 Principles for Good International Engagement as developed by the Organization for Economic Co-operation and Development's—Development Assistance Committee in the formulation of the most appropriate assistance to be provided to weakly performing states, namely: (i) move from reaction to prevention; (ii) align with local priorities and/or systems; (iii) promote coherence between donor government agencies; (iv) agree on practical coordination among international actors; (v) do no harm; (vi) mix and sequence aid instruments to fit the context; (vii) act fast; and, (viii) stay engaged long enough to give success a chance.

73. The CPS will, therefore, closely follow the identified two pillars for engagement with WPC through (i) selectivity and focus; and, (ii) strategic partnerships. A joint development strategy was formulated between ADB and AusAID in 2006 and a set of Performance Benchmark Indicators were also formulated in 2006 with the Government, ADB, AusAID, and NZAID as the guiding targets to achieve improvement in development impact in the identified priority sectors.

D. Conclusions and Lessons for the Country Partnership Strategy

74. In the past development partners programs have been spread thinly over a number of sectors and delivered, with the exception of the TTF and FTF, largely through grants and loans projects and TAs with benefits often ending upon activity completion. Implementation has often been resource intensive for all partners and donor coordination, and until recently, poor. TAs have not been well guided by government priorities and have, on many cases, created a situation of dependency. Although there has been ongoing support for the TTF, little attention has been paid to fiscal management and Tuvalu's ability to manage its recurrent budget. As a result, TA assistance to Tuvalu has been largely unsustainable and operational, and maintenance costs of infrastructure projects have only rarely been met. Key lessons learned include (i) the need to integrate assistance within government frameworks and systems; (ii) the importance of focusing on a few key sectors; (iii) the need to ensure that TAs are well defined, designed, and well managed by Tuvalu; (iv) the importance of good fiscal management; and, above all (v) a much better development partners coordination and collaboration starting with the Government's full disclosure of planned and approved interventions. A Completion Report for CSPU 2004-2006 is in Appendix 6.

IV. ASIAN DEVELOPMENT BANK'S STRATEGY

A. Summary of Key Development Challenges

75. Realizing Tuvalu's natural constraints—extremely small, remote, and a narrow natural resource base—the successive governments have rightly focused their priority to develop and strengthen the country's sole asset, its human capital. Emphasis on social inclusiveness includes free primary education, a generous scholarship program for tertiary education, and free health care system for all citizens. Primary schools on each of the 9 islands, a large secondary school on Vaitupu island are the results of such a policy. While Tuvalu scores reasonably well on most MDGs and the Human Development Index, declining English proficiency, a high drop-out rate, and an increasing percentage of secondary school repeaters are causes of concern. The health care system has also shifted from the more socially inclusive preventive health care towards the curative health care, which benefits more the well-off part of the population on Funafuti. While the overall budget for these 2 sectors is 35% of the total budget, only 15% is spent on actual development priorities, the rest on salaries. In adopting the joint agreement on the Benchmark Indicators, the Government has committed to increasing the non-salaried part of the primary education and preventive health care sectors with 5% by 2008.

76. Tuvalu's progress has been hindered by the shortcomings in producing credible and prioritized budgets. There are several reasons for the poor budgets (i) weak budgeting skills across ministries; (ii) lacking effective recording or monitoring of expenditure arrears; (iii) limited accounting of donor-funded activities into Treasury's general ledger; (iv) capacity constraints in ministries preparing sector plans with financial forecasts; and, (v) legacies of bad policy decisions. Mitigating against the latter, the Government has been successful in attracting *ad hoc* donor assistance to overcome immediate problems. However, as traditional development

assistance increasingly focuses on Management for Development Results, internal revenue streams are limited, and offshore revenues highly fluctuating, Tuvalu can no longer afford to produce budgets lacking in credibility, with weak budgetary control and poor in-year budget reporting, as these all impact negatively on the strategic allocation of the scare resources toward the identified priority areas. The *ad hoc* donor assistance in the form of unscheduled grants, while underpinning the budget, has undermined incentives for sound expenditure management of existing resources. However, the new Government is acknowledging the failures in achieving the goals and priorities by the various governments towards primary education and preventive health care and is determined to establish a public finance management system that can contribute and drive the delivery of these priority social service outcomes.

B. Strategic Framework

77. ADB's assistance to Tuvalu is aligned with the Key Results Area under ADB's Pacific Strategy 2005-2009, including (i) recognizing the need for increased flexibility and responsiveness to addressing issues facing the WPCs; (ii) recognizing the need for a longer-term, more flexible approach to capacity development; (iii) a deeper engagement with nonstate entities within the PDMCs; (iv) supply of essential policy and institutional reforms; (v) donor coordination to explore policy issues, joint strategy and programs; and, (vi) more explicit focus on governance and adoption of a regionwide results framework.

78. In 2006, ADB's and AusAID's common development assistance goals in Tuvalu paved way for the preparation of a joint development strategy. In alignment with *Te Kakeega II*, the joint strategy focuses on the fundamental constraints to enhancing the future opportunities for Tuvalu's human capital—targeting a healthy and educated population. The strategy is further reinforced by the joint formulation by the Government and ADB, AusAID and NZAID of the Performance Benchmark Indicators that target the key areas of concern—delivery of primary education and preventive health care through achievement of fiscal prudence. These benchmarks were promulgated by the Cabinet in early 2007 and are used by ADB, AusAID, and NZAID as defining targets for the alleviating the constraints to the implementation of *the Te Kakeega II.* The Country Partnership Strategy and Program Formulation is in Appendix 7.

79. The goal of ADB's and AusAID's joint strategy is to ensure maximum enhancement of Tuvalu's human capital to not only prepare it for a rather uncertain future in light of climate change but also to capture the few opportunities for a meaningful existence in a country with limited resource endowment. The joint strategy is guided by the principles of maximizing aid effectiveness, efficient aid management, strong donor coordination and harmonization, effective use of regional mechanisms, and support for Tuvalu's own development objectives harnessed, among others, in the Development Partners Agreement proposed for signing in early 2008. The joint strategy relies, however, on a strong commitment from Tuvalu to good economic and political governance.

80. With the CPS focusing on improvement of public finance management, under the joint strategy, ADB supports AusAID's work in Tuvalu in the education sector through the ongoing assistance to upgrade TMTI aimed at creating overseas employment opportunities. TMTI has successfully provided seafarers for primarily German shipping companies. Seafarers trained at TMTI are by far the most important source of remittances to the outer islands and thus the strengthening of TMTI is central to provision of quality vocational training and sustainable employment. In some islands, overseas remittances comprise as much as 50–60% of the family income. About 1,200 TMTI graduates are registered for employment as seafarers, of which 360

currently are working overseas.[15] Earnings of seafarers are in the range A$2 million to A$3 million per annum.

81. AusAID and NZAID have consistently addressed the educational issues in their respective assistance programs. In 2006, ADB funded TA[16] for the preparation of an Educational Masterplan for a subsequent investment project for a Secondary Vocational School development. However, as the priority of the new Government is on primary education, the proposed project was dropped. The Government of Japan and the European Union (EU) also contribute to the education sector with upgrading and construction of primary and secondary schools.

C. CSP Strategic Focus

82. Particularly in a micro-sized economy like in Tuvalu, poor expenditure allocation decisions have significant opportunity costs. For this reason, effective fiscal management will make the greatest contribution to meeting Government priorities and will be the focus of the Country Partnership Strategy (CPS). Backed by the joint strategy with AusAid, the Performance Benchmark Indicators, and the observer role of ADB at the TTF Board meetings that monitors performance of the Government, the CPS will focus on improving fiscal governance. In conjunction with the programs of the development partners, the CPS will thus contribute to improve the quality of Tuvalu's education system, vocational skills development, including at the TMTI, and ensure that basic health care is provided. In order to secure resources towards the priority sectors, improved financial management is a pressing necessity to subsequently produce a credible budget. To untie the binding constraint to prioritized budget allocation and directly support *Te Kakeega II* and the programs of AusAID and NZAID, ADB will together target (i) capacity development for improved financial management, and (ii) program assistance targeting fiscal prudence.

83. To expand the Government's capacity and develop broader demand for fiscal management, ADB, jointly with AusAID, will provide long-term technical assistance for improved budget management practices. Adapting to the local conditions, in-country mentoring and on-the-job training will be used, as appropriate. Initial support will focus on sound budget formulation to ensure that (i) revenue and expenditure items are as accurate and realistic as practicable; (ii) budgeted expenditure resources are allocated in line with Government priorities; (iii) the overall aggregate fiscal target for the budget is both understood and enforced; and, (iv) sector budgeting is outcome focused. In addition, under the CPS, ADB contribution towards total volume of resources is proposed to be structured similarly to a program loan/grant and include achievement of time-bound indicators as triggers for release of funds. The CPS proposes use of grant financing as program assistance to improve public financial management and an innovative approach to capacity development in the same area will be employed. These interventions should see the creditworthiness of Tuvalu improve in the medium to long-term, and thus enable a full access to future ADF allocations.

84. ADB's assistance complements the bilateral programs of AusAID and NZAID and brings compelling focus to assistance by EU, the Government of Japan, and Taipei,China. ADB's comparative strength is in support to public expenditure and financial management to enable achievement of the collectively agreed performance benchmark indicators—to attain the

[15] The number fell quite sharply from 431 in 2005 due to discipline problems. Steps have been taken to rectify this.
[16] ADB. 2004. *Technical Assistance to Tuvalu for the Preparation of an Education Sector Master Plan* (TA4306), Manila.

national objective to increase the non-salaried budget allocation for primary education and preventive health care with 5%, respectively.

D. Assistance for the Strategic Priorities

85. The country-specific ADF allocations have been derived on the basis of the results of the 2005 country performance assessment exercise, after applying the Performance-based Allocation (PBA) formula. ADF allocations for Tuvalu for 2007-2008 have been set at US$1.24 million. Additionally, an unused balance of US$1.43 million form the 2005-2006 ADF allocations will be carried over for 2007-2008 as allowed under the revised PBA Policy.[17] Due to its total public sector debt in net present value at the end of 2006 standing at 65% of GDP, Tuvalu will now receive its full ADF allocation, minus a 20% discount, as a grant for the period 2007-2008. This is equivalent to US$2.14 million. The grant will be structured as program assistance, where the necessary policy changes, triggers the release of funds. The grant will focus on improved financial management with the overall objective to assist Tuvalu achieve the Benchmark Indicators for public finance management, particularly to reduce its debt, more efficient management of public assets, and thereby increase resource allocation to the priority policy objectives, social development outcomes under the *Te Kakeega II*. For planning purposes, the indicative ADF amount for the periods 2009-2010 and 2011-2012 are likely to be around US$1.2 million, respectively, thus bringing the total ADF allocation for the CPS period to approximately US$ 5.1 million.

86. The policy focus of the Program Grant is envisaged to target (i) majority divestiture of the Government's shareholding in NBT; and, (ii) management contract for one public enterprise (PE). NBT has over the years acted as a *de facto* overdraft facility for the Government and therefore has prevented the implementation of prudent fiscal discipline. NBT has been consistently profitable; however, it joins the rank of the other government-owned lending institutions in facing a liquidity crisis, which in turn also hamper any private sector development. This liquidity crisis is a result of the accumulated Government overdraft stemming from budget support coupled with a considerable debt from its involvement in the Outer Island Agency Suspense Account, where deposits were remitted back into the consolidated revenues instead of back to NBT. The reduced banking service to the outer islands also constrains the mobilization of domestic savings that could be channeled towards private sector development. In the past, NBT previously shared ownership with a foreign commercial banks and a renewed interest by foreign banks is on the table, but is dependent on settling the overdraft debt.

87. The initial grant of US$2.14 million is targeting a program for approval in 2008 and with a relatively short implementation period. The indicative ADF allocations for the periods 2009-2010 and 2011-2012 totaling US$2.4 million could also be used for a follow-up program grant—assuming Tuvalu is still eligible for grant financing—towards private sector development or SOE improvements, where feasible

88. The Vaiaku Lagi hotel is a PE that is unprofitable. Yet, the hotel is the accommodation of choice by all tourist and visitors to Funafuti. But the facility is run down, by regional standards the service is poor, room rates are high, and the hotel is setting a poor standard that will inevitably impair prospects for tourism development. The Vaiaku Lagi hotel should be an obvious example to initiate management contract to the private sector as a concept in Tuvalu.

[17] ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development fund Resources.* Manila.

However, realizing the limited experience in proper hotel management within Tuvalu, the proposed management contract should be advertised regionwide.

89. The indicative annual TA support for 2008-2012 is set at around US$300,000. To overcome past failures in capacity development, assistance to improve financial management will be designed as a cluster-TA with sustained inputs delivered over 2-3 years. The TA will initially undertake a diagnostic analysis with the staff of the Ministry of Finance, Economic Planning to identify appropriate training modules and methodologies for performance gaps within the mandate of the ministry. A facilitator will be engaged to carry out this assessment in Tuvalu and the outcome will be a prioritized list of specific interventions to be implemented over the years. Achievement of performance benchmarks of staff competency will trigger the commencement of the next TA.

90. Realizing that past capacity development almost always involved specialized consultants that ended up being the implementers rather than the mentors/teachers, the cluster-TA will, to the extent possible, be designed to involve sustained long-term input of advisers with primarily training and coaching skills. This will be supported with short-term input of specialized consultants for refinement of existing systems or, when necessary, introduction and installment of new systems.

91. The country operations business plan for 2008-2010 is in Appendix 9. An Indicative Assistance Pipeline for Lending/Grant Products for 2008-2010 is in Table A7.1. An Indicative Assistance Pipeline for Non-Lending Products for 20080-2010 is in Table A7.2.

E. External Funding Coordination and Partnership Arrangements

92. Since early 2007, the Government, ADB, AusAID and NZAID have refined the draft Development Partners Agreement (DPA), which is based on the Paris Declaration. The DPA is not only intended to facilitate closer harmonization for improved aid effectiveness, but also to ensure that implementation of specific projects do not undermine the general priority direction as agreed upon in the Government's Performance Benchmark Indicators. Several drafts have been circulated to all Tuvalu's development partners and it is anticipated that the DPA will be signed by ADB, AusAID, and NZAID in early 2008 with most of the other development partners signing during 2008.

93. A past weakness with development assistance to Tuvalu was that the Aid Management Unit was not obliged to reflect the various assistance programs, planned or ongoing, in the budget. And it was equally difficult for development partners to get a clear picture of the overall external assistance. The Aid Management Unit has now been strengthened and the planned cluster-TA will ensure that all grant assistance will be reflected in the budget.

V. RISKS AND PERFORMANCE MONITORING AND EVALUATION

A. Risks

94. There is a real risk that ongoing support for recurrent budget needs may undermine the political will to manage expenditure in accordance with existing revenue. It might also undermine incentives for improved budget management, especially if Tuvalu does not see a need to direct additional revenue towards maintaining the CIF Targeted Minimum Balance or reducing debt. This will require close management by Tuvalu and its development partners.

95. Further, corruption appears now to be emerging as a risk in Tuvalu. The CPA scores on issues such as accountability to oversight institutions and state capture by vested interests have fallen somewhat between 2005 and 2007, suggesting that the risk of corruption needs to be taken more seriously than in the past. The governance assessment in Appendix 3 points to the need for public debate to develop an accepted definition of corruption, clarify how traditional customs can affectively interact with government institutions, and develop an accountability framework within which ministers and other public officials are expected to function.

B. Results-Based Monitoring Process and Plan

96. The Performance Benchmark Indicators is the key document for evaluating the intended impact and outcomes of the development assistance provided by the three development partners and the Government. The strength of the benchmarks is that these are anchored in *Te Kakeega II* and thus ensures the government's ownership. As monitoring capacity within the Government is currently weak, the Advisory Committee of TTF has agreed to monitor these indicators and will comment on achievement in its semi-annual reports.

97. The 5 indicators to be monitored are: (i) The Government's recurrent expenditure each year should *not* exceed the total of its recurrent revenue plus a sustainable TTF distribution; (ii) the target minimum value of funds retained in the CIF should be not less than 16% of the Maintained Value of the TTF; (iii) The Government's total debt liability at any time (both domestic and external) should not exceed 60% of GDP; (iv) increase the non-salaried expenditure on primary and preventive health care by 5% in 2008; and, (v) increase the non-salaried expenditure on basic education by 5% in 2008.

COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

Country Development Goals		CPS Outcomes		Key Areas of ADB's Intervention	Risks
Country-level Outcomes	Key Constraints	CPS Outcome(s)	Outcome indicators		
Good governance Macroeconomic growth and stability Employment and private sector development. Outer Island development. Social development Human resource development	Limited consequences for bad policy decisions Lacking budget credibility Pervasive government ownership of enterprise activities Low domestic resource mobilization	Budget allocations prioritized towards primary education and basic health sectors to improve and market Tuvalu's comparative advantages: its human capital Improved financial management	Non-salaried budget allocation for primary education and preventive health care increased by 5%, respectively by end of 2008 National Bank of Tuvalu enters into strategic partnership with a foreign bank. Vaiaku Lagi hotel is being advertised for private sector management contract	**Future assistance** Long-term cluster-TA for public expenditure and financial management. Program assistance for privatization and management contract of a selected state-owned enterprise Program assistance for SOE reforms for increased effectiveness and associated capacity development TA **Ongoing assistance** Loan(s) 1921/2088-TUV: Maritime Training Project Associated TA3942-TUV: Maritime Training Institute Strengthening TA4902-TUV: Capacity Building for Taxation Reform TA4466-TUV: Education Sector Reform and Development TA4214-TUV: Effective Waste Management & Recycling	A change in Government is potentially the gravest risk. Change management is not adopted nor accepted by all ministries.

COUNTRY AND PORTFOLIO INDICATORS

Table A1.1: Country Economic Indicators

Item		2002	2003	2004	2005	2006
A.	**Income and Growth**					
1	GDP Per Capita ($, current prices)	1,422	—	—	2,071	2,176
2	GDP Growth (%, in constant prices)	5.5	4.0	4.0	2.0	3.0
	Agriculture	(9.4)	—	—	—	—
	Industry	6.5	—	—	—	—
	Services	3.4	—	—	—	—
B.	**Saving and Investment** (% of GDP)					
1	Gross Domestic Investment	—	—	—	—	—
2	Gross Domestic Saving	—	—	—	—	—
C.	**Money and Inflation** (annual % change)					
1	Consumer Price Index	5.1	3.3	2.8	3.2	3.8
2	Total Liquidity (M2)	—	—	—	—	—
D.	**Government Finance** (% of GDP)					
1	Total Revenue and Grants	136.6	—	—	85.8	98.2
2	Total Expenditure	167.4	—	—	78.9	91.7
3	Overall Fiscal Surplus (Deficit)	30.8	(11.0)	(9.0)	(6.8)	(6.4)
E.	**Balance of Payments**					
1	Merchandise Trade Balance (% of GDP)	(52.7)	—	—	—	—
2	Current Account Balance (% of GDP)	11.7	—	—	—	—
3	Merchandise Export growth ($ fob, annual % change)	5.8	31.5	—	—	—
4	Merchandise Import growth ($ fob, annual % change)	52.3	30.4	—	—	—
F.	**External Payments Indicators**					
1	Gross Official Reserves ($ million, end of period)	—	—	—	—	—
2	External Debt Service (% of exports of goods and services)	—	—	—	—	—
3	External Debt (% of GDP)	34.2	—	—	—	—
G.	**Memorandum Items**					
1	GDP (current prices, $ million)	14.6	—	—	22.0	23.5
2	Exchange Rate (year average, A$ per $)	1.8	1.5	1.4	1.3	1.3
3	Population (mid-year, thousands)	10.3	10.3	10.4	10.6	10.8

— = data not available; GDP = gross domestic product; $ = US dollar; A$ = Australian dollar; M2 = money supply; fob = free on board; negative values in parentheses.

Sources: Government of Tuvalu, *Tuvalu National Accounts Report Revision in November 2003*, January 2004; Ministry of Finance, Economic Planning and Industries (MFEP), *Budget Address*, (2006, 2007); MFEP, *Tuvalu National Accounts*, various issues; MFEP, *Tuvalu Balance of Payments*, various issues; International Monetary Fund, *World Economic Outlook* database, available at http://www.imf.org/external/pubs/ft/weo/2007/01/index.htm; United Nations Economic and Social Development, *World Population Prospects (WPP): The 2004 Revision Population Database*, available at http://esa.un.org/unpp; Asian Development Bank Statistics Department (ADB), *Key Indicators 2007*, available http://www.adb.org/Documents/Books/Key_Indicators/2007/default.asp; ADB, *Asian Development Outlook 2007 Update*, forthcoming.

Table A1.2: Tuvalu Poverty and Social Indicators

Item	Period		
	1990	1995	Latest Year
A. Population Indicators			
1. Total Population ('000)	9.043 (1991)	9.510	10.178 (2004)
2. Annual Population Growth Rate (% change)	—	1.3 (1991-95)	0.7 (1996-2004)
B. Social Indicators			
1. Total Fertility Rate (births/woman)	3.4 (1991)	3.3	3.6 (2005)
2. Maternal Mortality Rate (per 100,000 live births)	—	—	—
3. Infant Mortality Rate (below 1 year/1,000 live births)	40.0	40.0	31.0 (2005)
4. Life Expectancy at Birth (years)	67.0 (1991)	—	—
a. Female	70.0 (1991)	—	63.0 (2005)
b. Male	64.0 (1991)	—	61.0 (2005)
5. Adult Literacy (%)	98.6 (1991)	—	95.0 (1998)
a. Female	98.9 (1991)	—	95.0 (1998)
b. Male	99.1 (1991)	—	95.0 (1998)
6. Primary School Gross Enrollment (%)	—	—	—
a. Female	—	101.1 (1998)	102.2 (2004)
b. Male	—	105.8 (1998)	95.1 (2004)
7. Secondary School Gross Enrollment (%)	—	—	—
a. Female	—	73.08 (1998)	81.3 (2001)
b. Male	—	83.12 (1998)	87.2 (2001)
8. Child Malnutrition (% below age 5)	—	—	—
9. Population with Access to Safe Water (%)	90.3 (1991)	—	100.0 (2004)
10. Population with Access to Sanitation (%)	78.0 (1991)	—	90.0 (2004)
11. Public Health Expenditure (% of GDP)	8.5	10.3	9.2 (1996)
12. Public Education Expenditure (% of GDP)	—	—	—
13. Human Development Index (Pacific)	—	0.652 (1994)	0.642 (2002)
Pacific Rank / number of PDMCs	—	5/12	11/15
14. Gender-Related Development Index	—	—	1.02 (2002)
Pacific Rank / number of PDMCs	—	—	10/15
C. Poverty Indicators			
1. Poverty Line (A$ per household per week)			
National	—	84.2 (1994)	—
Funafuti	—	126.9 (1994)	—
Outer Islands	—	53.4 (1994)	—
2. Poverty incidence (headcount index (%))			
National	—	29.3 (1994)	—
Funafuti	—	23.7 (1994)	—
Outer Islands	—	23.4 (1994)	—
3. Poverty Gap (%)			
National	—	13.3 (1994)	—
Funafuti	—	10.1 (1994)	—
Outer Islands	—	9.9 (1994)	—
4. Poverty Severity Index (%)	—	—	—
5. Inequality (Gini coefficient)			
National	—	0.43 (1994)	—
Funafuti	—	0.37 (1994)	—
Outer Islands	—	0.39 (1994)	—
6. Human Poverty Index (Pacific)	—	7.3 (1999)	9.9 (2002)
Pacific Rank / number of PDMCs	—	3/14	6/15

— = not available; GDP = gross domestic product; PDMCs = Pacific developing member countries.

Sources: Abbott, D., *Tuvalu Hardship and Poverty Status Discussion Paper* (10-Aug-03); Secretariat of the Pacific Community (SPC), Pacific Island Populations 2004 poster; SPC, *Pacific Islands Regional Millennium Development Goals Report 2004*, Statistical Annex, available online at http://www.spc.int/mdgs; SPC, Pacific Regional Information System (PRISM) (http://www.spc.int/PRISM); United Nations Development Programme (UNDP), *Human Development Report,* various years; UNDP, *Pacific Human Development Report* (1994, 1999, 2006 forthcoming); United Nations Educational, Scientific and Cultural Organization (UNESCO), Institute for Statistics website at http://www.uis.unesco.org; UNESCO, *The Education for All (EFA) 2000 Assessment: Tuvalu Country Reports*, available at http://www2.unesco.org/wef; World Health Organization (WHO), Regional Office for the Western Pacific, Western Pacific Region Health Databank, various revisions, available online at http://www.wpro.who.int; WHO, *The World Health Report,* various years (2000-2005); Asian Development Bank Statistical Database System, available http://lxapp1.asiandevbank.org:8030/sdbs/index.jsp, accessed 11 September 2007.

Table A1.3: Progress toward the Millennium Development Goals and Targets

		Goals and Targets	1990	1995	Latest Year	
C.		**Goal 98. Eradicate Extreme Poverty and Hunger**				
D.		**Target 1: Reduce incidence of extreme poverty by half from 1990 to 2015**				
	1.	Proportion of population below US$1 per day (PPP-values) (%)				
		National	—	17.2 (1994)	—	
		Funafuti	—	9.4 (1994)	—	
		Outer Islands	—	22.9 (1994)	—	
	2.	Poverty gap ratio (%)	—	13.3 (1994)	—	
	3.	Share of poorest quintile in national consumption (%)	—	7.4 (1994)	10	(2004)
E.		**Target 2: Reduce the proportion of people who suffer from hunger by half from 1990 to 2015**				
	4.	Prevalence of child malnutrition (% of children under 5)	—	—	—	
	5.	Proportion of population below minimum level of dietary energy consumption (%)	—	—	—	
F.		**Goal 99. Achieve Universal Primary Education**				
G.		**Target 3: Attain 100 percent primary school enrolment by 2015**				
	6.	Net enrollment ratio in primary education (%)	98.2 (1991)	98 (1998)	99.6	(2002)
	7.	Proportion of pupils starting Grade 1 who reach Grade 5	—	95.8 (1993)	99.7	(2002)
	8.	Literacy rate of 15-24 year olds (%)	95.0 (1991)	—	99.2	(2000-2004)
Goal 100.		**Promote Gender Equality and Empower Women**				
H.		**Target 4: Eliminate gender disparities in primary and secondary education by 2005 and to all levels of education no later than 2015**				
	9.	Ratio of girls to boys in: (%)				
		Primary education	87.0 (1991)	96.0 (1998)	107.0	(2004)
		Secondary education	105.0 (1991)	88.0 (1998)	96.0	(2003)
		Tertiary education	37.0 (1991)	—	108.0	(2003)
	10.	Ratio of young literate females to males (% of age group 15-24)	96.0 (1991)	—	100.0	(2000-2004)
	11.	Share of women in wage employment in the non-agricultural sector	38.0 (1991)	—	44.0	(2002)
	12.	Proportion of seats held by women in national parliament	7.7	7.7 (1997)	0.0	(2005)

	Goals and Targets	1990	1995	Latest Year	
I.	**Goal 101. Reduce Child Mortality**				
J.	**Target 5: Reduce infant and child mortality by two-thirds from 1990 to 2015**				
	13. Under-5 mortality rate (per ‘000 live births)	5 (1991	32 (2003)	38.0	(2005)
	14. Infant mortality rate (per ‘000 live births)	41 (1991)	21 (2003)	31.0	(2005)
	15. Proportion of 1 year old children immunized against measles	95.0	94.0	98.0	(2004)
K.	**Goal 102. Improve Maternal Health**				
L.	**Target 6: Reduce maternal mortality rate by three-quarters between 1990 and 2015**				
	16. Maternal mortality ratio (per 100,000 live births)	—	—	—	
	17. Births attended by skilled health staff (% of live births)	100.0	99.0 (1997)	100.0	(2002)
Goal 103.	**Combat HIV/AIDS, Malaria and Other Diseases**				
M.	**Target 7: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS**				
	18. HIV prevalence rate among: (%)				
	15-24 year old pregnant women	—	—	—	
	Adult rate (aged 15-49)	—	—	—	
	19. Contraceptive prevalence rate (% of women aged 15-49)	39.0	40.5	31.6	(2002)
	20. Number of children orphaned by HIV/AIDS	—	—	—	
N.	**Target 8: Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases**				
	21. Malaria:				
	Prevalence rate (per 100,000 people)	—	—	—	
	Death rate (per 100,000 people)	—	—	14.0	(2000)
	22. Proportion of population in malaria risk areas using effective malaria prevention and treatment measures	—	—	—	
	23. Tuberculosis (TB):				
	Prevalence rate (per 100,000 people)	145.0	—	57.0	(2004)
	Death rate (per 100,000 people)	8.4	—	5.4	(2004)
	24. TB cases, DOTS:				
	Detection rate (%)	—	—	100	(2004)
	Treatment success rate (%)	—	—	92.0	(2004)
O.	**Goal 104. Ensure Environmental Sustainability**				
P.	**Target 9: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources**				
	25. Forest area (% of total land area)	33.3	—	33.3	(2005)
	26. Nationally protected areas (% of total land area)	—	0.0 (1994)	1.1	(2004)

Goals and Targets	1990	1995	Latest Year	
27. GDP per unit of energy use (PPP$ per kg oil equivalent)	—	—	—	
28. Carbon dioxide emissions (per capita metric tons)	—	—	—	
Q. Target 10: Halve, by 2015, the proportion of people without sustainable access to safe drinking water				
29. Access to an improved water source (% households)				
Total	90.3 (1991)	—	100.0	(2004)
Urban	92.6 (1991)	—	94.0	(2004)
Rural	89.2 (1991)	—	92.0	(2004)
R. Target 11: By 2010, to have achieved a significant improvement in the lives of at least 100 million slum dwellers				
30. Access to improved sanitation (% households)				
Total	76.9 (1991)	—	88.5	(2004)
Urban	83.8 (1991)	—	93.0	(2004)
Rural	73.6 (1991)	—	84.0	(2004)
31. Access to secure tenure (slum population as % of urban population [secure tenure index])	0.0	—	0.0	(2001)

— = not available; DOTS = directly observed treatment, short course; GDP = gross domestic product; kg = kilogram; HIV/AIDS = human immunodeficiency virus/acquired immunodeficiency syndrome; PPP = purchasing power parity.

Sources: Abbott, D., *Tuvalu Hardship and Poverty Status Discussion Paper* (10-Aug-03); Secretariat of the Pacific Community (SPC), *Pacific Islands Regional Millennium Development Goals Report 2004*, Statistical Annex, available online at (http://www.spc.int/mdgs); United Nations Children's Fund , *The State of the World's Children 2003*; United Nations Economic and Social Commission for Asia and the Pacific, The Millennium Development Goals: Progress in Asia and the Pacific 2006, available at (http://www.unescap.org/); United Nations Development Programme, *Pacific Human Development Report 1999*; United Nations Educational, Scientific and Cultural Organization, *The Education for All 2000 Assessment: Tuvalu Country Reports*, available at http://www2.unesco.org/wef; United Nations Statistics Division, Millennium Indicator Database, available online at (http://millenniumindicators.un.org); World Health Organization, Regional Office for the Western Pacific (WPRO), Western Pacific Region Health Databank, various revisions (2001, 2002, 2004), available online at (http://www.wpro.who.int); WHO, *The World Health Report* (2004-2005); Asian Development Bank, Statistical Database System, available online at (http://www.adb.org/Statistics/sdbs.asp).

Table A1.4: Tuvalu Environment Indicators

Indicator	1990	Latest Year	
A. Energy Efficiency of Emissions			
1. GDP/Unit of Energy Use (PPP$/kgoe)	—	—	
2. Traditional Fuel Use (% of total energy use)	—	—	
3. Carbon Dioxide Emissions			
a. Metric Tons ('000)	—	—	
b. Metric Tons per Capita	—	—	
B. Water Pollution: Water and Sanitation			
1. % Urban Population with Access to Safe Water	92.6 (1991)	93.9	(2002)
2. % Rural Population with Access to Safe Water	89.2 (1991)	91.6	(2002)
3. % Urban Population with Access to Sanitation	83.8 (1991)	91.9	(2002)
C. Land Use and Deforestation			
1. Forest Area (km^2)	—	11.0	(1996-2003)
2. Average Annual Deforestation			
a. Km^2	—	—	
b. % Change [a]	—	—	
3. Rural Population Density (people/km^2 of *total* land)	—	222	(2002)
4. Arable Land (% of total land)	0.0 (1993)	0.0	(2001)
5. Permanent Cropland (% of total land)	0.0 (1993)	0.0	(2001)
D. Biodiversity and Protected Areas			
1. Nationally Protected Area			
a. Km^2	—	—	
b. % of Total Land	0.0 (1994)	1.1	(2004)
2. Mammals (number of threatened species)	0 (1996)	0	(2004)
3. Birds (number of threatened species)	1 (1996)	1	(2004)
4. Higher Plants (number of threatened species)	—	0	(2003)
5. Reptiles (number of threatened species)	2 (1996)	1	(2004)
6. Amphibians (number of threatened species)	0 (1996)	0	(2004)
E. Urban Areas			
1. Urban Population			
a. '000	3.8 (1991)	6.0	(2005)
b. % of Total Population	42.5 (1991)	57.0	(2005)
2. Per Capita Water Use (liters/day)	—	—	
3. Wastewater Treated (%)	—	—	
4. Solid Waste Generated per Capita (kg/day)	—	—	

— = no data available; GDP = gross domestic product; kg = kilogram; kgoe = kilogram oil equivalent; km^2 = square kilometer; PPP = purchasing power parity.

[a] A positive number indicates a loss of forest area, a negative number a gain.

Sources: Food and Agriculture Organization (FAO) of the United Nations, Statistical Databases (FAOSTAT), available http://faostat.fao.org; FAO*, State of the World's Forests 2005*; International Union for Conservation of Nature and Natural Resources (IUCN), *The IUCN Red List of Threatened Species*, various years, available http://www.iucnredlist.org; United Nations Children's Fund (UNICEF), available http://www.unicef.org/infobycountry; United Nations Statistics Division (UNSD), Millennium Indicator Database Online, available http://millenniumindicators.un.org; UNSD, Main Environmental Indicators Online, available http://unstats.un.org/unsd/ENVIRONMENT/q2004indicators.htm; World Resources Institute (WRI), *Earth Trends* Online, available http://earthtrends.wri.org; World Bank, World Development Indicators Online, available http://devdata.worldbank.org/dataonline/; Asian Development Bank Statistical Database System, available http://lxapp1.asiandevbank.org:8030/sdbs/index.jsp, accessed 27 March 2007.

Table A1.5: Development Coordination Matrix

Sectors and Themes	Current ADB Strategy/ Activities	Other Development Partners' Strategies and/or Main Activities: Multilateral Institutions and the UN System		Other Development Partners' Strategies and/or Main Activities: Bilateral	
Sector					
Agriculture and Natural Resources		SOPAC	• Fisheries Management Project	Taipei, China	• Improve and expand agricultural extension services • Training and Vegetable Planting • Milkfish Farming on Vaitupu
Education		EU	• Science equipment for Primary & Secondary schools • Outer Islands Primary school projects • Textbooks for Secondary schools	Taipei, China AusAID	• Support to TMTI • School Supplies
Health, Nutrition and Social Protection		UNDP	• Support women's Health Programme • Social Development Policy Project • HIV/AIDS Prevention campaign	NZAID India Japan	•Operation and Management of Health Services - NZMTS •Establishment of the Open Learning Centre Outer Islands Medical Facility Upgrade
Law, Economic Management, and Public Policy	• Law Revisions – Leadership Code • Demography/ Health Survey (jointly with AusAID)	UNDP UNESCO PIFS	• Seminar for Parliamentarians • Computer – Aid Management • Board of Governors Meeting – ADB	Taipei, China Turkey AusAID NZAID India	• General Elections • Council of Chiefs • Kakeega II Matrix • Australia Defense program • Support for Ministers Travel • Support for UN mission to N.Y • Land Reforms Microfilming • Office Maintenance – Prisons & Police Travel Document (Passports) • Advisor to Auditor General • Demography/Health survey • Staff Attachment – Auditor General's office AG's Office – Office equipment

Sectors and Themes	Current ADB Strategy/ Activities	Other Development Partners' Strategies and/or Main Activities			
		Multilateral Institutions and the UN System		Bilateral	
Sector					
Water Supply, Sanitation and Waste Management		EU	• Waste Management – Funafuiti & Nanumea		
Transportation and Communication				Japan AusAID Taipei, China	• Nivaga II – Fuel • Manufolau – Fuel Metaili Fuel (Australian Naval Program) • Nanumea Meapu Bridge • Niutao Olioli Causeway • Nukufeatu Jetty • Mataili Slipping • MSS ICT Development Activities • Funafuti High Speed Wireless Internet • Government Network Enterprise Internet • ICT Spares • Queens Warehouse maintenance
Multisector				Japan	• TEC Fuel provision • Establishment of Japanese C/P Fund
Theme					
Environmental Sustainability		SOPAC GEF	• Environmental Awareness programme • Tuvalu Energy Policy • Tuvalu Topo Update • Land Marketing • GEF Grant	Taipei, China	• Renovation of Niulakita Metrological Station
Gender and Development		UNDP with AusAID SPC	• Training of Staff • Meeting international commitment	Taipei, China	• Nui Women's Kitchen Project • Meeting international commitment
Governance	• Fiscal Governance	UNESCO		India	

Sectors and Themes	Current ADB Strategy/ Activities	Other Development Partners’ Strategies and/or Main Activities			
		Multilateral Institutions and the UN System		Bilateral	
Sector					
	(Modernization of Customs Act)		• Computer		• Vehicle
Inclusive social Development		UNDP	• Social Development Policy project	Japan	• Asau Community Hall on Vaitupu
Youth Policy		UNDP UNESCO	• Youth Parliament • Youth Corporate Plan • Extension of Life Skill • Exchange Youth Programme Environment Youth Workshop		
Private Sector Development				Taipei, China	• Support SME’s

SOPAC = Pacific Islands Applied Geoscience Commission; AUSAID = Australian Agency for International Development; EU = European Union; NZAID = New Zealand Agency for International Development; UNDP = United Nations Development Program; UNESCO = United Nations Educational, Scientific and Cultural Organization; PIFS = Pacific Islands Forum Secretariat; GEF = Global Environment Facility; SPC = Secretariat of the Pacific Community.
Source: Government of Tuvalu.

Table A1.6: Portfolio Indicators—Portfolio Amounts and Ratings
(public sector loans, as of 31 December 2006)

	Net Loan Amount		Total		Rating[a]								Potential Problem[b]		At Risk[c]	
					Highly Satisfactory		Satisfactory		Partly Satisfactory		Unsatis-factory					
Sector	$ million	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	(%)
Agriculture and Natural Resources																
Education	4		2	100			2	100					0	0.00	0	0.00
Energy																
Finance																
Health, Nutrition, and Social Protection																
Industry and Trade																
Law and Public Sector Management																
Multisector																
Transport and Communications																
Water Supply, Sanitation, and Waste Management																
Total	**4**	**100**	**2**	**100**	**0**	**0.00**	**0**	**0.00**	**0**	**0.00**	**00**	**0.00**	**0**	**0.00**	**0**	**0.00**

No. = number.
Source: Asian Development Bank estimates.

Table A1.7: Portfolio Indicators—Disbursements and Net Transfers of Resources
(public sector loans, as of 31 December 2006)

Disbursements and Transfers	OCR	ADF	Total
Disbursements[a]			
Total Funds Available for Withdrawal ($ million)	0.00	7.82	7.82
Disbursed Amount ($ million, cumulative)	0.00	5.44	5.44
Percentage Disbursed (disbursed amount/total available)	0.00	69.56	69.56
Disbursements ($ million, latest year)	0.00	1.18	1.18
Disbursement Ratio (%)[b]	0.00	32.4	32.4
Net Transfer of Resources ($ million)			
2006	0.00	1.14	1.14
2005	0.00	0.06	0.06
2004	0.00	0.01	0.01
2003	0.00	0.09	0.09
2002	0.00	(0.04)	(0.04)

ADF = Asian Development Fund, OCR = ordinary capital resources.
Source: Asian Development Bank estimates.

Table A1.8: Portfolio Implementation Status
(public sector loans, as of 31 December 2006)

No.	Sector	Loan No.	Seg. Title	Net Loan Amount OCR ($ million)	Net Loan Amount ADF ($ million)	Approval Date	Effective Date	Closing Date Original	Closing Date Revised	Progress (% completed)
1	ED	1921/ 2088	Maritime Training Project		4.15	16 Oct 02 03 Aug 04	19 Feb 03 13 Jan 05	30 Jun 05 30 Jun 06	30 Dec 07 30 Dec 07	52 52

ADF = Asian Development Fund, ED = education, No. = number, OCR = ordinary capital resources, Seg. = segment.
Source: Asian Development Bank.

Table A1.9: Evaluation Rating by Sector, Public Sector Loans
1996–2006

	Highly Successful		Successful		Partly Successful		Unsuccessful		No Rating		Total	
Sector	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Agriculture and Natural Resources											0	0.00
Education									2	100.00	2	66.67
Energy											0	0.00
Finance											0	0.00
Health, Nutrition, and Social Protection											0	0.00
Industry and Trade											0	0.00
Law and Public Sector Management			1	100							1	33.33
Transport and Communications											0	0.00
Water Supply, Sanitation, and Waste Management											0	0.00
Multisector											0	0.00
Total	**0**	**0.00**	**1**	**100.00**	**0**	**0.00**	**0**	**0.00**	**2**	**100.00**	**3**	**100**

No. = number.
Source: Asian Development Bank project (program) audit reports.

COUNTRY PERFORMANCE ASSESSMENT RATINGS (2007)

Country Performance Assessment	Rating	Cluster Rating
A. Economic Management		**3.3**
1. Macroeconomic Management (33.3%)	3.5	
2. Fiscal Policy (33.3%)	3.5	
3. Debt Policy (33.3%)	3.0	
B. Structural Policies		**2.5**
4. Trade (33.3%)	2.5	
5. Financial Sector (33.3%)	2.5	
6. Business Regulatory Environment (33.3%)	2.5	
C. Policies for Social Inclusion/Equity		**3.4**
7. Gender Equality (20.0%)	3.5	
8. Public Resource Use (20.0%)	3.5	
9. Building Human Resources (20.0%)	4.0	
10. Social Protection and Labor (20.0%)	3.0	
11. Policies and Institutions for Environmental Sustainability (20.0%)	3.0	
D. Public Sector Management and Institutions		**3.1**
12. Property Rights and Rule-based Governance (20.0%)	4.0	
13. Quality of Budgetary and Financial Management (20%)	3.0	
14. Efficiency of Revenue Mobilization (20.0%)	2.5	
15. Quality of Public Administration (20%)	3.0	
16. Transparency, Accountability, and Corruption in the Public Sector (20.0%)	3.0	
E. Economic and Social Policy and Institutional Performance		**3.1**
F. Public Sector Management and Governance Performance		**3.1**
G. Portfolio Performance		**5.5**

GOVERNANCE ASSESSMENT

A. Background

1. On 31 July 2006, ADB approved its second Governance and Anticorruption Action Plan (GACAP II), which aims to improve ADB's performance in implementing governance and anticorruption policies in sectors where ADB is active. Among other things, GACAP II requires the preparation of governance and anticorruption risk assessment and management plans (RAMPs) as an integral part of country partnership strategies (CPSs). RAMPs will focus on specific thematic issues (public financial management, procurement and anti-corruption) at the country level and in two priority sectors where ADB is active.

2. Recognizing the importance of developing a robust and practical implementation approach, ADB has been working closely with the Samoan Government to prepare the first Pacific pilot RAMP. In addition to the three thematic areas, the Samoa RAMP is focusing on the drainage and sanitation, and education sectors. Once complete, ADB will review the Samoa RAMP experience and draw lessons for conducting RAMPs in other Pacific DMCs. In the meantime, ADB is required to include governance assessments in CPSs. To that end, as a transition measure until our approach to GACAP II implementation in the Pacific has been determined, governance assessments, such as in this appendix, will be included in CPSs. Although not fully aligned with GACAP II requirements in that they do not contain RAMPs, these assessments represent a solid move in that direction with their emphasis on the same GACAP II themes of PFM, procurement and anti-corruption.

B. Introduction

3. Tuvalu became a British protectorate in 1892 and a British colony in 1916, as part of the Gilbert and Ellice Islands. On attaining independence in 1978, the country chose to separate from the Gilbertese islands (now part of Kiribati) and revert to its pre-colonial name. Tuvalu is a member of the Commonwealth, and has two levels of government. A unicameral, 15-member parliament, *Fale i Fono*, is elected by universal suffrage for four-year terms and has the power to make laws.[12] In addition, six-member councils, also popularly elected on four-year terms, administer the country's nine atolls. Effective executive power in Tuvalu rests in the cabinet, which consists of the Prime Minister and not more than five ministers.[13] The cabinet is collectively responsible to Parliament for its actions. Tuvalu's judicial system is made up of three courts with general trial and appellate jurisdiction (the high court, the court of appeal and the sovereign in council) and three lower courts with limited jurisdiction (magistrates' courts, island courts and land courts). A chief justice visits twice a year to preside over sessions of the High Court.[14]

4. Tuvalu does not have formal political parties, although there are no laws against their formation. Until about ten years ago, politics in Tuvalu was relatively low-key, and the country was fairly stable politically. Since then however, political competition has intensified, and the country has experienced several votes of no-confidence and frequent changes of government.

---

[12] The Parliament comprises two members each from seven of the country's islands, and one from the smallest island, Nukulaelae. It is presided over by a Speaker, who is elected from within the group of 15 members of parliament.

[13] Tuvalu's Prime Minister is elected by Parliament from among its members. The five-member cabinet is then selected by the Prime Minister from the members of parliament.

[14] In addition to its obligations under international law, the country has five sources of law: the constitution, acts of parliament, customary law, applied laws, and the common law.

This factional turmoil almost brought Tuvalu's parliament to a stand-still in 2003 and there is now widespread debate over whether the prime minister should be chosen directly by Tuvalu's citizens rather than through parliament. Tuvalu's most recent election was held in August 2006, again resulting in a change of prime minister.

Table 3.1: Governance Indicators, 2006

	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Tuvalu	0.72	1.39	-0.28	-0.79	1.06	-0.07
Pacific Average	0.29	0.54	-0.47	-0.53	0.11	-0.33

Source: World Bank. *Governance Matters VI: Governance Indicators for 1996-2006*, June 2007.
Notes: The Pacific Average has been calculated for those countries for which data are available for the particular year, from the group comprising Cook Islands, Fiji Islands, Federated States of Micronesia, Kiribati, Papua New Guinea, Republic of the Marshall Islands, Samoa, Solomon Islands, Timor Leste, Tonga, and Vanuatu. The indicators are measured in the range of -2.5 to +2.5, with a higher score indicating better governance.

5. As Table 3.1 illustrates, Tuvalu's governance performance is well above the Pacific island average on all of the key indicators. As part of its broader *Second Governance and Anti-corruption Action Plan* (GACAP II), ADB is focusing its 2007 governance assessments in Pacific developing member countries on three key issues: public financial management, procurement, and anti-corruption issues. Based on readily available information rather than new analysis, following is a synopsis of the status of Tuvalu's progress in each of these areas.

C. Public financial management

6. Tuvalu is a micro-state. Its nine atolls provide a total land area of 26 square kilometers. With a population of only 11,000 people and an annual gross domestic product (GDP) of about $20 million, it is the second smallest developing country in the world. The public sector contributes about 70% of GDP and employment, and 10% of the annual budget derives from the successful TTF. Two-thirds of the population is engaged in subsistence farming and fishing and, although GDP is relatively low at about $2,000 per person, Tuvalu has been very successful at securing offshore income, so that national income has been as much as twice this level.[15] Sustained growth since the mid-1990s[16] enabled the government to finance improvements in health, education and infrastructure.

7. However, Tuvalu's economic growth prospects remain uncertain. Almost all of the growth up to 2004 was due to major public construction projects, expansion of the public sector arising from a larger civil service wage bill, and growth in the PEs. Agriculture and fishing contracted over the six years to 2002, and the last of the series of construction projects was completed in 2004. Geographic isolation continues to limit economic growth prospects, and there is ongoing uncertainty in relation to most of the sources of external revenue. Income from leasing of the dot.tv domain name, for instance, has been stagnant since 2003. Climate change and sea level rise are also key concerns. The country has no sub-surface fresh water and increasing salinity intrusion of the soil is a serious challenge. GDP growth eased over 2004 and 2005, but then increased again to about 3% in 2006, largely as a result of a 25% increase in public sector spending.

[15] See ADB's 2006 economic report on Tuvalu for further details.
[16] The Tuvalu economy grew at a real rate of 7.3% per annum from 1996 to 2002.

8. Tuvalu's public financial management performance has recently been assessed using an abbreviated form of the accepted *Public Expenditure and Financial Accountability* (PEFA) framework[17]. Tuvalu rated poorly on 21 of the 24 indicators measured, highlighting the need for reform and improvement across most key aspects of public financial management. Notably, weak budgeting skills across ministries limit the administration's ability to prioritize, prepare realistic budgets and revise budgets in an environment of expenditure constraint. There is a high incidence of variances, expenditure is not accurately recorded, and there is no computerized expenditure monitoring system. Tuvalu's budget documentation is not comprehensive, and the government's oversight of fiscal risks from other public sector entities is very poor. Overall, the public has limited access to fiscal information.

9. Internal controls in Tuvalu are very poor, and monitoring and reporting are weak across the board. Treasury's cash accounting methodology does not comply with the present international cash accounting standard and, in preparing the government's accounts, Treasury has consistently failed to disclose all the information required under the legislation. There is no internal audit function[18] and no monitoring of the internal controls prescribed in the *1990 Financial Instructions*. Monthly cash flow forecasts exist, but are not updated regularly. Although Treasury is able to monitor actual expenditure against approved budget levels by reference to residual funds available, its budget management information system is defunct and therefore unable to generate progress reports for ministries. Not surprisingly, ministries are regularly incurring expenditure in excess of the amount budgeted. Bank reconciliations are significantly in arrears.

10. External scrutiny of public financial management is adequate. The budget is publicly debated in the parliament and all sessions of parliament are broadcast on the radio. Although constrained by delays in the submission of government accounts for audit, The auditor-general undertakes all audits of government activities promptly and in accordance with international auditing standards. Of concern is the fact that, according to the most recent PEFA report, little or no action is taken by ministries to address weaknesses highlighted by the auditor-general.

11 Tuvalu will need external technical assistance and financial management training to strengthen its basic public financial management capacity, before it will effectively be able to manage under the program budgeting approach introduced in 2004, or introduce any medium-term budget framework or process.

D. Procurement

12 According to the 2006 PEFA report, Tuvalu undertakes, on average, two public tenders each year, with an average value of A$250,000. Public procurement in Tuvalu is governed by the general requirements of the *Public Tenders Board Regulations 1979*, which do not reflect prevailing generally accepted procurement practices and, in any case, are not relevant to all types of procurement. These regulations provide only a general legislative framework and outline only the very basic tendering requirements for building and works contracts. They

[17] ADB (2007) *Public Expenditure and Financial Accountability: Tuvalu*, Final Report, Prepared by J.W. Leonardo, April. Under the internationally accepted PEFA framework, Tuvalu's performance was assessed in relation to seven dimensions of public financial management: credibility of the budget; comprehensiveness and transparency; degree to which the budget is prepared with due regard to government policy; predictability and control in budget execution; accounting, recording and reporting; external scrutiny and audit operations; and appropriateness of donor practices in country. The analysis covered all government expenditure for the three years to 30 June 2006.

[18] Discussions are underway (2007) between the Auditor General's Office and Minister of Finance to re-establish an internal audit capability.

require procurement for all work not undertaken by the Ministry of Works and Energy to be put to public tender, but they do not include a threshold for small purchases and they do not provide for the use of less competitive procurement methods; they require that tenders be publicized, but do not require the public release of tender results; and they do not provide for any procurement complaints mechanism. Even taking into account the small size of Tuvalu's procurement requirements and its private sector, there is a need to revise the procurement rules and processes to ensure they provide adequate controls and uphold principles of competition and value for money.

E. Anti-corruption

13. Corruption is an issue on which little real research and analysis has yet been done in Tuvalu. The common assessment is that corruption is not a serious problem, but this appears to be based on an implicit assumption that Tuvalu's small size, clan-based social structure and communal traditions ensure unacceptable behavior will be visible and therefore able to be addressed. However, these very features can also exacerbate the risk of corruption occurring. Transparency International, for example, argues that the close-knit nature of Tuvaluan society, in which family connections and reciprocity provide the basis of social relations, causes notions of impartiality and independence to become blurred.

14. Certainly, Tuvalu's judiciary is independent and provides fair trials, and the civilian-controlled police force is effective in maintaining internal order. The constitution and law provide for freedom of speech and the press; nongovernment organizations are active across all levels of society; religious, academic and individual freedom is generally respected; and, in 2001, the country's sole radio station was privatized.

15. At the same time, there have been allegations of corruption against certain members of government. There is also widespread public perception that public funds have been mismanaged at times and that public officials benefit unreasonably from their positions. Travel benefits are a particular source of public concern. More broadly, there are no sanctions against public officials for failures in service delivery.[19] Tuvalu has no ombudsman, and there are limited checks and balances on executive power. Performance audits are rare and financial audit recommendations are not usually followed up. Inadequacies in the preparation and publication of reports across government may well be due to capacity constraints, but they contribute to public perception that government lacks commitment to transparency and accountability. ADB's 2006 economic report indicates progress is being made in improving public information flows in Tuvalu. This will be an important step in enabling effective civil society engagement in government decision-making.

16. Clearly, there are several aspects of Tuvalu's institutional and strategic frameworks that need to be strengthened in support of good governance. This cannot simply be a mechanical exercise of strengthening systems or their capacity. What is needed first is an all-encompassing debate and examination of the issues as they apply in Tuvalu, involving all sectors of society. For instance, Tuvalu does not have a comprehensive anti-corruption strategy or even a commonly accepted definition of what behavior is and is not corrupt. Although the penal code provides some direction, laws against corruption are weak, and the line determining what is not

---

[19] In fact, Tuvalu's national development plan, *Te Kakeega*, does not have a concrete action plan and includes very few defined development targets that public servants must achieve. There is no mechanism in place to ensure implementation of the plan or monitor progress towards its objectives. There is also limited linkage between *Te Kakeega* and the budget, and limited capacity within the public service to prepare much needed corporate and sector plans to target the national development priorities.

acceptable is unclear. For example, at what point do traditional gift-giving and its reciprocal obligations become bribery? Further, Transparency International asserts that the weakness of parliamentary oversight indicates “a level of contempt for the inherited parliamentary system of government”. There is a clear need for public debate to develop an accountability framework within which ministers and other public officials are expected to function. The resulting framework must, inter alia, clarify the way in which traditional customs and social patterns can most effectively interact with formal government institutions and processes.

F. Conclusion

17. In seeking to strengthen governance, the challenge for Tuvalu is building adequate capacity whilst maintaining an affordable public sector. As one of the smallest countries in the world, Tuvalu’s capacity to provide the full range of government institutions and services will always be constrained. Development partners too are limited in the support they can provide, by Tuvalu’s own absorptive capacity. Yet already, the public sector is arguably too large, crowding out the private sector in terms of both employment opportunities and wage rates, influencing income distribution and encouraging rent-seeking behavior. Careful management is needed to ensure the higher wages, better opportunities and broader range of contacts available to public servants do not lead to serious inequities in Tuvaluan society. See footnote for references.[20]

[20] ADB (2007) *Tuvalu: 2007 Country Performance Assessment*, Draft Report, July.
ADB (2007) *Public Expenditure and Financial Accountability: Tuvalu*, Final Report, April.
ADB (2006) *From Plan to Action: Tuvalu Economic Report 2006*, June.
Transparency International (2004) *National Integrity Systems Country Study Report: Tuvalu*, Asia Pacific School of Economics and Government, Australian National University.
World Bank (2007) Governance Matters VI: Governance Indicators for 1996-2006, June 2007.

DEVELOPMENT PARTNERS AGREEMENT

A. Declaration by the Government of Tuvalu and Development Partners on Improving Aid Coordination and Effectiveness

1. The Government of Tuvalu and Tuvalu's Development Partners declare their willingness to build partnerships in an environment of cooperation, mutual trust and accountability to improve ODA effectiveness and maximise benefits for the people and nation of Tuvalu. Our aim is to support the implementation of Tuvalu's National Strategy for Sustainable Development 2005–2015 (Te Kakeega II) and provide improved opportunities to the people of Tuvalu, especially the poor, to access the benefits of development. The objective of this declaration is to commit development partners to an ongoing process of effective coordination in the implementation of ODA for Tuvalu. While the Government of Tuvalu and some Development Partners are not signatories to the Paris Declaration on Aid Effectiveness, all concur that it is relevant in the Tuvalu context and so subscribe to the guidance the Declaration provides and outlined below.

2. The five principles of the Paris Declaration are:

   (i) Ownership: Partner countries exercise effective leadership over their development policies and strategies and coordinate development actions.
   (ii) Alignment: Donors base their overall support on partner countries' national development strategies, institutions and procedures.
   (iii) Harmonisation: Donors' actions are more harmonised, transparent and collectively effective.
   (iv) Managing for Results: Managing resources and improving decision-making for results.
   (v) Mutual Accountability: Donors and partners are accountable for development results.

3. Although this declaration does not constitute a legally binding instrument, it represents a shared recognition between the Government of Tuvalu and the Development Partners on enhancing aid effectiveness in Tuvalu.

4. These principles are subscribed to as the basis on which the Government of Tuvalu and its development partners will seek to bring about the effective implementation of the Tuvalu's National Strategy for Sustainable Development 2005–2015, Te Kakeega II, promulgated by the Government of Tuvalu in November 2005 and endorsed by Development partners at the May 2006 Government/Donor Roundtable held in Suva, Fiji Islands.

5. To implement our respective partnership commitments as outlined above, the Government of Tuvalu and the Development partners commit to:

B. Ownership: The Government of Tuvalu exercises full ownership and leadership over its policies, and strategies and development actions

6. The Government of Tuvalu commits to:
   - Annual progress reports of Te Kakeega II implementation as committed to in Chapter 13 of Te Kakeega II.

- Align the national budget to support agreed priorities for the implementation the implementation of Te Kakeega II.
- Further strengthen its ownership and leadership role in coordinating aid at all levels with development partners, civil society and the private sector.

7. Development Partners commit to:
   - Respect Government of Tuvalu ownership and leadership of its development management processes, and support the strengthening of the institutional and human capacity of ministries and agencies working towards the targets of Te Kakeega II.
   - Support the monitoring and evaluation framework for Te Kakeega II to ensure the ongoing alignment and scope of their future development assistance to Government of Tuvalu.

C. Alignment: Development Partners will base their overall support on Government of Tuvalu strategies, institutions and procedures

8. Government of Tuvalu commits to:
   - Ensure the presence of a relevant regulatory framework and appropriate management and institutional arrangements for the enhancement of aid effectiveness and delivery of results.
   - Continue to improve relevant public financial management systems that are periodically reviewed according to the performance benchmarks as promulgated by Cabinet in March 2007.
   - Lead efforts to promote long-term capacity development through the development of strategies and actions at the sector level.

9. Development partners commit to:
   - Base their overall support on the priorities outlined in Te Kakeega II and align their development programmes and projects with the Public Sector Investment Programme (PSIP).
   - Use the monitoring and evaluation framework of Te Kakeega II as the basis for monitoring progress in and impact of their programmes.
   - Ensuring their development assistance, where necessary, provide coordinated support to strengthen Government of Tuvalu institutions, systems and procedures.
   - Make increasing use of the Government of Tuvalu’s institutions, systems and procedures, as they attain mutually agreed standards, for administering development assistance.
   - Avoid the creation of new parallel structures (eg PIU, PMUs) for day to day management and implementation of ODA financed activity.

D. Harmonisation: Development Partners’ actions are more harmonised, transparent and collectively effective

10. The Government of Tuvalu commits to:
    - Continue to work with the development partner offices in Suva and Funafuti to identify improved mechanisms for effectively dealing with harmonisation and alignment issues in the Tuvalu context.

11. Development Partners commit to:
- Develop and adopt to the maximum extent possible shared analyses and monitoring frameworks, common arrangements and simplified procedures for programme/project management, including reporting and auditing.
- Increase the proportion of development cooperation managed through Sector and/or thematic programmes, and other programme based approaches.
- Reducing the number of separate, duplicative missions and diagnostic reviews and studies.
- Make increasing use of delegated cooperation arrangements where possible and appropriate.

E. Managing for results: Managing resources and improving decision-making for results

12. The Government of Tuvalu commits to:
- Develop a monitoring and evaluation framework for Te Kakeega II based on the key performance benchmarks promulgated by Cabinet in March 2007 and
- Prepare annual progress reports on Te Kakeega II ensuring that the findings contribute to the National sector strategies as promulgated by Parliament.
- Regularly reprioritising the Te Kakeega II targets, and reallocating available development resources accordingly, and linking priorities to budget processes to achieve targeted development results.

13. Development Partners commit to:
- Realigning to the maximum extent possible their programmes and projects to prioritise activities in line with the Public Sector Investment Programme.

F. Mutual Accountability: The Government of Tuvalu and Development Partners are accountable for development results

14. The Government of Tuvalu commits to:
- Strengthening the role of all stakeholders including civil society and private sector in the planning and implementation of development cooperation programmes.
- Making available to all stakeholders information on the use of ODA resources to enhance transparency and accountability.
- Undertake the necessary ongoing reforms to enhance transparency and accountability in the use of available development cooperation resources.

15. Development Partners commit to:
- Provide timely, transparent, and comprehensive information on ODA flows to improve transparency and accountability in the use of ODA resources.
- Make planning and delivery of their assistance more transparent and accountable to all stakeholders in order to improve effectiveness and to maximise the benefits for the people of Tuvalu, in particular the poor.

G. The Way Forward

16. We, the Government of Tuvalu and the Development Partners of Tuvalu, express our willingness to give our utmost effort in working towards the effective implementation of the Government of Tuvalu's National Strategy for Sustainable Development 2005 - 2015, Te Kakeega II. We will monitor progress in implementing the strategy, which will be reported in the

government's annual progress reports and through the Suva based Government/Donor Working Group and periodic Government/Donor Roundtables.

17. We the undersigned, hereby confirm our wiliness to jointly work on enhancing aid effectiveness and efficiency in Tuvalu.

Signed this day, the [xxth] of [Month] in [Location], 2007

For the Government of Tuvalu

Minister of Finance

For the Development Partners

New Zealand; Australia; Asia Development Bank; European Union; Japan; Taipei,China; UN Agencies.

GOVERNMENT OF TUVALU BENCHMARKS FOR FISCAL AND BUDGET MANAGEMENT

A. Introduction

Rationale for benchmarks:	To achieve Te Kakeega II goals of *sustainable budgets* & their *effective use* to achieve public policy priorities. To help provide a clear message to all (i.e. The Government Ministers, officials, Parliament & the public) *why* implementing these particular goals is vital to achieving matters, and to enable them to *monitor* their *implementation progress*.
Process for updating benchmarks:	The Government will update recommended actions under the benchmarks annually following the October Tuvalu Trust Fund Advisory Committee's Annual Report, in consultation with the Governments of Australia and New Zealand, and the Asian Development Bank.

1. Sustainable Budgets

	Tuvalu delivers a balanced budget:
Benchmark 1.1	The Government's recurrent expenditure each year should *not* exceed the total of its recurrent revenue plus a sustainable Tuvalu Trust Fund (TTF) distribution (Consolidated Investment Fund (CIF) drawdown) where: "*Recurrent expenditure*" includes special development expenditure, debt servicing, scheduled loan repayments, but excludes XB items and The Government's contributions to the TTF. "*Recurrent revenue*" includes revenue from The Government's normal revenue activities/sources such as taxes, duties, charges, license fees and pre-approved recurrent donor grants (i.e. grants approved prior to the current year). "*Sustainable TTF distribution*" is defined as 4% of the TTF's 'Maintained Value' at 30 Sep in the preceding year if available from the CIF.[21]
	Consolidated Investment Fund (CIF) Target Minimum Balance:
Benchmark 1.2	The target minimum value of funds retained in the CIF should be not less than 16% of the Maintained Value of the TTF, at the beginning of the TTF year so as to ensure that a '*sustainable TTF distribution*' is available to help finance annual budgets. Drawdowns from the CIF should not exceed 25% of the opening balance in that year. The The Government will seek to rebuild the minimum value of the funds retained in the CIF from future returns from the TTF.

Recommended	When *recurrent revenue* plus *sustainable TTF distribution* less

[21] It is notable that 4% of the TTF Maintained Value – which equals ¼ of the CIF Target Minimum Balance – is the amount the TTF investment strategy is designed to provide for distributions that on average per annum equal this sum recommended by TTFAC and accepted by THE GOVERNMENT.

action to achieve Benchmark	*recurrent expenditure* is a surplus, this should normally be used to replenish the CIF value as necessary to maintain it at a level no less than the Target Minimum Balance and preferably higher, or used to reduce debt levels.
Benchmark 1.3	**External Debt Limit:** The Government's total debt liability at any time (both domestic and external) should not exceed 60% of GDP, as specified in Te Kakeega II.
Recommended action to achieve Benchmark	The Ministry of Finance will maintain an up-to-date register of all of the Government's external and domestic debt liabilities - with details of the resultant financial obligations including timing of interest payments and principal repayments, and any arrears. The Government will draw down from the CIF to repay as much as possible of its confirmed outstanding debts, where: The first priority will be repaying The Government's outstanding liability to the National Bank of Tuvalu regarding the Outer Island Agency Suspense Accounts, which is estimated to total $5.2 million as at 30 Sep 2006, followed by other confirmed outstanding Government debts (e.g. to some of its PEs). THE GOVERNMENT will draw down the CIF again in early 2007 and if necessary 2008 to repay the remaining balance of its confirmed outstanding debts by the end of FY2008.

2. Fiscal Management and Effective Use of Budget Resources

	Tuvalu will increase the proportion of the total health and education budgets that are spent on basic health and education including vocational training. [22]
Benchmark 2.1	In FY 2006 The Government allocated 26% of its budget to education & sport and 19% of the education budget to basic education.[23] In 2007 The Government commits to undertake planning to improve the quality of basic education. In 2008 The Government will increase its budgeted expenditure on basic education on non-salary expenditure by *at least* 5%.
Benchmark 2.2	In FY 2006, the Government allocated 10.6% of its budget to health and 2% of the health budget to primary and preventative health services.[24] In 2007 The Government commits to undertake planning to improve the quality of basic health. In 2008 The Government will increase its budgeted expenditure on primary and preventative health services on non-salary expenditure by *at least* 5%.
Recommended	Tuvalu Maritime Training Institute total expenditure of funding for all

[22] The definition of basic education and basic health are respectively (i) primary education until Year 8 and vocational training, and (ii) primary and preventive health services.

[23] 2006 total education and sport equals A$5,882,331. Basic education excludes salaries, scholarships, Tuvalu National Provident Fund, allowances and XBs.

[24] 2006 total health equals A$2,414,908. Primary and supplementary health services excludes salaries, scholarships, Tuvalu National Provident Fund, allowances and XBs

Actions to Achieve Benchmark	enrolled students each year accurately reflected in the budget and paid in full into the TMTI account on time annually.
Recommended Actions to Achieve Benchmark	The Government will seek an independent review as soon as possible of all scholarships (including in-service scholarships) awarded for the years 2000 through 2006, to assess the results achieved by awardees and their value to Tuvalu, to assess whether it is in Tuvalu's interest to continue the scheme, and what changes should be made to it if it is to continue. The broad findings, conclusions and recommendations of this study will be made public. Based on these results The Government will consider amending the existing policy on awarding such scholarships.
Recommended Actions to Achieve Benchmark	The Government will seek an independent expert review of the Tuvalu Medical Treatment Scheme to assess its benefit to the health and wellbeing of the people of Tuvalu, and options for more effectively providing health benefits for Tuvalu. The broad findings, conclusions and recommendations of this study will be made public.

GDP=gross domestic product; The Government=Government of Tuvalu.
Source: Country Desk Officers from ADB, AusAID, NZAID and the Government of Tuvalu.

COMPLETION REPORT FOR TUVALU CSPU 2004-2006

Item	Major Achievement	Lessons and/or Recommendations
Country Development Goals The National Development Strategy 1995-1998 (Kakeega o Tuvalu) still served as the Government's basic strategy and included 5 priority areas (i) public sector reforms; (ii) improvement of economic infrastructure; (iii) Education for Life aimed at raising standards of education and training; (iv) encouragement of export-oriented business development; and, (v) upgrading of human settlements. ADB's overall strategy for Tuvalu was to foster good governance through (i) capacity development for public financial management and enhancing transparency and accountability within ministries and state-owned enterprises (SOE); and, (ii) promote human and social development through skills development and improving essential services, particularly for education, health, water supply and waste management.	The National Development Strategy (NDS) was rather ambitious, too broad-brushed, and fell short of concrete recommendations to implement the goals. ADB's assistance program was aligned closely with the NDS and included a proposed loan for secondary education, 1 PPTA for the education sector loan and 4 ADTA in (i) public financial management; (ii) Waste Management and Recycling; (iii) Water, Sanitation and Waste Management; and, (iv) Improving governance of SOEs. A draft RRP was prepared for the Education Sector loan, but the proposed project was dropped due to revised priorities by the new Government in September 2006. The TA for Public Financial Management was implemented and is closed, and the TA for Effective Waste Management & Recycling is still active. The TAs for Water, Sanitation and Waste Management and for Improving governance of SOEs were not implemented as absorptive capacity was not in place.	Tuvalu is one of the smallest countries in the world with a population of only 10,500 and a correspondingly small pool to draw qualified people from. Consequently, absorptive capacity is limited. However, Tuvalu receives a plethora of assistance in various forms and most development partners have in the past been willing to provide *ad hoc* assistance whenever called upon. Such level of assistance has had the effect most consultants or volunteers are actually doing the work instead of teaching the target groups on how to do it. The results have been a strong donor dependency, which in turn has created a situation where bad decision making within the Government actually had no consequences for the politicians. It has been too easy to make lofty promises. Realizing the narrow resources base of Tuvalu and the few opportunities there exist, development partners should focus on fewer, but vital, sectors that could have a positive impact in the future.
Expected CPS Outcomes Outcome 1 Improve government financial management within ministries and SOEs.	The TA was implemented as designed and within the timeframe. However, the impact quickly evaporated as	One reason for less than desired outcome was the lack of a proper assessment as to the root causes for the

Item	Major Achievement	Lessons and/or Recommendations
	the ministry did not commit 100% counterpart staff and consultants to a large extent did the work rather that coached. This is not necessarily the fault of the consultants but rather a symptom of too much *ad hoc* assistance by many others. There was no serious commitment by the Government to improve the management of the SOEs and this area is still badly managed.	performance gaps in public financial management and accountability. Such assessments have to be made together with a targeted ministry rather than designed from outside. Better up-front assessment – or as the first part of a TA- should be an integrated design part to ensure government's full commitment.
Outcome 2 Improved essential services for education, health, water supply and waste management.	The ambitious goal of Education for Life unfortunately prioritized the tertiary education over the primary education. This led to a very expensive scholarship scheme abroad at the expense of primary and secondary education, with the result that English proficiency declined and the number of repeaters increased. ADB prepared an educational masterplan with a proposed loan for secondary schools to address the problems. However, the new Government in late 2006 wanted emphasis on primary education and the education sector already had support from AusAID, NZAID, the Government of Japan, and the European Union and the proposed project was dropped. The TA on Effective Waste Management and Recycling is still due to be closed soon. No TCR has been produced yet, but the impact is only modest and with no assurance that the Government will follow-up with its own program. Although waste management and recycling is an extremely.	Considering that four development partners were already working in the education sector—AusAID, NZAID, Government of Japan, and the European Union—it was probably a tactical error not to involve these traditional partners in the sector in the formulation of the proposed loan. With the benefit of hindsight it is probably also fair to state that addressing the secondary school issues would not have removed the problems facing the primary education. In a country with only one asset—the human capital—a more holistic view should be applied to such an important sector and all involved development partners should be in agreement as to where ADB's comparative advantage lies. Aside from rising sea-levels due to global warming, atoll communities have for a very long time been used to waste disposal in the oceans. Such deep-rooted perceptions are difficult to change and especially if no adverse effect

Item	Major Achievement	Lessons and/or Recommendations
	important sector for an atoll country, the severity does not seem to be understood nor followed by most people.	can be demonstrated—it will be difficult to gather support for such projects. An alternative approach in atoll countries would probably be to see if waste management and recycling could be turned into profitable enterprises.
CPS Implementation		
Quality and Portfolio Management	The CSPU was too ambitious and covered too many areas. This was the main reason for the non-implementation of 2 TAs as the capacity to implement by the Government was overestimated. However, in a micro-state like Tuvalu it is easy to identify all the problems/challenges, but less easy to ensure commitment on how to tackle the problems. The implemented projects were designed and carried out in accordance with ADB's guidelines, but commitment to ensure sustainability from the EAs was lacking.	ADB can be as effective as it wants in implementing projects, but if the Government views the assistance from a multilateral development partner on par with bilateral donors—effective portfolio management is not possible. The Government of Tuvalu used its development partners to rectify immediate problems rather than for long-term development opportunities within the realities of the country's endowment.
Results Management	Proper results management is only possible for a development partner if the full picture of assistance to the country is disclosed. The previous governments had the Aid Coordination Unit separated from the normal budget and it was therefore not possible to get a comprehensive overview of ongoing and planned assistance from other development partners. While this suited the governments to solve its short-term/immediate problems, sustainability of interventions were rarely ensured.	More time should probably be spent on proper analyses as to what areas should be addressed by a multilateral organization like ADB in such a small country as Tuvalu with its limited resource base. Implementation capacity is limited by most ministries; too many donors and NGOs offer *ad hoc* assistance; windfall revenues from dot.tv internet domain, fishing licenses, and the TTF create temporary relief and spending spree, but do little for prudent fiscal discipline. Generous grant assistance to Tuvalu makes ADB a

Item	Major Achievement	Lessons and/or Recommendations
		peripheral partner. In such a scenario it would probably be better for ADB to sharpen its focus on one or two areas where it has an obvious advantage. Future CPSs should be more realistic and assistance should preferably only be considered for processing based on an initial government request to ADB. This could ensure better preparedness and genuine wish for assistance.
Partnership with Government	While ADB has been welcome as a development partner, previous governments have had limited understanding of the difference between a development bank and a development agency. TAs were often seen as measures to solve urgent problems, whereas the rationale behind investment loans were not understood. Grant donors always had better rapport with the Government.	
Development Partners Coordination	Tuvalu has enjoyed generous aid from Taipei,China and the Government of Japan. Other traditional donors have also assisted Tuvalu with considerable funding. However, coordination among the development partners have not been good and only recently has the need for such coordination been discussed—in particular as a result of the high maintenance costs of infrastructure projects, which has caused scarce funding being directed away from the obvious priority areas: basic education and preventive health care.	The Paris Declaration has facilitated a better understanding for the need of better development partners' coordination to enhance aid effectiveness. A draft development partners' agreement is currently being circulated among all development partners and is scheduled to be signed first by the Government, ADB, AusAID and NZAID in late 2007. As this agreement has Tuvalu's National Strategy for Sustainable Development as its base, it is envisaged that projects in the future will be markedly more sustainable than in the past.

ADB=Asian Development Bank; ADTA=advisory technical assistance; AusAID=Australian Agency for International Development; EA=executing agency; NZAID=New Zealand International Aid & Development Agency; RRP=Report and Recommendation to the President; SOE=state-owned enterprises; TA=technical assistance; TCR=TA Completion Report.
Source: Asian Development Bank Staff.

COUNTRY PARTNERSHIP STRATEGY AND PROGRAM FORMULATION

1. The country partnership strategy and program formulation process for the first CPS for Tuvalu began in 2006 with the development of a joint strategy between the Australian Agency for International Development (AusAID) and ADB. This strategy subsequently led to the formulation of a set of Performance Benchmark Indicators which were derived from the Government's own priorities as stated in its National Strategy for Sustainable Development 2005-2015 (Te Kakeega II).

2. ADB has observer status to the TTF Board meetings—where AusAID and NZAID are full members— and used these opportunities to discuss with the Government, AusAID and NZAID the most appropriate assistance ADB could provide to support and complement in achieving the Performance Benchmark Indicators. The subsequent preparation of CPS 2008-2012 was undertaken in close coordination with the Government, AusAID and NZAID to be fully aligned with Te Kakeega II.

Table A.7: The Proposed CPS Formulation Process

Pre-CPS Formulation Mission	20-23 November 2006
Conceptual Design Meeting/Stock-Taking Meeting (chaired by DG PARD)	15 March 2007
Draft Initiating Paper for RMT/Peer Review	26 May 2007
Initial Consultation Mission	5 June 2007
Initiating Meeting (chaired by VPO2)	7 August 2007
CPS Formulation Mission	27 Nov-3 Dec 2007
Draft CPS for Interdepartmental Review	12 Feb 2008
MRM	5 Mar 2008
Draft CPS for Government Review/Endorsement	III Mar 2008
Government Endorsement	IV Mar 2008
Submit to Management for Circulation to the Board	IV Mar 2008
Management Approval for Circulation to the Board	I Apr 2008
Printing	III Apr 2008
Board Circulation	III Apr 2008
Board Discussion	IV May 2008
Chairperson's Summary	I Jun 2008
CPS Web Release	II Jun 2008

CPS=country Partnership Strategy; DG=Director General; PARD= Pacific Department; VPO2=Vice President, Operations Group 2.
Source: Country Partnership Strategy Team Leader.

COUNTRY COST-SHARING ARRANGEMENTS AND OTHER FINANCING PARAMETERS

Table A.8: The Financing Parameters for Tuvalu

Item	Parameter	Remarks/Explanation
Country Cost Sharing Ceiling for the loan portfolio over the period 2008–2012[a]	Up to 99%	Higher percentages of financing would be provided for projects and activities with strong evidence of ownership and commitment, and addressing binding constraints to growth and development. The assessment of ownership and commitment would take into account budget and planning processes. The availability of full time and dedicated staff to coordinate, supervise and assistance provided by ADB and other development partners would form a key consideration in determining whether to provide a high financing ratio. The aggregate loan portfolio would be kept to a level consistent with the sustainability of the public debt position.
Country Cost Sharing Ceiling for the TA portfolio and other grants over the period 2008–2012[b]	Up to 99%	Higher percentages of financing would be provided for projects and activities with strong evidence of ownership and commitment, and addressing binding constraints to growth and development. This would bring TA financing more in line with those of other development partners. The assessment of ownership and commitment would take into account budget and planning processes. The availability of full time and dedicated staff to coordinate, supervise and assistance provided by ADB and other development partners would form a key consideration in determining whether to provide a high financing ratio.
Cost Sharing Ceiling for all sectors	Up to 99%	Sector specific variations have not been proposed.
Recurrent Cost Financing	No country limits	At the project level, recurrent cost financing would be considered if consistent with project objectives, provided there is strong demonstration of arrangements to ensure sustainability after ADB financing ceases. Integration of ADB financing in budget and planning processes would be strongly emphasized to help ensure that increased recurrent costs from ADB projects avoid adverse impacts on fiscal sustainability.
Taxes and duties	There are no taxes and duties that ADB would not finance, subject to compliance with the ADB's Charter	At the project level, ADB would consider whether taxes and duties constitute an excessively high share of project costs. ADB could monitor local taxes for possible distortions and ensure these remain consistent with acceptable practices. Taxes and duties are considered reasonable, and there are no taxes and duties specifically targeted at ADB projects. Tax and duty arrangements set out in ADB's charter are complied with.

ADB = Asian Development Bank; ADF=Asian Development Fund, TA = Technical Assistance.

a Projects financed with ADF grant funds will be counted as part of the loan portfolio.

b The country cost sharing ceiling for TA and other grants will exclude projects that are ADF-grant financed. The TA and other grants portfolio excludes projects that are ADF grant financed.

Source: Asian Development Bank Staff.

INDICATIVE ROLLING COUNTRY OPERATIONS BUSINESS PLAN 2008-2010

I. INDICATIVE LENDING AND NONLENDING PROGRAM

A. Indicative Lending Level

1. Tuvalu is a category A country and is eligible for Asian Development Fund (ADF) resources with an allocation of US$1.24 million for the 2007–2008 period and a carry-over amount from the 2005-2006 period of US$1.43 million. For the period 2008-2010 an indicative allocation of US1.20 million has been allocated.

2. **2007 Lending Program**. No new lending is envisaged for 2007 (Table 1). Given limited capacity in Tuvalu, the focus is on implementation of ongoing loans 1921/2088-TUV: Tuvalu Maritime Project and the associated TA 3942-TUV: Tuvalu Maritime Training Institute Strengthening.

3. **2008 Assistance Program**. The new Government has clearly indicated that, for the time being, it is not willing to borrow—including from ADB's highly concessional ADF resources—due to current financial constraints. The public sector gross debt stood at the end of 2006 at A$21.0million, or 70% of the gross domestic product (GDP); net debt stood at A$10 million (35% of GDP); and the net present value of net debt stood at A$3 million at end of 2006, equal to 11$ of GDP. The debt service payment of ADB's first loan begins in 2008 and will also have implications for the budget. However, the Government has expressed a strong interest in making use of grant financing for a public finance management program. Such a program would facilitate clearance of some of its arrears—the so-called Outer Islands Agency Suspense Account—with the National Bank of Tuvalu (NBT).[25] These arrears carry no interest, but are causing NBT an operating loss of almost A$500,000 per year. The account is a major impediment on the profit performance of NTB, is crowding out private sector credit, and severely hinders the Government's ability to negotiate with potential joint-venture partners[26] for the long-term strengthening of the bank and its service to customers. The program grant will also promote increased efficiency of a selected State-owned Enterprise (SOE), the Vaiaku Lagi hotel will be offered for management contract to the private sector, domestic and/or overseas. Concept paper is in Annex 1.

4. Using a grant program as a facilitation mechanism to reduce debt would be consistent with the Government's National Sustainable Strategy for Development*,* which includes social development, outer island employment, and private sector development among its eight strategic areas, and would also reinforce ADB's strategic focus on promoting human and social development through better access to rural financing. Expansion of banking services could also mobilize domestic capital, with subsequent potential for increase in private sector development. Tuvalu is eligible for the whole ADF allocation—US$1.43 million from 2005-2006 and US$1.24 million from 2007-2008 minus a 20% volume discount, amounting to US$2.14 million—as grant.

5. Depending on the outcome of the 2008 grant program another grant/lending program will be considered for 2009/2010 with the focus to more broadly address the inefficiencies of the SOEs and thereby reinforce ADB's focus on improved financial management.

---

[25] The decision on Tuvalu's grant eligibility was confirmed in September 2007. A program approach will be applied for the purpose of achieving the Performance Benchmark Indicators jointly developed by the Government of Tuvalu, ADB, AusAID, and NZAID.

[26] For example, the Australian and New Zealand Banking Corporation or the Bank of the South Pacific.

B. Indicative Nonlending Program

6. The indicative nonlending assistance is approximately US$300,000 per year. The binding constraints to sustainable development have been identified as lack of budget credibility, weak budgetary control, and poor in-year budget reporting, which all are impacting negatively on the strategic allocation of scarce resources toward basic education and basic health service. The Government, therefore, has not been able to pursue its goal of providing the people with adequate basic social services. ADB's focus thus remains firmly committed to improving public finance management and accountability to achieve more focus and prioritized resource allocation through the formulation of a credible budget. However, it should be noted that ADB's capacity development in this area to date has not had sustainable impact because (i) the relevant Government agencies have limited absorptive capacity, exacerbated by frequent turnover of human resources in Government service; and, (ii) short-term highly skilled experts normally engaged for traditional advisory TAs are not necessarily gifted for training or implementing change management. An alternative approach, delivering a long-term cluster-TA with focus on change management and engaging facilitators with the necessary training skills, must be initiated. For 2007–2008 (Table 2) the indicative nonlending program includes preparation of a cluster-TA to support (i) establishment of a financial management information system; (ii) financial governance; (iii) budgeting; (iv) public procurement improvement; and, (v) drafting of public financial management legislation and revision of the Treasury instructions. The cluster-TA will be designed to be implemented over a period of approximately 2.5-3.0 years.

7. Further capacity development in 2010 will either (i) directly assist in SOE reforms; or, (ii) continue broadly within the public financial management framework with inclusion of SOE reform as a specific priority.

II. SUMMARY OF CHANGES TO LENDING AND NONLENDING PROGRAMS

8. The proposed loan to secondary education has been dropped from the program as the bilateral funding agencies have since offered continued grant assistance in this area. In accordance with its fiscal targets, the new Government has indicated that any investment project would be unaffordable at this juncture. The Government has signaled interest in using ADF grants for a public finance management program.

III. INDICATIVE INTERNAL RESOURCE REQUIREMENTS

9. It is estimated that 16 person-weeks would be required for processing the grant program and 10 person-weeks would be required for processing the nonlending program.

IV. COUNTRY PARTNERSHIP STRATEGY

10. A results-based CPS will be developed in early 2008. The CPS will be underpinned by the joint-country strategy between ADB and AusAID, which is based on a set of performance benchmark indicators developed jointly by the Government of Tuvalu, ADB, AusAID, and NZAID. A development partners agreement framework has been drafted for the consideration of the Government and its development partners including the European Union, Government of Japan, the Government of Taipei,China, and the United Nations agencies. The CPS will be closely aligned to the Government's National Sustainable Strategy for Development 2005–2015.

Table A9.1: Indicative Assistance Pipeline for Grant Products, 2008–2010

Sector Project/Program Name	Targeting Classification	Thematic Priority	Division	Year of Project Preparatory TA	Total	Cost ($ million) ADB OCR	ADF	Total	Gov't.	Cofi-nancing
2008 Firm										
Financial										
Program for Financial Management			SPSO	2008	2.14			2.14	TBD	Grant
2009 Stand-by										
Financial										
Program for SOE Reform			SPSO	2009	1.20			1.20	TBD	Grant

ADB = Asian Development Bank, ADF = Asian Development Fund, Gov't = government, OCR = ordinary capital resources, SPSO = South Pacific Subregional Office, TA= technical assistance.
Source: Asian Development Bank estimates.

Table A9.2: Indicative Assistance Pipeline for Nonlending Products and Services, 2008–2010

Sector Assistance Name	Responsible Division	Assistance Type	Sources of Funding ADB Source	Amount ($'000)	Others Source	Amount ($'000)	Total ($'000)
2008 (Firm)							
Law, Economic Management, and Public Policy							
Cluster TA Capacity Development for Financial Management	SPSO	ID	JSF	800.0[27]			800.0
2009 None							
2010 Stand-by							
Law, Economic Management, and Public Policy							
Capacity Development for Financial Management (Phase II)	SPSO	ID	JSF	300.0			300.0
Total				**1.100.0**			**1.100.0**

ADB = Asian Development Bank, ID = institutional development, JSF = Japan Special Fund, SPSO = South Pacific Subregional Office
Source: Asian Development Bank estimates.

[27] Combining indicative planning figures for 2008-2010.

Table A9.3: Summary Information on Proposed Indicative Nonlending Products and Services for 2007

Project Name	**Capacity Development for Financial Management**
Objective, Components, and Outputs	During 2006, an abbreviated public expenditures and financial accountability exercise was carried out to identify the depth of the problems faced by the Ministry of Finance. The key binding constraints were identified as lack of budget credibility due to weak budgetary control and poor in-year budget reporting, which impacts negatively on the strategic allocation of scarce resources for provision of basic service delivery. The objective of the cluster technical assistance (TA) is to assist the Government of Tuvalu in budget and financial management so as to make much needed prioritization of scarce public resources toward basic service delivery for the people. The cluster-TA will encompass the following components: (i) public financial reporting; (ii) improved budget management; (iii) medium-term expenditure framework; (iv) public financial management legislation; and, (v) public finance ordinance. The outputs are (i) increased capacity and skills of staff across the Ministry of Finance to formulate and adhere to a credible budget; and, (ii) optimal functioning of all IT hardware and software in support of public expenditure and financial accountability.
Expected Results	The TA will strive to build the necessary capacity within the Ministry of Finance, Economic Planning and Industries through a combination of short-term sector specialists to achieve a minimum level of public financial management and long-term advisers (volunteers) with more skills in teaching. The cluster-TA approach has been chosen to link the different TA work to the achievement of defined milestones for each cluster component.

Program Grant for Improved Financial Management

Concept Paper

Date: **4 February 2008**

PART 1. GENERAL INFORMATION
(modality, focus/classification, coverage and responsible parties)

1. Modality of financial assistance

- ☐ Project loan
- ☐ Program loan
- ☐ Sector loan
- ☐ Sector development program loan
- ☐ Multi-tranche Financing Facility
- ☐ Credit lines to development finance institutions
- ☒ ADF grant-financed
- ☐ Other:

2. Assistance focus

a. If assistance focuses on a particular sector or subsector, specify the
Sector(s): Law, Economic Management, and Public Policy
Subsector: Public finance and expenditure management

b. Targeting classification
- ☐ Targeted intervention
- ☒ General intervention

c. Key thematic area(s)
Themes:
- ☒ Sustainable economic growth
- ☐ Inclusive social development
- ☐ Governance
- ☐ Gender and development
- ☐ Environmental sustainability
- ☐ Regional cooperation
- ☒ Private sector development
- ☐ Capacity development

Subtheme: Promoting macroeconomic stability, Private Sector Investment

3. Coverage
- ☒ Country: Tuvalu
- ☐ Regional

4. Responsible division/department: South Pacific Subregional Office/ Pacific Department

5. Responsible officer(s): Emma Ferguson; PARD/ Thomas Gloerfelt-Tarp, SPSO

PART 2. PROJECT DESCRIPTION

I. PROJECT RATIONALE

Widely scattered in a 900,000 km^2 exclusive economic zone of ocean almost 1,000 km north of the Fiji Islands, Tuvalu consists of 9 low-lying coral atolls with a total area of only 26 km^2, and a population of 9,652 people.[28] Few opportunities exist for economic development and ecologically sustained growth. The annual gross domestic product (GDP) is around US$20 million, with the capital island, Fongafale on the Funafuti atoll hosting more than half of the population and accounting for two-thirds of the GDP. The public sector employs 10% of the population. Subsistence fishing and agriculture provides about 70% of employment opportunities. Real GDP per capita is estimated to have grown at an average annual rate of 2% between 1995 and 2005, due to public expenditure, particularly through one-

[28] Source: Secretariat of the Pacific Community 2006.

off construction projects.

The fragile nature of the Tuvalu economy stem from the heavy reliance on income earned from Tuvalu Trust Fund (TTF), [29] fish licensing fees, .tv internet domain—revenue sources that are totally outside of the Government's control. The fluctuating revenues from these sources—that ranged annually over the period 2000–2005 from A$13 million to A$47 million—have caused complacency during the windfall years. In addition to being volatile, the future years' revenue is difficult to forecast. Expenditure decisions are, thus, made in the face of considerable uncertainty as to how they will be funded. Budget credibility suffered together with the reduced service delivery as the planning and management of key public services is undermined by the general absence of a multi-year perspective and the present poor in-year reporting capability.

The fiscal budget revenue amounted to A$35.9 million and expenditure to A$39.7 million in 2007. The trend level of expenditure and net lending is found to be above the trend level of revenue and grants, giving rise to an underlying budget deficit. If recent trends continue, it is estimated that the budget will be in deficit by approximately A$2.5 million in a typical year, which is on the order of 10% of GDP. This would be an unsustainable fiscal position. The weak fiscal position has arisen because expenditure was allowed to grow in years when revenue was high, and it has been difficult to cut expenditure back to fit into the lower level of revenue and grants.

The principal structural weaknesses impeding public finance management are (i) a large and continuous trade imbalance; (ii) a large public sector with a low productivity rate with lack of focus on customer service; (iii) a pervasive government ownership of enterprise activities, many of which require fiscal concessions and/or subsidies; (iv) an often weak fiscal situation; (v) a small under-developed private sector, which accounts for only one-quarter of GDP; (vi) high tax rates and import duties; (vii) an investment approval process that is non-transparent and burdensome for investors; (viii) an underdeveloped financial system typified by low domestic resource mobilization; (ix) a growing labor force experiencing high levels of under-employment; and, (x) a land tenure system which makes it difficult to obtain land for commercial development. The risks related to expansion of the fiscal deficits have already led to an extensive "crowding out" of the private sector in Tuvalu as a direct consequence of government taking on board businesses the private sector could assume a role in, and as an indirect consequence fiscal deficits absorb the country's capital away from the private sector. The large deficits quickly draw down the Government's liquid financial reserves that in turn results in very tight expenditure restraints, compression of expenditure on capital, maintenance, and procurement of goods and services.

Acknowledging the fundamental development issue that arises from the management of the fiscal deficits, *Te Kakeega II* denotes paramount goals of *sustainable budgets* and the *effective use* of resources to achieve public policy priorities, attainment of education and health objectives. The Government of Tuvalu (GOT) agrees with the need for correction in fiscal management and has adopted, in close coordination and consultation with the Board of TTF and the development partners more broadly, a road map for greater fiscal control based on a set of performance benchmark indicators. These are aimed at building capacity to implement the development objectives of the *Te Kakeega II* and strengthening the domestic economy. Demand and capacity for prudent fiscal management is central to achieving balance between the volatility of the revenues and the social service delivery and needs of the small but dispersed population. This has been jointly recognized between the development partners and the Government as the central focus for successful implementation of the *Te Kakeega II.*

In the context of the joint development strategy formulated by GOT, ADB and AusAID in 2005, the Performance Benchmark Indicators adopted by the Government and agreed with ADB, AusAID, and NZAID as guiding targets to

[29] The Tuvalu Trust Fund (TTF) was established in 1987 with contributions from the Governments of Australia, New Zealand, United Kingdom, as well as from the Republic of Korea with a total of A$26.4 million. The proceeds from the overseas TTF investment over and above the agreed maintained value can be used for budget support. The Government has, subsequently, contributed additional funds as did Australia, Japan, and the Republic of Korea. A TTF requirement is that the real value of contributions is maintained by the reinvestment of the inflationary premium (as measured by the Australian CPI). Distributions to the Government's CIF are only allowed to the extent that the TTF's current market value exceeds what is termed its "maintained" capital value, the real value of contributions. TTF now has a maintained market value of A$113 million and has its origination made available A$65.7 million to the Government's budget. Development partners have continued to contribute to the TTF. TTF's Board is composed of representatives of the Governments of Australia, New Zealand, and Tuvalu. The Board is responsible for overseeing and administering the TTF in accordance with the terms of the international agreement that created the trust. In addition, the Tuvalu Trust Fund Advisory Committee (TTFAC) established under a Deed to provide independent economic and financial advice to the Board and Government of Tuvalu, with members appointed by countries represented on the Board. A 2005 review of TTF concluded that to date the fund has satisfactorily met its core purpose, which is to *"assist the Government [of Tuvalu] to achieve greater financial autonomy in the management of its recurrent budget."* ADB is a regular observer to the meetings of the TTF Board.

achieve improvement in the overall development impact, the AusAID and NZAID assistance are largely linked to reward the GOT for gradual achievement of the Benchmarks. In particular, these key konors are focused on the Government's 5 Performance Benchmark Indicators aimed at ensuring (i) prudent recurrent fiscal expenditures; (ii) maintenance of fiscal reserves; (iii) prudent debt management; (iv) sufficient education; and, (iv) health spending. TTF is acknowledged among the development partners as the most efficient means to work together with GOT to ensure financial stability and manage its recurrent expenditure. AusAID will channel at least 50% of its A$3 million yearly program allocation for Tuvalu to support the Benchmark Indicators through TTF. Similarly, NZAID contributes on average 15-20% of its annual allocation of around NZ$2.2 million to TTF toward achievement of the Benchmark Indicators. In addition to this support, the AusAID and NZAID programs provide a 10% incentive payment of their respective country allocations upon achievement of the Benchmark Indicators.

In the Country Partnership Strategy (CPS), ADB has aligned its assistance with *Te Kakeega II* and the assistance provided by AusAID and NZAID through a focus on improved public expenditure and financial management. The CPS proposes to use grant financing as program assistance to embrace harmonization with AusAID and NZAID incentive program of assistance for GOT to achieve the Benchmark Indicators—the targeted improved public financial management and the broader development objectives under the national sustainable development plan, *Te Kakeega II*. As an innovative approach to develop capacity in public finance management, the Program Grant will align its tranche conditions to the jointly adopted benchmarks indicators with conditions that directly support the achievement of these indicators. Under its non-lending program, the CPS will encompass a long-term cluster-TA for capacity development to the Ministry of Finance, Economic Planning and Industries to support the Program Grant with the main focus on prudent financial management with an introduction of private sector management contract of a PE, support to improved PE performance, revenue management, and public finance management capacity building.

II. THE PROPOSED PROJECT

Investment in primary education and basic health are the top priorities for the Government as the human capital are the only sustainable assets in Tuvalu. In order to secure resources towards these priority sectors, improved financial management is a necessity to produce a credible budget. Based on the jointly formulated performance benchmark indicators by GOT, ADB, AusAID and NZAID, ADB can directly support the targeted non-salaried increase of 5% by 2008 to the primary education and basic health care sectors through (i) capacity development for improved financial management and (ii) a Program Grant targeting fiscal prudence. The Program Grant is envisaged to be implemented in tandem with a long-term cluster technical assistance project to develop capacity for fiscal management under conditions, where public sector human resource turn-over is significant, requiring for methodologies akin to those available for weakly performing countries. The Program Grant will have the following policy objectives: (i) majority divestiture of government holdings in the National Bank of Tuvalu (NBT) through international competitive and transparent procedures and assumption of a private-sector joint venture partner, and (ii) targeted private sector management of the government-owned Vaiaku Lagi Hotel (VLH).

A. Impact

The impact of this program will be to initiate a few, but important, steps towards achieving (i) improved public expenditure and financial management; (ii) better banking services to the outer islands, and possible mobilization of domestic savings to assist private sector development; (iii) de-link social obligations from commercial operations; and, (iv) ensure TTF remains the most efficient mechanism to support recurrent fiscal deficit.

B. Outcome

The intended outcome of the Program Grant CPS is an increase in the allocation of scarce resources towards the Government's priority areas: primary education and preventive health care. The proposed Program Grant will facilitate (i) majority divestiture of government shareholding in the National Bank of Tuvalu to a foreign bank aiming for improved mobilization of domestic savings for private sector development and provisions of financial services in the outer islands; and, (ii) private sector management contract of a state-owned enterprise. The attainment of the objectives supported by the Program Grant will be monitored through a progress made toward achieving the Benchmark Indicators under harmonized conditions by the Board of the TTF, meetings that ADB observes and through the continued harmonized implementation of the biennial Country Performance Assessments.

C. Outputs

The Program Grant will be structured with a maximum of two tranche releases. The appropriate condition(s) will be identified and formulated during the Program processing.

The Program Grant will enable establishment of a private sector strategic partnership for the NBT. The Government's current ownership of NBT has left the bank dysfunctional along commercial principles. In particular, a large non-interest bearing debt causes an operating loss around $500,000 per year and prevents NTB from unlocking domestic savings for private sector development and from expanding its services to the outer islands.

The Program Grant will also establish a private sector strategic partnership for a PE, particularly for the VLH, a prime example of how the public sector is crowding out private sector by operating principally commercial business at a loss. VLH has the potential to operate as a profitable operation as it is the preferred choice of accommodation by business or official visitors to Funafuti. Currently the facility and the business is poorly run and run-down and by regional standards, the service is poor and the room rates are high. The hotel appears to act as a market leader for higher-quality accommodation in Funafuti, setting a poor standard that will inevitably impair prospects for tourism development, even if currently in its infancy.

D. Stakeholder Participation and Consultation

The proposed Program Grant has been prepared through the extensive consultations in the preparation of the Country Operational Business Plan and the Country Partnership Strategy. The civil society and the private sector were consulted. There is a broad understanding for a need of change. All private sector stakeholders and the Chamber of Commerce have indicated a need for greater access to credit that NBT is not able to extend in the current conditions. As a result, the National Development Bank of Tuvalu is beginning to take greater risks in areas typically catered for by a commercial bank, such as real estate, creating distortions in the private sector. The VHL can open options for tourism, a development favored by the private sector, if operated professionally and under business principles as opposed to an extension of a government department catering for non-revenue generating functions. While the civil society has expressed its support to the Program Grant, as always in a change process, an advocacy is required to address anti-change positions and concerns regarding potential reductions in the social welfare benefits as a result of the change process.

E. ADF Grant Component

Due to its total public sector debt in net present value at the end of 2006 standing at 65% of GDP, Tuvalu will now receive its full ADF allocation, less a 20% discount, as a grant for the period 2007-2008. This is equivalent to US$2.14 million. The Program Grant will be structured as policy-based program assistance, where the necessary policy changes trigger the release of grant proceeds. The Program Grant will focus on improved financial management with the overall objective to assist Tuvalu achieve the Benchmark Indicators for public finance management, particularly to reduce its debt, more efficient management of public assets—promoted under harmonized assistance by AusAid and NZAID, and thereby increase resource allocation to the priority policy objectives, social development outcomes under the Te Kakeega II. For planning purposes, the indicative ADF amount for the periods 2009-2010 and 2011-2012 are likely to be around US$1.2 million, respectively, thus bringing the total ADF allocation for the CPS period to approximately US$5.1 million.

The policy focus of the Program Grant is envisaged to target (i) majority divestiture of the Government's shareholding in NBT; and, (ii) management contract for one PE. NBT has over the years acted as a *de facto* overdraft facility for the Government and therefore has prevented the implementation of prudent fiscal discipline. NBT has been consistently profitable; however, it joins the rank of the other government-owned lending institutions in facing a liquidity crisis, which in turns starve the private sector. This liquidity crisis is a result of the accumulated Government overdraft stemming from budget support coupled with a considerable debt from its involvement in the Outer Island Agency Suspense Account, where deposits were remitted back into the consolidated revenues instead of back to NBT. The reduced banking service to the outer islands also constrains the mobilization of domestic savings that could be channeled towards private sector development. In the past, NBT previously shared ownership with a foreign commercial banks and a renewed interest by foreign banks is on the table, but is dependent on settling the overdraft debt.

VLH is another PE that is unprofitable. Yet, the hotel is the accommodation of choice by all tourist and visitors to Funafuti. But the facility is run down, by regional standards the service is poor, room rates are high, and the hotel is setting a poor standard that will inevitably impair prospects for tourism development. The VLH should be an obvious example to initiate management contract to the private sector as a concept in Tuvalu.

F. Special Features

In the context of the joint development strategy formulated by GOT, ADB and AusAID in 2005, the Performance Benchmark Indicators adopted by the Government and agreed with ADB, AusAID, and NZAID as guiding targets to achieve improvement in the overall development impact, and the AusAID and NZAID assistance largely linked to reward the GOT for gradual achievement of the Benchmarks. The Government's five Performance Benchmark Indicators are aimed at ensuring (i) prudent recurrent fiscal expenditures; (ii) maintenance of fiscal reserves; (iii) prudent debt management; (iv) sufficient education; and, (iv) health spending.

In the CPS, ADB has aligned its assistance with *Te Kakeega II* and the assistance provided by AusAID and NZAID through a focus on improved public expenditure and financial management. The CPS proposes to use grant financing as program assistance to embrace harmonization of assistance for GOT to achieve the Benchmark Indicators, the targeted improved public financial management, and the broader development objectives under the national sustainable development plan, *Te Kakeega II*. As an innovative approach to develop capacity in public finance management, the program grant will align its tranche conditions of the Program Grant to either the jointly adopted benchmarks indicators or to conditions which directly support the achievement of these indicators.

G. Tentative Project Investment Plan

N.A.

H. Tentative Financing Plan

Table 2: Tentative Financing Plan

($ million)

Source	Total	%
Asian Development Bank	2.14	100.00
Other Cofinanciers	0.00	0.00
Government	0.00	0.00
Total	**2.14**	**100.00**

Source: ADB Staff estimate

Although cofinancing has not been confirmed at this stage, ongoing discussions with AusAID on possibilities for a rearranging its contribution to the Tuvalu Trust Fund and increasing its assistance in a cofinancing arrangement to Tuvalu have commenced, where a portion of this assistance could be allocated directly towards achievements of tranche conditions.

I. Implementation Arrangements

1. Project Management

No project management is envisaged under the Program Grant.

2. Implementation Period

The Program Grant is expected to be implemented over a maximum 1-year period.

3. Procurement

The policy-based Program Grant contains no procurement. A negative list will be constructed.

4. Consulting Services

The Program Grant will not finance consulting services. An associated cluster TA for public finance management is expected to support implementation processes to ensure time attainment of the milestone conditions. Broader PARD, particularly PLCO assistance will also be sought to support marketing of the privatization options.

5. Project Performance Management System

Project Performance Management System will be derived from the policy matrix and policy letter and directly support the 5 Benchmark indicators adopted by the Government with the agreement of the key donor partners. These will be monitored by the Board of the TTF.

6. Stakeholder Participation and Consultation during Implementation

The private sector and civil society were consulted during the conceptualization of the Program Grant and endorsed the proposed assistance package.

III. TECHNICAL ASSISTANCE

As part of a proposed cluster-TA for Improved Financial Management, TA resources will be available to assist with identification of potential overseas partners as well as to provide advice on due diligence on divestiture, risk allocation, legal instruments required for establishing the envisaged strategic partnership.

IV. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Project Economic and Financial Justification

N.A.

B. Social Aspects

There are no direct social aspects of policy-based Program Grant. However, the staff at the VLH may be affected on the basis of performance assessment under a new management contract. Design of the appropriate severance pay will be addressed in the tender process and in connection with the establishment of the partnership contractual provisions. Social benefits will be accrued in the medium to long-term in the expanded access to credit by the private sector and private sector development and subsequent private sector employment, improved hotel services generating opportunities for tourism service businesses, and through the reduction in the fiscal implications of the two entities thus divested from and the subsequent greater resources made available for social sector development, to support education and health outcomes leading to improvements in human capital productivity.

C. Environmental Aspects

There is no environmental impact of this Program Grant. Category C

PART 3. KEY ISSUES AND PROJECT CATEGORIZATION

I. KEY ISSUES FOR MANAGEMENT ATTENTION

It will be important to identify the appropriate trance condition(s). While there have been expressed interest in the past by foreign banks to acquire controlling interest in the NBT as well as foreign interest by a private sector group for management contract of the Government-owned VLH, the outcome of such a take-over and management contract respectively, neither can be assumed to as 100% done deals. Also, given the relative small size of the grant coupled with the uncertainty of take-over/management contract, a single tranche condition may be preferred.

For a country with very limited private sector activity and a cultural over-reliance of the Government to provide most, if not all services, a 2-months public advertisement in the international/regional media with invitations for a controlling stake in the NBT and management contract for the government-owned hotel, would have shown such a considerable political commitment as to qualify as the major tranche release. After all, the Government is likely to spend considerable funding to clear non-performing debts in NBT and probably be forced to offer redundancy packages to some of the staff in the hotel.

II. PROJECT CATEGORIZATION

☐ Category 1 (very complex and/or high risk project)
☒ Category 2 (project of medium-complexity and/or risk)
☐ Category 3 (project closely following previous projects or less complex)

The geographical isolation, the small size as well as population, the extremely limited resource endowment, the high debt vulnerability, the deteriorating CPA score in the governance cluster, coupled with a place in the fourth quintile using the low-income countries under stress (LICUS) index characterize Tuvalu as a weakly performing country (WPC). As such, special consideration for engagement is warranted and this CPS emphasizes the intent of the Paris Declaration through a much strengthened partnership with other development partners in full agreement by the Government. Project implementation experience from Tuvalu has in general been characterized by poorly performing executing agencies and a relatively weak political will. However, with the new Government enjoying a comfortable majority, the political will is much stronger today.

PART 4. STATUS OF PREPARATION AND PROPOSED PROCESSING PLAN

I. PROJECT PREPARATION

A reconnaissance mission was fielded 27-30 November 2007, which identified objective and scope in an Aide Memoire. A staff consultant has been engaged to compile background information and the report is due 15 February 2008. Program Grant fact-finding scheduled for April 2008.

II. PROPOSED PROCESSING SCHEDULE

Program Grant fact-finding mission 10-14 March 2008
1'st draft RRP by 15 April 2008
Interdepartmental circulation 22 April - 8 May 2008
MRM 22 May 2008
Program Grant negotiations 23 June 2008
Board consideration 6 August 2008
Signing of Program Grant 14 August 2008
Effectivity 28 August 2008

III. ESTIMATED INTERNAL RESOURCE REQUIREMENTS FOR FURTHER PROCESSING

5 person-months

ADB = Asian Development Bank, DMF = design and monitoring framework, MRM = management review meeting, PPN = project preparatory note, PPTA = project preparatory technical assistance, SSTA = small-scale technical assistance, TA = technical assistance.

Project Title	Program Grant for Improved Financial Management

PRELIMINARY DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
Impact Improved public expenditures and financial management	Mobilization of domestic savings increases lending for business purposes	Reports from National Bank of Tuvalu (NBT)	**Assumptions** • Private sector business acumen will develop **Risks** • High turn-over of trained staff
Outcome Primary education and basic health care sectors prioritized for development	5% increase for non-salaried expenditures in 2008 for the primary education and basic health sectors	Annual Budget Respective ministries annual reports	**Assumptions** • Increasing expenditures on salaries are being reined in. **Risks** • A credible budget will not be produced
Outputs 1.Government majority divestiture of its shareholding in NBT 2. Private sector management contract for 1 state owned enterprise (Vaiaku Lagi Hotel)	Deed of Sale Incorporation of new Bank in Tuvalu Management contract executed	The Government Gazette The Government Gazette Attorney General report	**Assumptions** • Political will to push through with needed reforms **Risks** • Foreign bank may not be interested in taking over majority shareholding in NBT
Activities with Milestones 1.1 Official regional inquiries to solicit foreign bank interest in NBT 1.2 Regionwide advertisement for management of Vaiaku Lagi hotel 2.1 Selection of foreign bank and initial negotiations by Oct 2008 2.2. Identification of interested parties to management of hotel and invitation for proposals by Nov 2008 3.1. Sale negotiations of Government's shareholding in NBT by Nov 2008 3.2. Award of management contract of Vaiaku Lagi hotel by Feb 2009 4.1 New bank replaced NBT by Mar 2009			**Inputs** • ADB $2.41 Million