2016

THIRTY-THIRD REPORT OF THE TRUST FUND ADVISORY COMMITTEE

Mission: 12-28 April 2016

PART 1

REPORT TO THE GOVERNMENT OF TUVALU AND THE TRUST FUND BOARD

TTFAC Secretariat

1 May 2016

Part 1 Contents

1. INTRODUCTION

(1) Part 1 of this document is a summary report to the Government of Tuvalu and the Board of the Tuvalu Trust Fund on the interim advice for 2016 given to the Government by the Tuvalu Trust Fund Advisory Committee.

(2) That advice is recorded in Part 2 of this document.

2. 2015 FISCAL DEVELOPMENTS & PROSPECTS

(3) Tuvalu's national budget has grown significantly in recent years, both in terms of domestic recurrent revenue and total expenditures. Increasing domestic revenues driven by buoyant fishing revenues, have provided Tuvalu with an opportunity to:

- consolidate its overall fiscal position and strengthen fiscal buffers for the medium term
- prudently increase investment levels into projects with prospects of producing an acceptable social and economic return; and
- sustainably manage ongoing operational expenditure.

(4) Tuvalu's 2016 Budget projects a record level of expenditure of $72.3 million, more than doubling the expenditure levels in 2013 of $32.5 million (122 per cent). Domestic revenue grew by only 52 per cent over the same period.

(5) The major spending components are:

- $19.977 million in staff costs;
- $14.864 million in investment expenditure;
- $5.287 million in Scholarships (including the SELF);
- $5.285 million in goods and services;
- $5. 0 million to be distributed to the Tuvalu Survival Fund (TSF);
- $4.78 million to be distributed to the TTF;
- $3.7 million in TMTS costs (Medical referrals);
- $2.33 million in travel; and
- $$2.23 million in maintenance costs.

(6) Three-quarters of the total budgeted expenditure in 2016 will be covered by anticipated domestic revenue collections of $54.6 million. The resulting financing gap of $17.6 million will be partially covered by $11.6 million in development partner budget support and the remaining $6 million will need to be financed from the reserves in the CIF.

(7) Driven by fishing revenues and contributions from the TTF, domestic revenue has grown by $16.7 million (49 per cent) over two years (2014 and 2015). The 2016 estimate for domestic revenue continues the practice of building in further growth, anticipating $54.6 million to be collected during 2016, which, if achieved, would set a new record for Tuvalu. Reforms to tax administration and tax auditing have resulted in improved tax revenue collection.

(8) Income from fishing licenses are at historic highs but revenue volatility remains subject to fluctuations in the AUD/USD exchange rate. If the number of days allocated to Tuvalu under the Vessel Day Scheme, (VDS), remain constant, current revenue levels can be expected to continue over the next 2-3 years at least.

(9) Revenue returns from the .tv Top-level Domain lease management arrangement Tuvalu holds with Verisign Inc. are likely to remain constant over the next few years. However, with contract expiry looming in 2021 preparatory planning to extract higher returns from this national asset should commence as soon as possible.

(10) Based on past performance TTFAC considers that the $14.8 million budgeted for investments is ambitious; the probability that it will be fully executed is low. For example, 2015 unspent monies marked for investment projects were carried over and transferred into the Tuvalu Development Fund (TDF).

(11) It is likely that cash spent from the 2016 budget investment provision may not amount to more than $0.1 million (as opposed to the $4.7 million reported). This suggests that the project management and implementation capacity of Ministries is low and that capital budgeting is a problem. A simple capital works programme will assist in budget execution.

(12) As at March 2016 the CIF had exceeded its benchmark minimum value (16 per cent of the TTF) by almost $10 million. The Budget projects that the CIF will fund the 2016 budget deficit to the tune of $6 million. Assuming no further draw-down and forward projections hold fast, by September 2018 the CIF will have around $31 million, representing around 18 per cent of the TTF.

(13) Expenditures are creeping up regardless of long-term affordability and value for money. The two main examples are the education and health sectors. Ongoing sectoral reforms that are aimed at curbing the growth in spending and getting better value for money are summarised below.

3. PUBLIC SECTOR MANAGEMENT: PROGRESS AND PROSPECTS

(14) Public financial management (PFM) has been sufficiently reformed that further refinements/continuous improvements should be fully integrated into the contracts of top public servants (Permanent Secretaries). Attention can turn to performance management for better results; better horizontal collaboration between Ministries, Public Enterprises (PEs) and Public Trading Enterprises (PTEs); and better overall governance from the highest levels.

(15) The next wave of public sector management reforms appear very promising – addressing the main issues of concern. TTFAC found some apparent "teething problems" among a generally positive picture of progress, but it is too early for to pass judgements or offer advice.

(16) The big worry is the capacity to deal with TK III: a thorough TTFAC review in six months' time is recommended.

4. PRIVATE SECTOR DEVELOPMENT INITIATIVES

(17) There is still a strong need for further reform of the government's involvement in commercial activities. The worsening problems with internet and telephone reliability illustrate the very high cost of failure to get the intended benefits of better service delivery through PE/PTE reforms. TTFAC understands that action is planned to address specific ICT infrastructure issues, and more SOE reforms may follow.

(18) Progress with the general policy of developing a bigger stronger private sector has been very disappointing. The strengthening of prudential supervision of the banking sector is likely to reveal one dimension of a weak private sector: unsustainable rates of loan defaults. This highlights the fact that a financial literacy programme is one of the components that appears to be missing from a proposed comprehensive pro-business package as intended in TK III. TTFAC has also suggested other supportive measures.

5. TE KAKEEGA III – 2016-2020

(19) The text was finally approved at a special session of Parliament shortly before the TTFAC Mission began, and the consensus document was launched at a Prayer Breakfast at which TTFAC was represented. Implementing TKIII will be a major challenge and we remain concerned that government lacks sufficient capacity to do it on its own, especially the major civil works planned. Considerable external assistance will be required.

6. ONGOING SECTORAL REFORMS

(20) The total budget for government funded scholarships (including the SELF scheme) is $5.2 million. Measured against the TKII Fiscal Ratio of 5% of domestic revenue the cost of scholarships is currently running at 9.7%, roughly $2.5 million more than the target. Under guidance of the respective Secretaries in Office of the Prime Minister (OPM) and Ministry of Education, Youth and Sports a comprehensive review of manpower planning and the scholarship process is underway. The results of the

review are expected in August with new processes adopted ahead of the 2017 budget rounds. Linking scholarships to jobs and labour requirements of the nation, not only to government, would have some effect on stimulating private sector development and economic growth.

(21) The Tuvalu Medical Scheme continues to be a major expense to government. In 2015 total expenditure was $3.6 million represented about 8% of total government expenditure, or 51% of the entire health budget. The initial 2015 TMTS budget of $1.86 million was blown out by 52%, requiring three separate supplementary budgets to accommodate the increase – the latest in April 2016 to pay outstanding 2015 bills. Measured against the TKII Fiscal Ratio of 6% of domestic revenue the TMTS scheme is currently running at 6.8%.

(22) Precise details of the number of patients accessing the TMTS are vague as proper records are not systematically kept, however, in 2015 it is estimated that 90 patients were in receipt of TMTS allowances. This would suggest that the average cost per patient approaches $40,000.

(23) The total budget for TMTS in 2016 is $3.7 million and accounts to mid-April 2016 show expenditure of $1.03 million, close to $300,000 per month. At this rate there would appear to be sufficient resources within the 2016 budget allocation. However, hidden costs such as the cost of THC and PMH staff administering the scheme and salaries paid to government employees on extended sick leave overseas are additional expenses not captured.

(24) The Ministry of Health is seriously trying to curb costs and systems abuse, tackling issues on several fronts. The recruitment of specialist doctors to treat patients with specific health conditions in Tuvalu, as opposed to referring them overseas, is important. However, because of the lack of statistics it is unclear which medical conditions give rise to the greater number of referrals. In theory there should be a direct correlation between the number of specialist doctors in Tuvalu and the number of overseas referrals. Increasing the former should decrease the latter.

7. IMPLICATIONS FOR TTFAC OF AN EXPANDED PRM

(25) TTFAC was consulted about whether the current arrangements would allow TTFAC to review and report on progress on a new and possibly expanded Policy Reform Matrix. We understand that this matter is now on the agenda of the May meeting so these are our views:

(26) All of us see merit in a PRM that focuses the government and lead donors on a short-list of the highest priority reforms – but we all also share a concern to keep a manageable balance between the additional demands that a more extensive PRM could place on TTFAC and the law and practice relating to TTFAC. Briefly, the issues of "manageable balance" are:

(1) ***potential conflict with TTFAC's primary role*** of providing both evaluations and recommendations to the government: (a) TTFAC needs to discharge its primary obligations and cannot allow them to get squeezed out if

extra PRM work means there's not enough time for the "pure-TTFAC" information gathering and evaluation; and (b) if we think there's something wrong with an agreement entered into with a donor (e.g. a commitment to implement a reform that TTFAC considers has turned out to be a high risk, low priority distraction from more urgent reforms) TTFAC must report accordingly;

(2) its ***collegial way of working as a self-managing team*** – already there's a potential problem if one or more parties to the International Agreement choose to appoint its representative on terms of reference quite different to those of other committee members.

(3) its ***freedom to detect and decide what issues to pursue in more depth*** – a fixed focus for a three-year period needs to be balanced against the need for some flexibility to be responsive to emergent issues;

(4) ***conflicts of interest/damage to TTFAC's reputation*** – at times individual TTFAC members have performed TA work outside their TTFAC duties, and also TTFAC as a whole has recommended that TTFAC as a whole perform additional tasks outside their official duties – these practices create obvious conflicts of interest if TTFAC ends up in effect evaluating its own work. Accommodating the extra demands of a more extensive PRM could extend TTFAC beyond fact-finding, evaluation and recommendations.

8. RECOMMENDATIONS

(27) There are no action points for the TTF Board. TTFAC recommends that the Board **note** the TTFAC Interim Report for 2016.

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Mission: 12 – 28 April 2016

PART 2

ADVICE TO THE GOVERNMENT OF TUVALU

TTFAC Secretariat

28 April 2016

Contents

Part 2

Acronyms Used

Acronym	Description
ACCPAC	Accounting Package
APTC	Australia-Pacific Technical College
AUD	Australian Dollar
CIF	Consolidated Investment Fund (Tuvalu Government)
CPI	Consumer Price Index
CPU	Central Procurement Unit
CSO	Community Service Obligation
CWM	Colonial War Hospital
DBT	Development Bank of Tuvalu
DFAT	[Australian] Department of Foreign Affairs and Trade
DWFN	Distant Water Fishing Nations
FNU	Fiji National University
FTF	Falekaupule Trust Fund
FVT	Fiji Volunteer Teachers Scheme
GDP	Gross National Product
GM	General Manager
HR	Human Resources
HRM	Human Resource Management
ICT	information & communication technologies
IMO	International Maritime Organisation
JV	Joint Venture
KPI	Key Performance Indicator
NAPA	National Adaptation Programmes for Action
MCT	Ministry of Communications & Transport
MFAT	[New Zealand] Ministry of Foreign Affairs & Trade
MFED	Ministry of Finance & Economic Development
MTFF	Medium-Term Fiscal Framework
NAFICOT	National Fishing Corporation of Tuvalu
NBT	National Bank of Tuvalu
OAG	Office of the Auditor General
OPM	Office of Prime Minister
PAC	[Parliamentary] Public Accounts Committee
PBD	Planning, Budget & Donor Liaison Department, MFED
PE	Public Enterprise
PERMU	Public Enterprise Reform Management Unit
PFM	Public Financial Management
PMH	Princess Margaret Hospital
PNA	Parties to the Nauru Agreement
PRIF	Pacific Regional Infrastructure Facility
PRM	Policy Reform Matrix
PS	Permanent Secretary (CEO of a Tuvalu Government Ministry)
PSD	Private Sector Development
PTE	Public Trading Enterprise
ROC	Republic of China (Taiwan)
SDE	Special Development Expenditure
SELF	Student Education Loan Fund

Acronym	Description
SPH	Suva Private Hospital
TA	Technical Adviser
TC	Tropical Cyclone
TCT	Tuvalu Consumption Tax
TDF	Tuvalu Development Fund
THC	Tuvalu High Commission
THRS	Tuvalu Health Reform Strategy
TK II	Te Kakeega II (previous national development strategy)
TK III	Te Kakeega III (National Strategy for Sustainable Development)
TMTI	Tuvalu Maritime Training Institute
TMTS	Tuvalu Medical Treatment Scheme
TNPF	Tuvalu National Provident Fund
TSF	Tuvalu Survival Fund
TTC	Tuvalu Telecommunications Corporation
TTF	Tuvalu Trust Fund
TTFAC	Tuvalu Trust Fund Advisory Committee
.tv or .TV	Tuvalu’s country top-level internet domain name
TVET	Technical & Vocational Education & Training
UK	United Kingdom
UNDP	United Nations Development Program
UNOPS	United Nations Office for Project Services
USD	United States Dollar
VLH	Vaiaku Lagi Hotel
VDS	Vessel Day Scheme

1. Introduction

1.1 Preamble

The advice in Part 2 is addressed primarily to the Government of Tuvalu.

1. The Tuvalu Trust Fund Advisory Committee (TTFAC) convened in Funafuti from 12-28 April 2016. The Committee comprised Malcolm Ponton, Pete Rodger and Richard Neves (14-21 April) and was supported by Lee Faiva Moresi and Ms Salai Sualo (TTF Secretariat). The team is grateful for the goodwill and support that is so important for the success of the TTFAC role.

1.2 Mission Focus

2. As usual, TTFAC:

- examined the fiscal results for last year (2015), fiscal forecasts for the current year (2016) and forward estimates (2017 and 2018) and fiscal risks that have been identified in earlier reports (see para below for a summary of responses to identified risks);
- followed up key recommendations in earlier reports to check progress;
- identified issues arising from the policy, planning and fiscal decisions since its October 2015 report; and
- received TTF board members' requests to investigate particular subjects.

3. Earlier TTFAC recommendations that were followed up included:

- new payroll software integrated with ACCPAC – see para 114 below;
- assets register – see paragraphs 115-116 below;
- robust implementation process for Te Kakeega III (TK III) – see Section 5. Te Kakeega III - 2016-2020 beginning on page 44 below;
- extend good practices to wider public sector – see paras 121-122 below;
- reform private sector development policies – see Section 4. Private Sector Development Initiatives beginning on page 41; and
- continue to strengthen governance institutions – see 3.3 Strengthening Governance Institutions and Processes pp 38-39 below.

4. Additional issues arising from recent decisions included:

- content and status of ongoing PFM reforms centred around the new Ministry of Human Resource Management (paras 118-119 below); and
- detailed content of final version of TK III – see paras 152-154 below.

5. The requested investigations included:

- maintenance (overcoming the backlog etc) – see paras 115-116 below;
- shipping – both capital expenditures and operating costs (Section 3.4 starting on p. 39 below);
- ongoing review of scholarships – especially proposed central committee over all parts of an integrated policy framework (umbrella arrangement) – see paras 182-187 below;

- integration of planning and key aspects of public sector management – especially budget allocations and operational focus, in response to TK III (Section 5 beginning on page 44 below);
- the Tuvalu Medical Treatment Scheme (TMTS) – paras 166-176 below; and
- unfinished action re Naficot in the "Integrated Reform Matrix" (paras 126-127 below).

1.3 RECOMMENDATIONS TO THE GOVERNMENT

TTFAC recommends that the Government of Tuvalu:

a. ***Commence planning*** to extract higher returns from .TV national asset.

b. ***Operationalize*** the Cabinet-approved Contracts Management Unit.

c. ***Introduce*** a capital works programme as a tool for the Planning, Budget and Donor Coordination Department of MFED to use to improve the way in which capital projects are planned, budgeted and implemented.

d. ***Request*** the next TTFAC mission to review and report on further progress with all of the following initiatives: new payroll accounting module; asset register; strengthening linkages between planning, budgeting and results; sustaining core public sector operational capacity; extending public service good practices into the wider public sector; strengthening governance institutions; and improving management of shipping services.

e. If a new Policy Reform Matrix is proposed, ***consider suggesting*** that it include the enactment of the Public Budget, Accounts and Audit Committee Act and a new Act making consequential changes to the Audit Act as proposed by the Auditor General, plus other clarifications and strengthening of the powers of the Office of the Auditor General (OAG).

f. ***Give urgent attention*** to improving the inadequate ICT services.

g. ***Support*** the other moves under way or being considered to boost private sector development in Tuvalu;

h. ***Ask MFED***, in consultation with TNPSO, NBT, DBT, TNPF and other stakeholders, to give urgent consideration to existing donor "financial literacy" initiatives as implemented around the Pacific.

i. ***Consider approving*** a policy that all Ministries, PEs and PTEs (i.e. the wider public sector) keep under review all options for switching from public to private sector provision of services.

j. ***Take action*** to overcome information barriers that may limit local participation in government and donor purchasing.

k. ***Re-balance*** existing tertiary scholarships giving more emphasis to TVET.

l. Broaden the scope of manpower planning to include the private sector.

m. ***Rebalance*** scholarship awards to boost private sector development.

n. ***Redirect and limit*** the SELF scheme to finance foundation and certificate courses in Tuvalu.

o. ***Explore*** the possibility of expanding the FVT to supply TVET teachers.

p. ***Assess*** the feasibility of establishing an APTC or similar technical skills training facility in Tuvalu.

q. ***Establish*** a training institute in Tuvalu to provide certified training in accordance with labour shortages/demands in Tuvalu and overseas markets.

r. ***Up-skill*** Tuvaluan tradesmen/women to meet the required certification standards in Australia and New Zealand.

s. ***Establish*** a simple database, or record book, keeping track of the number of patients under the Tuvalu Medical Treatment Scheme, type of illness, expenditure made against individual patients broken down into main costs, travel, allowances, carers etc., and conduct historical analysis.

t. ***Undertake*** a cost benefit analysis of increased specialist support at Princess Margaret Hospital and the number of overseas referrals.

2. 2015 Fiscal Developments & Prospects

2.1 Overview

Revenue

6. A growing domestic revenue base driven by buoyant fishing revenues presents an opportunity for the Government of Tuvalu to consolidate the overall fiscal position and strengthen fiscal buffers for the medium term.

7. The main fiscal policy challenge is to comprehend whether there is an ongoing increase in the Tuvaluan revenue base. Uncertainties will continue in global markets, exchange rates and levels of tuna fishing – and all will create reservations about the contribution of future revenues to Tuvalu's fiscal position.

8. The Vessel Day Scheme (VDS) is enabling Tuvalu to capture more value from the fish caught in its waters. There are risks to this revenue and the Government must therefore allocate some of this revenue to fund the active efforts that are required to continually manage and minimise these risks; and budget on the basis of balanced revenue estimates that are not set at the higher end of expectations.

9. The 2016 Budget assumptions around fishing revenue are based on a USD 12,500 average price for all Vessel Days, which is at the higher end of expectations. There is a risk that this price will not be achieved across all the Vessel Days allocated to Tuvalu.

Investment Spending

10. Another emerging issue is the planning around investment expenditure and managing the planning and budgeting process around investment spending. In 2015 $4.6 million of investment spending and $0.477 million in maintenance spending was transferred into the Tuvalu Development Fund (TDF). When these monies are combined with the $14.8 million provided in the budget the intended capital expenditure for 2016 now approaches close to $20 million on a cash basis. The probability of this occurring needs to be viewed in light of past annual expenditures of around $0.1 million.

Recognition of Recurrent Expenditure

11. The classification "Special Development Expenditure" (SDE) has for some time included $1.6 million of on ongoing expenditures. These should rightfully be reflected in the forward estimates of recurrent expenditure; future expenditure ceilings for the recurrent budget need to take these into account; and the SDE provision accordingly reduced. The estimates of SDE expenditure of $20 million projected over two years (2017 and 2018) contain no planned activities i.e. they anticipate future TK III decisions.

Treasury Management Issues: Cash and Reserves

12. As at March 2016 the Consolidated Investment Fund (CIF) had exceeded the guideline benchmark minimum by almost $10 million and is most likely not required to fund any deficits, as there is sufficient cash in the General Government Account to cover what is most likely to be a reduced budget balance.

13. The CIF balance is now almost 25 per cent of the TTF maintained value, exceeding the guideline minimum of 16 per cent. The CIF should be matched against the revenue and expenditure profile. Work should be undertaken to project the future liquidity requirements of the Government over the next five years, and within this review articulate what steps that need to be taken to increase the maintained capital of the TTF to $200 million by 2020. This noble but ambitious goal would require the maintained level of the TTF to increase by around a third in a period of four years. In the absence of a significant increase in contributions,

perhaps from new contributors, it may be difficult to achieve that goal in such a short period of time.

14. Other expenditure worries are increasing costs of staffing, scholarships and TMTS.

Public Sector Wages

15. Currently, Tuvalu's public sector wages are a greater proportion of GDP than many other Pacific countries. This partly reflects diseconomies of scale – there is a core of activities that every sovereign nation must undertake regardless of country size. But there is an "opportunity cost" – the money that pays a large salary bill is not available for other expenditures, which could improve service delivery to the community.

16. Additionally, the employment of public servants also has a social aspect. This universal redistributive approach through public sector staffing is far less efficient than an approach that identifies the needy and assists accordingly. The provision of $0.1 million for the implementation of a payroll system will assist in improving overall pay management and effectiveness, but it will not alter expectations of future pay rises than can be created by the government's policy decisions.

Scholarships

17. Concern remains around expenditure in the scholarships (including the loan scheme) area. The growth in expenditures on scholarships and the SELF has seen the $1.8 million expenditure in 2013 growing to $5 million per annum in 2016 onwards. Whilst expenditure in the education sector is important, there are issues around quality of expenditure to ensure that the investment provides the skills that are required in the Tuvaluan labour market and the international market where Tuvaluan participation drives remittances. Could the extra $3.2 million have gone into TVET? These issues are discussed in more detail in 6.3 Education Sector Reform Issues starting on p.49 below.

Tuvalu Medical Treatment Scheme (TMTS)

18. The Tuvaluan medical treatment scheme costs $3.5 million per annum but improves health outcomes for only a few. There could be opportunities to make better utilisation of these funds and these are also discussed elsewhere in the report (see p. 47 below).

2.2 Responses to Potentially Controllable Major Fiscal Risks.

19. The previous TTFAC report highlighted the following fiscal risks. Overall, the government's response has been both comprehensive and effective.

#	RISK	RESPONSES
1	Continuing failure to control some fast-growing expenditure programs, notably the Tuvalu Medical Treatment Scheme (TMTS) and the Student Education Loan Fund (SELF);	Continuing significant efforts by government to bring these two expenditure programmes under control are reported and evaluated with TTFAC recommendations (refer p. 47 below for TMTS and p. 50 below for scholarships)
2	An urgent need to complete implementing some public-sector management reforms to improve revenue collection and strengthen controls on spending;	Revenue collection will need to be reviewed in the next TTFAC mission when more data is available. See para below re TCT retained by PTEs and para 14 below re spending concerns.
3	The need to keep funding reductions to the deferred maintenance backlog now a start has been made this year to overcome years of under-funding;	TTFAC welcomes the MFED's move to start the preparation of a government asset register with PRIF assistance. This is a big step towards the improvements our last report recommended in

#	RISK	RESPONSES
4	The emerging need to increase capital expenditure to strengthen and protect vital infrastructure as part of the post-Pam strategy of increased resilience;	planning, funding and action on maintenance and acquisition of capital assets – another big step would be the capital works programme that is discussed below106 at paras 105-106.
5	Likely funding of reform/capital injections/ community service obligations (CSOs) for some troubled public businesses to protect/improve services.	TTFAC concern re Tuvalu Telecommunications Corporation (TTC) was and still is the biggest issue: TTC service problems are now worse than before but NZ MFAT and World Bank are addressing them – see para 142 below.
6	Some Special Development Expenditures (SDEs) that are supposed to be "one-off" appear likely to be included in future recurrent expenditure.	There is enough evidence to act now to reclassify some SDE spending as recurrent and make the consequential changes to the MTFF reporting, etc. – see para. 11 above.
7	The emerging need to re-invest some fishing revenue back into that sector to preserve and increase the income and other benefits to the people of Tuvalu.	Paras 62-72 below summarise ways to reduce risks and preserve and increase benefits from the fishing sector, but the costs of such measures are not yet clear. **The costs of these measures, which are required to ensure that forecast gross revenues from fishing are collected, have not been incorporated into the Budget or medim-term fiscal framework (MTFF).**
8	A planned increase in civil service and MPs remuneration with effect from 1 January 2016, to compensate for inflation since these rates were last increased at the start of 2014.	TTFAC suggests that expectations about future inflation adjustments are just one of a number of issues about longer-term management of the public sector wage bill – see paras 94-97 below.
9	Expected new pressures to finance items on the Te Kakeega III 'wish list' of longer-term policies and actions.	An investigation is concluding into the benefits of PRM 3 and the possibility of a PRM 4. TTFAC comment in Part 1 paras (25-26) above.

2.3 Medium Term Fiscal Framework (MTFF)

20. The medium term fiscal framework (MTFF) is a tool to guide the Government in optimising its fiscal policy-making. By creating a series of measurements that relate three year rolling plans to broad projections of social needs (e.g. government spending per head of population) and economic capacity to meet those needs (e.g. spending as a proportion of Gross National Product) it reveals the need for fiscal decisions: to prioritise any new spending within those plans; to seek better value for money from existing expenditure, better performance in revenue collections, etc.

21. Tuvalu faces development challenges (which Te Kakeega III attempts to address) that require financial resources that will ultimately be acquired through either own source means or development partners. The MTFF enables the Government and its main development partners to agree on a shared picture of central fiscal issues that are revealed by realistic projections of current expenditures and revenues from the government's own sources, the impacts of proposed reform initiatives, the demands of the capital programme when project spending is added, the level of committed donor support, the ongoing uncertainties, etc.

22. TTFAC was encouraged by its finding that the basic foundation for a simple MTFF with a reasonably robust forward expenditure system is in place in Tuvalu. Administrative simplicity is the key, and with a little more work the Tuvaluan MTFF could further assist the Government's ability to comprehend the ongoing budgetary impact of the decisions taken.

23. As noted in the Overview above, a number of new initiatives undertaken in the past few years have been funded through the Special Development Expenditure (SDE) provision in the Budget for one year. A more detailed review of expenditures under the SDE provision since 2014 revealed total ongoing expenditures of around $1.6 million. To ensure consistent treatment of fiscal components, these expenditures should be reflected in the forward estimates of recurrent expenditure, future expenditure ceilings for the recurrent budget need to take these into account and the SDE provision accordingly reduced.

2.4 Fiscal Management Process Issues

24. Fiscal management – getting the big numbers roughly right – depends on lower-level fiscal management processes – especially revenue management and public financial management (PFM) – to ensure high-quality decisions on the detail. And large problems at these lower levels can certainly undermine and upset apparently sensible and sustainable fiscal policies developed by using the MTFF approach outlined above.

25. TTFAC noted the sudden and unexpected arrival of the Talamoana, and some other shipping issues where operating costs and on-shore capital costs appeared to have been over-looked in the decision to purchase a ship. Saving money on purchasing a ship only to find that it cannot safely discharge cargo on an Outer Island without harbour works that could cost as much as $40 million is not a high-quality decision. These examples suggested a weakness in the otherwise very comprehensive set of policies introduced by the 2015 Treasury Instructions.

26. It emerged that the Talamoana decision was made by a previous Government prior to the new Treasury Instructions. One weakness in this case was the lack of a central unit to record that decision and record progress – and the very recent establishment of a unit within OPM charged with project monitoring and reporting appears to be designed to address exactly that problem.

27. However, because the project monitoring unit was in the process of being set up during our mission, TTFAC was unable to discuss the details of how this new unit's activities will be integrated with the work of the new Planning, Budget and Aid Coordination unit within MFED. That is critically important because the fundamental weakness in the original decision, and some other shipping decisions was that crew costs, fuel costs and onshore costs were not taken into account in the decision nor were they recorded as future fiscal commitments.

28. This serves to re-emphasise the need for **all** fiscal commitments – whether they arise from internal government processes or external agreements with donors or international organisations or commercial entities – to receive Cabinet authorisation **only after** proper identification, analysis and evaluation of all the direct **and indirect** fiscal implications. Government actions to ensure safe, affordable, regular and reliable shipping services to the outer islands involve much wider issues than the capital cost of a ship.

29. N.B. In the case of PEs and PTEs directed to perform non-commercial activities, the Community Service Obligation (CSO) approval process set out in Part IV of the Public Enterprises (Performance and Accountability) Act 2009 must **also** be followed – Cabinet approval alone is not enough. More generally, TTFAC remains concerned about inadequate arrangements for the government's fiscal decision-making to receive the specialised expert analysis and advice needed for some very large and complex decisions that this government will face. We report progress at paragraph 158 d below.

30. It is **recommended** that the next TTFAC Mission be asked to investigate and report on this issue of integration of the work of the OPM project Monitoring and Evaluation unit with the Planning, Budget and Aid Coordination unit within MFED and with arrangements for

access to the specialised expert analysis and advice needed for some very large and complex decisions that this government will face. (Refer to full set of recommendations at paragraph 161 below.)

2.5 Fiscal Analysis

31. Table 1 below attempts to provide a summary of the major fiscal indicators from 2013 to 2018. On the whole it outlines the good fortune Tuvalu has recently experienced.

32. The major issue is to ensure that the gains that have been made and assumed to be made over the period of the budget and forward estimates can continue to overcome the challenges the country faces.

Table 1 – Tuvalu Fiscal Indicators 2013 to 2018

[A] Income and Expenditure

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Domestic Recurrent Revenue					
Total Taxation Income	$5,969,053	$8,450,558	$7,383,654	$7,531,327	$7,681,953
Total Govt Charges & Royalties	$21,662,157	$35,737,260	$39,752,515	$37,750,500	$35,528,191
Total Investment Returns	$14,288,684	$6,211,911	$7,485,152	$5,605,152	$5,605,152
Total Domestic Revenues	**$41,919,894**	**$50,399,730**	**$54,621,320**	**$50,886,978**	**$48,815,296**
Total Recurrent Expenditure					
Total Operational Costs	$25,842,930	$29,266,932	$32,192,866	$32,908,436	$33,532,391
Total Grants and Subsidies	$10,160,778	$14,665,210	$13,032,059	$12,848,753	$12,968,124
Investment Expenditure	$94,880	$92,599	$73,034	$75,225	$76,730
Total Financing Expenditure	$577,762	$665,042	$696,759	$698,453	$699,617
Total Expenditure	**$36,676,350**	**$44,689,783**	**$45,994,718**	**$46,530,867**	**$47,276,862**
Structural Balance	**$5,243,544**	**$5,709,946**	**$8,626,602**	**$4,356,111**	**$1,538,434**
Non Recurrent Expenditure					
Special Development Expenditure	$4,714,090	$9,841,073	$21,432,028	$10,000,000	$10,000,000
Transfers to the TTF	$0	$3,000,000	$4,780,000	$0	$0
Total Non-Recurrent Expenditure	**$4,714,090**	**$12,841,073**	**$26,212,028**	**$10,000,000**	**$10,000,000**
Domestic Financing Gap	**$529,454**	**($7,131,127)**	**($17,585,425)**	**($5,643,889)**	**($8,461,566)**
Development Partner Financing	**$11,628,551**	**$7,802,051**	**$11,564,451**	**$8,906,667**	**$8,350,000**
Overall Budget Balance	**$12,158,005**	**$670,924**	**($6,020,975)**	**$3,262,778**	**($111,566)**

[B] Balances/Reserves

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Trust Fund Balance (end Sep) *	$148,850,511	$148,002,255	$153,000,000	$157,000,000	$164,000,000
Consolid[d] Invest[t] Fund (end Sep)*	$18,778,929	$25,415,215	$34,000,000	$37,000,000	$41,000,000
CIF as a % of TTF Market Value	12.6%	17.2%	22.2%	23.6%	25.0%
General Government Account *	$17,682,173	$25,519,298	$19,000,000	$19,000,000	$16,000,000
Tuvalu Survival Fund *	$0	$0	$5,000,000	$5,000,000	$5,000,000
Tuvalu Development Fund *	$2,268,507	$6,710,151	$5,000,000	$4,000,000	$3,000,000
Public Debt					
Falekaupule Trust Fund	$2,577,727	$2,556,154	$2,366,154	$2,230,000	$2,100,000
TMTI Original Loan	$1,853,185	$1,743,988	$1,634,811	$1,520,000	$1,410,000
TMTI Supplementary Loan	$2,112,257	$2,007,155	$1,901,783	$1,800,000	$1,700,000
DBT Equity Injection	$444,708	$435,827	$430,000	$420,000	$410,000

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Estimated Total Debt	**$6,987,877**	**$6,743,124**	**$6,332,748**	**$5,970,000**	**$5,620,000**

[C] Key Assumptions

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Economic Assumptions					
AUD/USD			0.710	0.750	0.800
GDP growth			4.0%	2.0%	2.0%
CPI Inflation			2.5%	3.0%	2.0%

[D] Fiscal Ratios

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Fiscal Ratios					
Tax Revenue to GDP	14%	20%	16%	16%	16%
Domestic revenue to GDP	102%	117%	122%	111%	104%
Recurrent expenditure to GDP	89%	103%	102%	102%	101%
Wages & salaries to domestic revenue	36%	32%	36%	40%	42%
TMTS to domestic revenue	7%	7%	7%	7%	8%
Scholarship Schemes to domestic revenue	4%	6%	8%	9%	10%
Domestic Funding Gap to GDP	1%	-17%	-39%	-12%	-18%
Dev[t] Partner Assistance to GDP	28%	18%	26%	19%	18%
Overall Budget Balance to GDP	30%	2%	-13%	7%	0%

Note: 2014 and 2015 supplied by ACCPCC, 2016 to 2018 were taken directly from the budget papers. Estimates modelled by TTFACSC

33. The fiscal ratios above are an important part of the Medium-Term Fiscal Framework (MTFF) approach to overall fiscal management. They provide points of reference so that:

(i) at the aggregate level the:

- medium-term implications of current spending and revenue decisions can be seen in context – e.g. relative to the macroeconomic picture;
- importance of the economic assumptions (see bottom of previous page) can be tested by showing how the impact of Government decisions may change if factors like economic growth, inflation, exchange rates, etc. turn out to be different from the ones assumed; and
- macro issues can be identified in advance – like sustainability of spending relative to own revenue sources and donor sources; the impact on local prices of different types of government spending; the capacity to meet temporary increased demands for local labour for projects, etc.

(ii) at the sector level, or even individual programmes:

- the proportion of total funding allocated to essential core activities of government, like the education and health sectors, and sub-programs can be tracked over time; and
- these sector ratios can be set and monitored as indicators of overall spending priorities.

2.6 Overall Fiscal Position of the Government

34. In 2015, total reported expenditure of $57.5 million (133 per cent of GDP) and domestic revenue collections of $50.4 million (117 per cent of GDP) were the highest recorded in Tuvalu. The domestic financing gap of $7.1 million was covered through development partner budget support of $7.8 million (17 per cent of GDP), resulting in an overall budget surplus of $0.671 million (1 ½ per cent of GDP).

35. The Budget anticipates further growth in domestic revenue (albeit at a more modest pace than what has been recently experienced) for 2016 on the amounts receipted in 2015. These estimated revenues continue to be driven by greater fishing revenues. On the back of this growth the Government has budgeted an increase in total expenditure consisting of:

- growth in ongoing operational spending and grants and subsidies; and
- significant increase in investment spending.

Table 2 – Fiscal Indicators 2013 to 2018 (per cent of GDP)

	2013 Actual	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Domestic Revenue to GDP	85%	102%	117%	122%	111%	104%
Total Expenditure to GDP	82%	100%	133%	161%	123%	123%
Structural Balance to GDP	11%	13%	13%	19%	10%	3%
Domestic Financing Gap to GDP	3%	1%	-17%	-39%	-12%	-18%
Donor Financing	25%	28%	18%	26%	19%	18%
Overall Budget Balance to GDP	28%	30%	2%	-13%	7%	0%

Figure 1 – Total Expenditure and Total Domestic Revenue 2013 to 2018 ($)

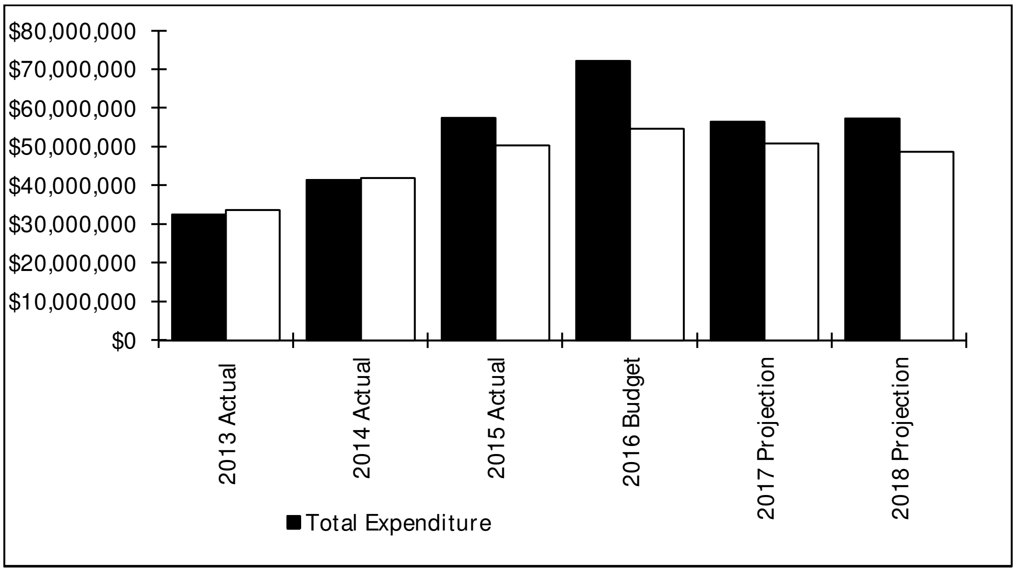
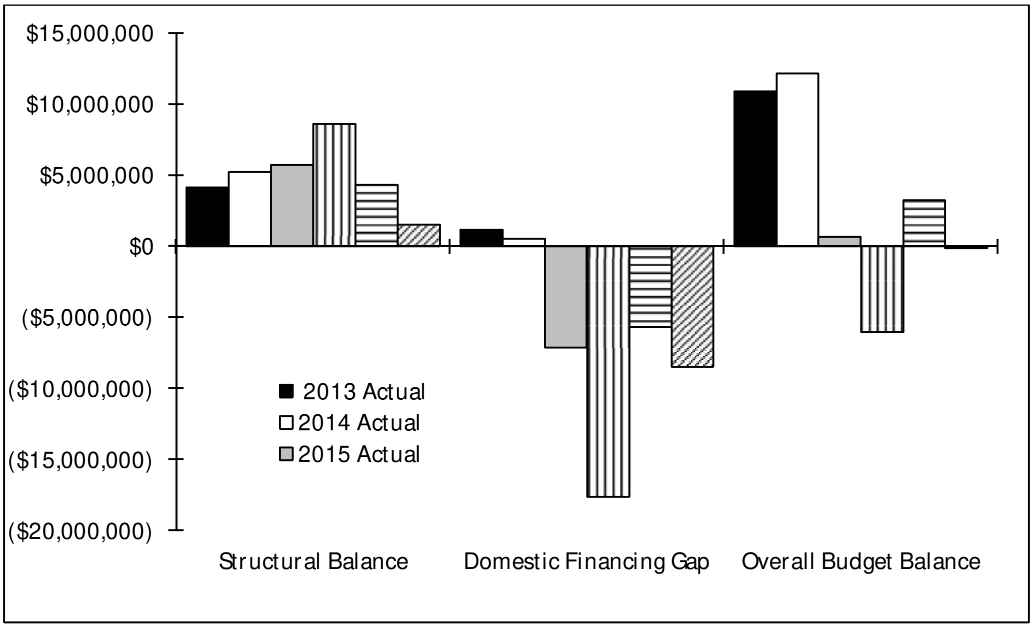


Figure 2 –Various Reported Budget Balance Measures 2013 to 2018



36. Figure 2 outlines the trends in the various fiscal measures used and published by the Government.

The structural balance represents the difference between domestic revenue (taxation income, fishing revenues, other royalties and TTF distributions) and recurrent spending (as classified in the budget). The projected decline in the structural balance from 2017 reflects the rate of growth in expenditure outpacing domestic revenue growth. The growth is mainly in salaries, the TMTS and scholarships.

37. The domestic financing gap incorporates the impact of the SDE into the expenditure picture. The principle of spending in this area appears to be one off. On detailed examination of past expenditures it is clear that there is a proportion that is ongoing in its nature and should be classified as ongoing expenditure that is recurrent. A domestic financing gap emerged in 2015 and is projected for the 2016 budget and the 2017 and 2018 projections.

38. SDE spending also includes contributions to the TTF by the Government, and that whilst SDE expenditure of $10 million is projected in 2017 and 2018 there are no details of planned expenditures that will occur from it. At this point it could be considered to be a policy spending reserve or a further buffer.

39. The structural balance and the domestic financing gap are the key indicators used by the Government in ascertaining sustainability.

40. The reported overall budget balance takes into account the budget support provided by development partners. In 2016 an overall budget deficit has been projected which if it eventuated would need to be covered by the Government's reserves in either from the General Account or the CIF (most probably the former).

41. The overall budget balance is the key fiscal measure of sustainability, it outlines the actual net financing requirement of the public sector, and the impact on cash reserves or borrowings which may be required to finance the operations of the government.

42. However, it is unlikely that expenditure will reach the levels outlined in the budget and the overall budget into the deficit that is provisioned for in the 2016 Budget will not be reached. Reported investment spending in 2015 of $4.6 million and maintenance spending of $0.477 million was not actually spent but transferred into the Tuvalu Development Fund due to administrative difficulties with spending. This is effectively a carryover of money into the following year. As a result the actual adjusted spending level was closer to $49.5 million, with an adjusted budget balance of $5.8 million surplus.

Table 3 – Adjusted Expenditure Figures for 2015 ($)

Fiscal Measure	Reported Expenditure	Adjustment	Adjusted Expenditure
Investment Expenditure	$9,841,073	$4,606,000	$5,235,073
Recurrent Expenditure	$44,689,783	$477,000	$44,212,783
Total Expenditure	**$54,530,856**	**$5,083,000**	**$49,447,856**
Structural Balance	$5,709,946		$10,792,946
Domestic Financing Gap	($7,131,127)		($2,048,127)
Overall Budget Balance	$670,924		$5,753,924

43. In reviewing the 2016 budget there are adjustments that should be considered to estimate actual spending levels at the end of the year. Adjusting for a more realistic levels of investment and maintenance spending and removing the impact of contributing funds to the TTF and the recently-established Tuvalu Survival Fund (TSF) would reduce total expenditure from $72.5 million down to around $49.4 million as outlined in Table 4. This would appear more in line with prior years spending.

Table 4 – Adjusted Expected Expenditure for SDE in 2016

Fiscal Measure	2016 Budget
SDE Expenditure	$26,212,028
Less TSF	$4,780,000
Less TSF	$5,000,000
Less Non Executed Investment	$13,000,000
Adjusted SDE Expenditure	$3,432,028

44. During the period from 2013 to 2015 reported overall budget balances were surpluses of $15.1 million in which were in reality $20.2 million. Correspondingly the three years from 2016 to 2018 outlines reported budget deficits amounting to $2.9 million should be higher, perhaps to $7.9 million to accommodate the expected spending of the monies that were transferred into the TDF.

45. In 2016 – it is anticipated that 75 per cent of total budgeted expenditure would be covered by projected domestic revenue collections. The reported financing gap of $17.6 million would be partially covered by $11.564 million in development partner budget support and the remaining component of the overall budget deficit $6.021 million would need to be

financed from the General Government Account which has recently built up a significant amount of money.

46. On face value, a massive increase in actual spending of this magnitude is concerning. However the are some considerations that need to be considered:

- To what extent does "spending" include balance sheet movements? - this primarily relates to monies that have been earmarked as contributions to the TTF (which are actually savings) and TSF.
- The level of increased ongoing expenditure and the quality of that expenditure to achieve the desired outcomes of the Government.
- The management of cash and reserves where monies budgeted in one year are actually for capital projects that will take place over a number of years.

47. The increase in expenditure in the 2016 Budget projects a $4.78 million contribution to the TTF. There is also a projected $5 million contribution to the TSF to assist with the country's disaster management responses following the experiences of Cyclone Pam in 2013 where a significant amount of damage was suffered by Tuvalu. At the time of the budget no projects had been nominated to be covered from the TSF.

48. The $14.8 million budgeted in 2016 for investment projects is ambitious. The probability that it will be fully executed is low, particularly as the investment task for 2016 now approaches close to $20 million on a cash basis. The probability of this occurring needs to be viewed in light of past expenditures of around $0.1 million.

49. Assuming that investment expenditure remains at past levels and that no money will be spent from the TSF, and that the contribution of $4.78 million will be made to the TTF, the actual expenditure levels in the SDE are most likely to approach around $3 ½ million (of which around half are ongoing expenditures) as demonstrated in Table 4.

2.7 The Consolidated Fiscal Picture

50. The public accounts of Tuvalu incorporate the:

- Tuvalu Trust Fund (the national sovereign wealth fund);
- Tuvalu Consolidated Investment Fund (The cash reserves of Tuvalu for budgetary financing needs which are invested abroad);
- Tuvalu General Account (the working account of the Treasury);
- The Falekaupule Trust Fund (the outer island development fund);
- Tuvalu Development Fund (a combined development partner and Tuvalu Government development fund for project and asset investments); and
- The Tuvalu Survival Fund (for activities and investments dealing with climate change activities and investments);

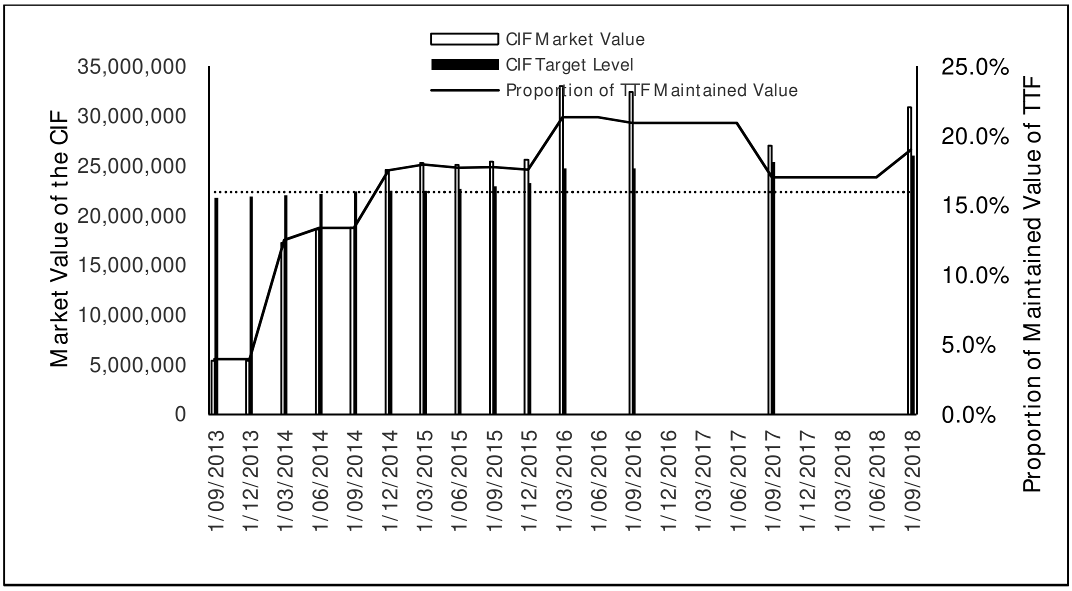
51. The actual balance of these funds is outlined in the Table 1. An indicative modelling effort outlines the value of those funds up until the end of 2018.

52. The TTF automatically distributes funds to the CIF which effectively supports the General Government Account in financing budgetary expenditures. A target of not letting the value of the CIF fall below 16 per cent of the Maintained value of the TTF has been previously established.

53. As at March 2016 the CIF had exceeded the minimum value by almost $10 million. At this stage it does not appear that the CIF will be required to fund the overall budget deficit predicted for 2016. The 2016 overall budget balance should be able to be fully funded from the General Government Account.

54. Further to this the budget anticipates drawdowns of 2.9 million contribution for the two year period of the forward estimates then by September 2018 the CIF will have around $31 million representing around 20 per cent of the TTF.

Figure 3 – Consolidated Investment Fund 2013 to 2018



55. The projected profile of the CIF presents a significant question about the cash/liquidity requirements of the Government in relation to the current revenue and expenditure profile. With the onset of fishing revenues, which are well in excess of the current expenditure needs, there is now an opportunity to outline a medium term approach towards the ongoing capitalisation of the TTF.

56. Work should be undertaken to project the future liquidity requirements of the Government over the next five years. The Government has stated a policy goal of increasing the maintained capital of the TTF to $200 million by 2020. Achieving this would require the maintained level of the TTF to increase by around a third in a period of four years. In the absence of a significant contribution it may difficult to achieve that goal in such a short period of time.

57. The suggested work would ensure a more integrated approach to liquidity management. The investment profile of the CIF mirrors TTF. The difference between the two is that the CIF can be accessed for whatever amount is required at any point in time, whereas the TTF can only distribute the excess of the maintained value of the TTF at the end of the year.

2.8 Total Domestic Revenue

58. In nominal terms, the collection of $50.4 million in domestic revenue in 2015 was the highest ever recorded for Tuvalu, consisting of:

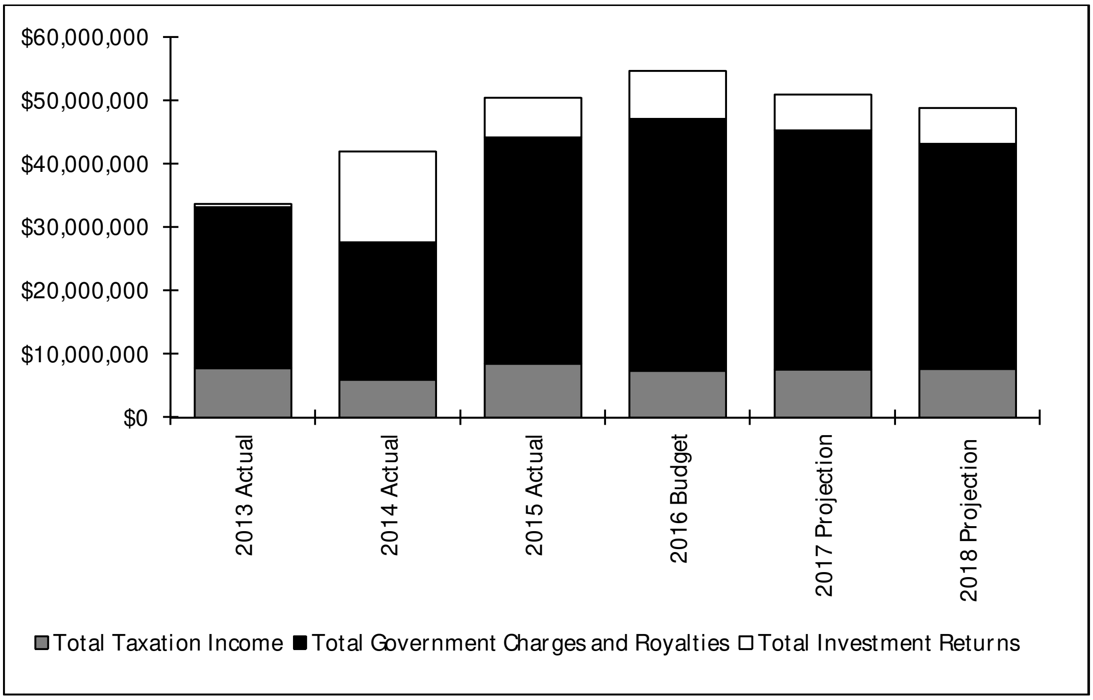
- $26.5 million - fishing revenues;
- $3.5 million - duties, excises and other taxes;

- $6.3 million - .TV domain royalties;
- $5.0 million - income/company tax;
- $4.7 million - distribution from the TTF;
- $3.8 million - other sources.

59. Driven by fishing revenues and contributions from the TTF, annual domestic revenue has grown by $16.7 million (49 per cent) over two years (2014 and 2015). The outcome in 2015 exceeded the original budget estimate (which had already built in a fair degree of built in growth) by $5.2 million (11.4 per cent). The 2016 estimate for domestic revenue continues the practice of building in further growth, anticipating $54.6 million to be collected during 2016, which if achieved, would be a new record for Tuvalu.

60. The greatest risk to achieving the estimate of $54.6 million is the volatility in fishing revenue. Fishing revenues are estimated to make up two thirds per cent of the domestic revenue received by the Government compared to just over half in 2013. Fishing revenue is making the overall pie bigger, and takes up a bigger slice of that pie.

Figure 4 – Total Domestic Revenue 2013-2018 ($)



61. Since 2013 domestic revenues have grown to historically high levels relatively and as percentage of GDP. The 2016 National Budget assumes these trends to continue, albeit at a more modest rate. There is always a fine balance to be struck between credible revenue estimates and a level of prudency which ensures that expenditure levels are not increased unsustainably.

Figure 5 – Total Domestic Revenue 1997-2018 ($)

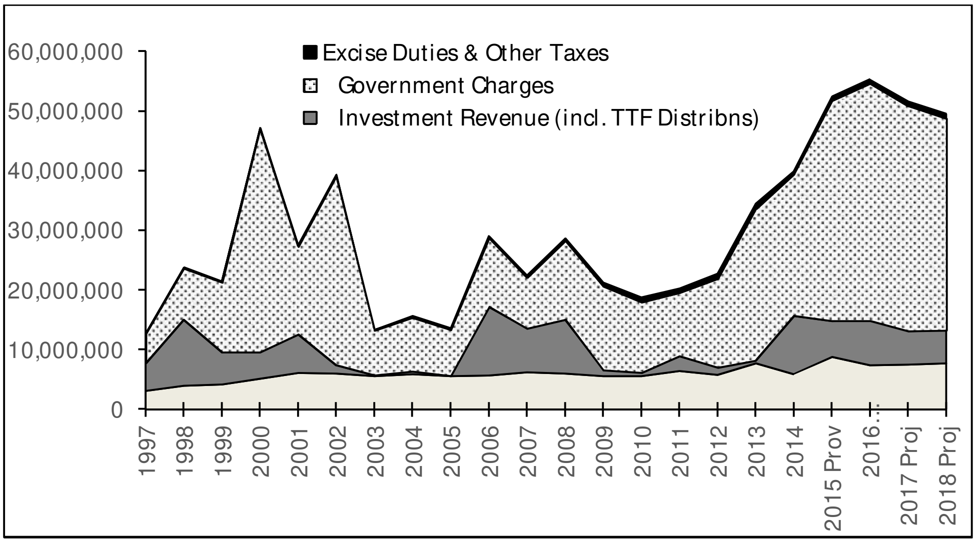
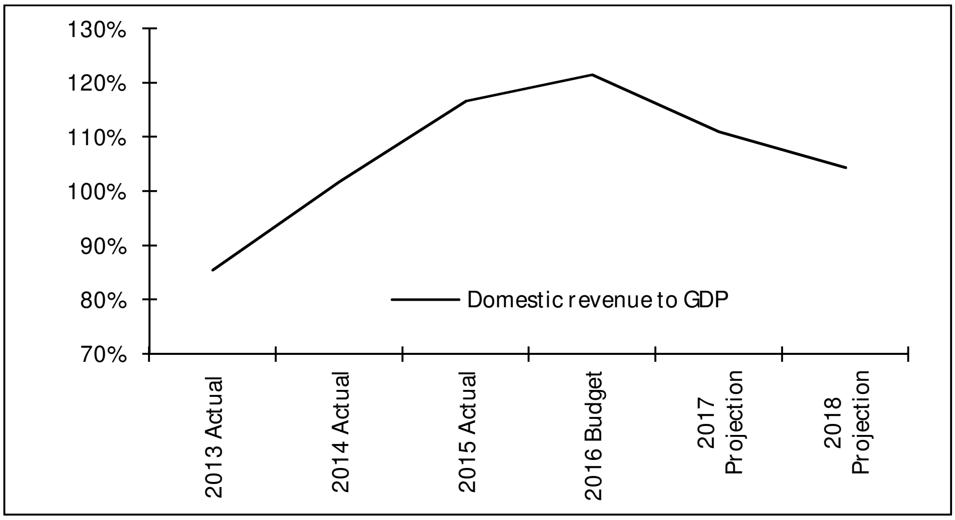


Figure 6 – Total Domestic Revenue 2013-2018 ($)



62. Increased fishing revenues are a positive outcome reflecting the benefit of the Vessel Day Scheme (VDS) in enabling Tuvalu to get a greater share of the true value of the fish caught in Tuvaluan waters. There are risks to these revenues. Firstly the number of fishing days sold (through the allocation of the total allowable effort), secondly the price for which they are sold and thirdly, the USD/AUD exchange rate.

63. There are real risks, and an active effort is required to continually mitigate against these risks.

64. The first risk around Tuvalu's proportion of the total allowable catch in the Pacific can be mitigated by entering into more pooled arrangements where vessel days can be traded when climatic and oceanic conditions result in a shift of where the stock is and where shipping vessels may wish to fish.

65. In 2016, Tuvalu had an allocation of 1,790 days out of the total allowable effort of 45,000 days (4 per cent) of the grouping of Pacific countries known as Parties to the Nauru Agreement (PNA). Tuvalu can mitigate the risk on both the number of days sold and the price for which the days sell (in USD terms) by ensuring they continue efforts to enter into pooling arrangements where they are able to trade days. Whilst bilateral arrangements can

be struck, these are riskier if as the fish may not be inhabiting Tuvaluan waters and secondly, they can lead to a lower price as the leverage of a united cartel in a multilateral negotiation is far higher than one seller in a bilateral scenario.

66. Revenues from the sale of vessel days in USD terms are unlikely to recede to pre-2014 levels, there may be some volatility in price but these are not likely to be great in magnitude over the next couple of years due to the improved negotiation position of the fishing nations in the vessel day scheme. It needs to be noted that since 2008 the VDS scheme has increased from a price of USD 1,200 a day to the current level of USD 12,500 which has been negotiated recently.

67. The increased VDS price would also inform the bilateral price.

68. Overall the VDS prices continue to hit all-time highs, but that has been the trend for the past few years, it should be noted that USD 10,000 was being charged when Bangkok tonnage prices were at lows of USD 900 a tonne compared to the USD 1,500 which are being experienced at the moment.

69. Nevertheless, the 2016 Budget assumptions around fishing revenue are based on a USD 12,500 price, which is at the higher end of expectations. Revenue estimates need to be balanced and should not be set at the higher end of expectations. The recent difficulties with the US which reduced the overall days purchased under the Treaty from 6,000 days to 4,000 days resulted in Tuvalu having 251 days of the 700 originally sold under the US Treaty returned. The impact has seen some of these days resold under the lower daily rate pooling (93 days) and bilateral (158 days) agreements.

70. A more reasoned approach would have been to have budgeted for around 1,790 days at a base price of USD 10,000, a low case scenario of USD 8,000 and a high case scenario of USD 10,000 could then be presented as a sensitivity analysis.

71. The third risk is around the AUD/USD exchange rate – fortunately the budget assumptions are conservative in predicting a strengthening AUD (reducing the overall figure into the forward years).

72. The impact could be either offset or worsened depending on the exchange rate. A basic sensitivity table outlines the scenario in the 2016 budget and outlines a number of alternative scenarios, which are well within the bounds of possibility. The Tuvalu budget should aim to outline the best estimate of anticipated revenues but equally publish alternative scenarios to better quantify the risks to revenue.

Table 5 – Domestic Revenue 2014 to 2018 ($)

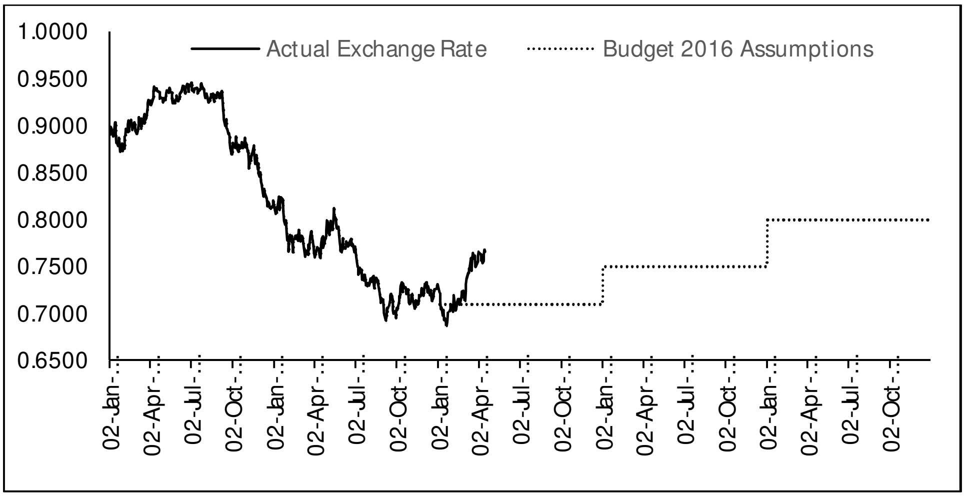
	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Taxation					
Income tax	$2,519,409	$2,084,011	$1,595,963	$1,627,882	$1,660,440
Company tax	$469,492	$2,963,425	$2,700,000	$2,754,000	$2,809,080
TCT	$151,460	$228,081	$350,000	$357,000	$364,140
Import duties	$1,256,882	$1,380,910	$1,243,000	$1,267,860	$1,293,217
TCT imports	$1,099,632	$1,110,634	$773,450	$788,919	$804,697
Excise Duties	$389,080	$458,598	$323,257	$329,722	$336,317
Other taxes	$83,098	$224,900	$397,983	$405,943	$414,062
Total	**$5,969,053**	**$8,450,558**	**$7,383,654**	**$7,531,327**	**$7,681,953**
Growth previous year	-23%	42%	-13%	2%	2%
Government Charges					
Fish licences	$13,587,607	$26,498,352	31,477,465	29,798,667	27,936,250
Marine Dept[t]	$1,641,844	$1,912,026	740,570	755,381	770,489
Other charges	$918,548	$1,053,258	1,196,452	1,196,452	1,196,452
.TV	$5,514,159	$6,273,625	6,338,028	6,000,000	5,625,000
Total	**$21,662,157**	**$35,737,260**	**$39,752,515**	**$37,750,500**	**$35,528,191**
Growth previous year	-15%	65%	11%	-5%	-6%
Investment Returns					
Dividends	$2,649,139	$537,518	1,885,062	1,885,062	1,885,062
Interest	$762,069	$741,050	620,000	620,000	620,000
Rents	$166,078	$205,543	200,090	200,090	200,090
TTF Distribution	$10,711,398	$4,727,802	4,780,000	2,900,000	2,900,000
Total	**$14,288,684**	**$6,211,911**	**$7,485,152**	**$5,605,152**	**$5,605,152**
Growth on previous year	3041%	-57%	20%	-25%	0%
Total Domestic Revenues	**$41,919,894**	**$50,399,730**	**54,621,320**	**50,886,978**	**48,815,296**
Growth on previous year	25%	20%	8%	-7%	-4%

73. The decline in domestic revenues projected in 2017 and 2018 are due to:

- fishing revenues and .TV royalties declining as a result of an assumed strengthening of the Australian dollar (total revenues are assumed to be USD 26.8 million over the three years with AUD/USD 0.71 in 2016, 0.75 in 2017 and 0.80 and 2018); and
- reduced contributions from the TTF (due to the increased level which is required to be maintained onwards from 2016 to 2018 due to significant contributions by the Tuvaluan Government).

74. Exchange rates are notoriously difficult to forecast and historically the AUD/USD has demonstrated great volatility as illustrated in Figure 2. Revenues from fishing have also benefited from the weakening of the Australian dollar from historical highs. Around two thirds of domestic revenue is initially received in USD, as well as the currently anticipated development partner support is mostly pledged and contracted in USD.

Figure 7 – AUD/USD exchange rate 14Jan-16Apr and Tuvaluan Budget Assumptions



75. In 2016 the Australian dollar has been weaker than the assumption at the 2016 Budget, which will be a buffer against other downsides (for example the US Treaty reductions) should they arise as the current assumptions for fishing revenue into the three years are assuming:

- a modest increase in fishing revenues which are kept constant across the period of the forward estimates;
- the royalties from the .TV are assumed to remain constant at USD 4.5 million over the period of the budget and the forward estimates, this is a contracted amount.

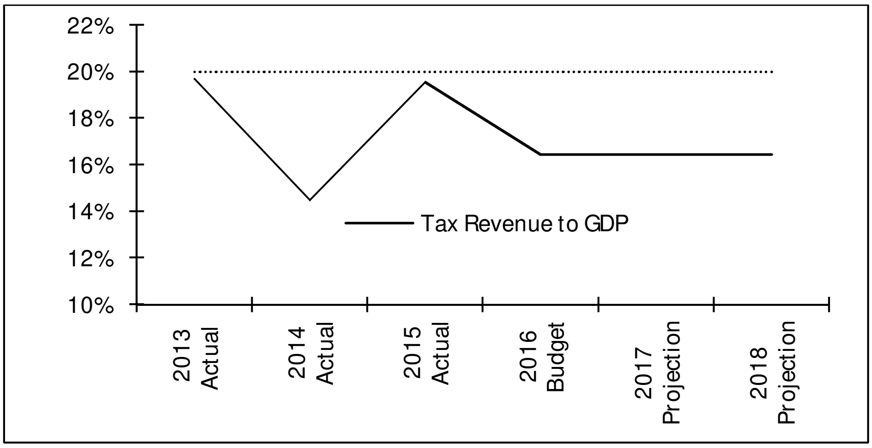
76. Another difficulty and point of risk is the timing lag between the agreed sales and receipt of money: typically there is an undefined delay further exacerbating the volatility issue.

77. As explained above, revenue management and compliance is a key ingredient in ensuring some robustness in the own source revenue base. Continued efforts to improve compliance with income and company tax, TCT, and excise duties are needed.

78. Reforms to tax administration and tax auditing, and improved manpower and training resources for these roles proved effective by improving tax revenue collections.

79. Taxation receipts of $8.5 million in 2015 were the highest ever achieved, despite not reaching the 2015 budget estimates. Taxation receipts in 2015 grew by 42 per cent on 2014 (which appeared uncharacteristically low) driven predominantly by a strong rebound in Company tax, which is mainly comprised of the taxes paid by one of the joint venture fishing firms, two per cent growth is assumed into the forward years.

Figure 8 – Domestic Tax Revenue to GDP (%) 2013 to 2018

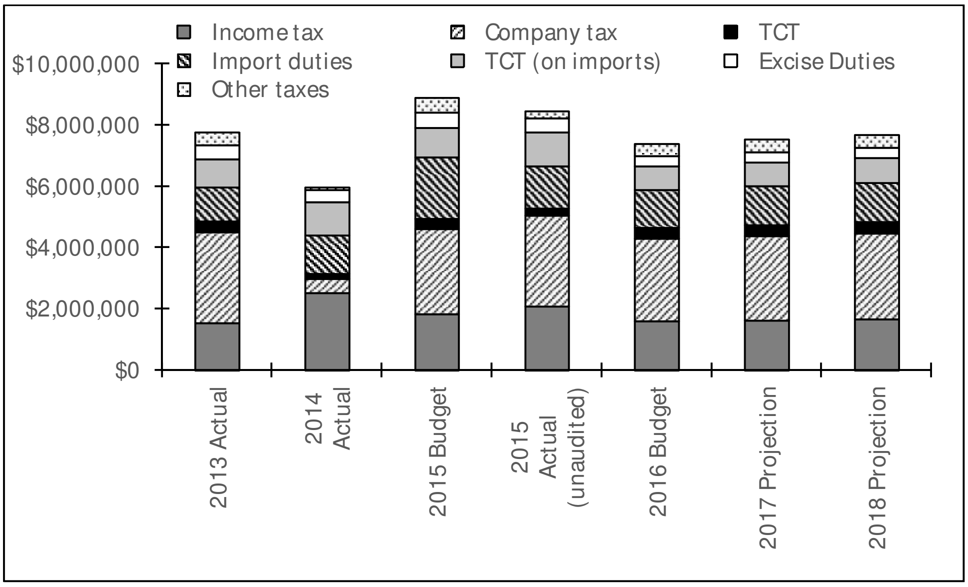


80. The Government has previously outlined a tax revenue ceiling of 20 per cent of GDP, over the past three years the average of the three years has been 17.9 per cent of GDP. The budget appears to project deterioration in tax revenue collections to 16 per cent of GDP. The decrease in tax is driven by reduced income tax collections resulting from the increase in the tax-free threshold from $6,000 to $8,000 at an estimated cost of approximately $0.230 million per annum.

81. Achieving the 20 per cent ceiling would appear to be difficult. It would, in effect require another $1.65 million to be collected from the annual tax base. This seems unlikely to be achieved as the economic base is small and any scope to increase the tax collection base by nearly 22 per cent, or to achieve this result through rate changes, would be very limited and politically challenging to implement.

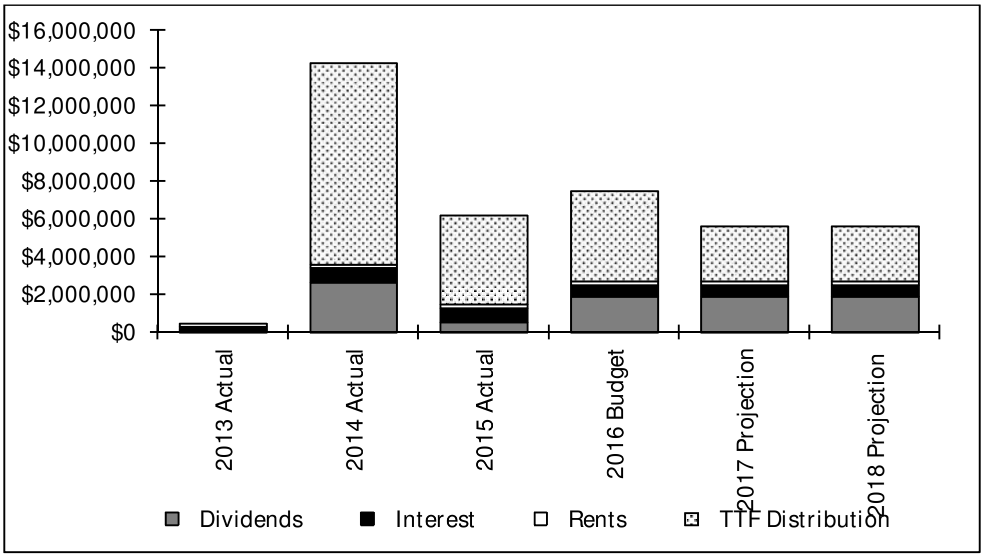
82. Efforts will need to focus on continuing compliance, ensuring that companies are paying the right levels of tax. Getting back to around 18 per cent of GDP, which has been the recent historical achievement, would require an annual base increase of around $0.8 million. The projected increase in the Tuvalu Consumption Tax from seven to ten per cent should in itself raise around a third of that amount ($0.250 million).

Figure 9 – Domestic Taxation 2013 to 2018 ($)



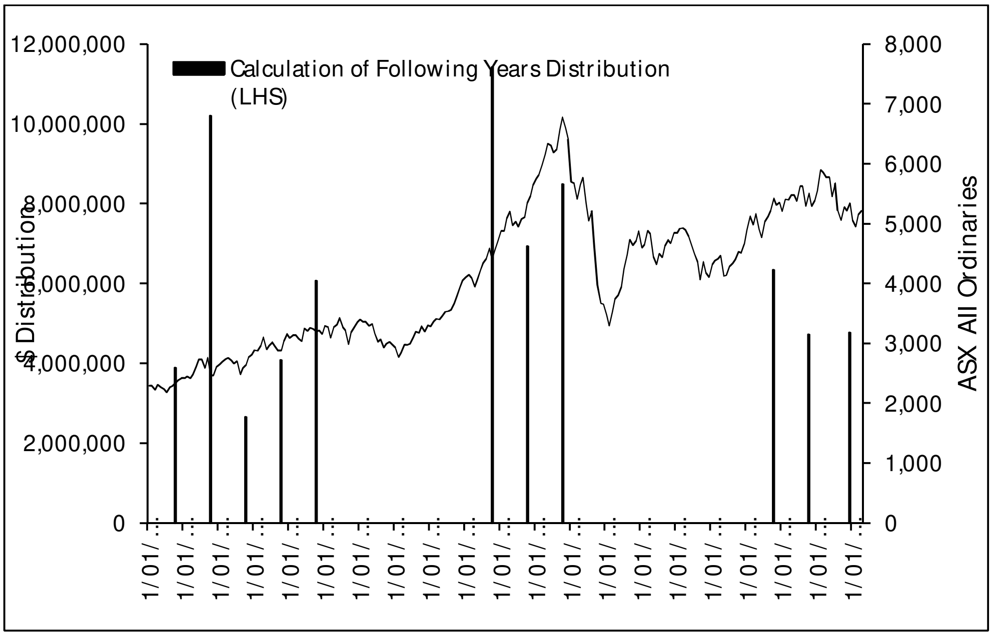
83. Total revenue from investment returns has recently been dominated by interest earned on CIF balances as well as automatic distributions from the TTF.

Figure 10 – Total Investment Returns



84. In the period from 1997 to 2016 there have been 10 automatic distributions made from the TTF to the Budget. The automatic distribution, which is the excess of the market value to the maintained value, reflects the partial recovery of the global stock market following the global financial crisis.

Figure 11 – TTF Automatic Distributions and the ASX All Ordinaries 1997 to 2016



85. As figure 12 illustrates that as expected the automatic distributions are forthcoming following a period of strong growth in a low inflation environment. The budget assumes a 2.9 million per annum distribution in 2017 and 2018, this relies on modest growth of around four to four and a half per cent, per annum in the market value of the fund.

86. Interest from the CIF cash balance is also assumed to be stable at $0.620 million per annum over the period of the budget and forward estimates, this is reliant on the balance of the monies and interest rates overall.

2.9 Total Expenditure

87. The 2016 budget outlines total expenditure in terms of recurrent and special development expenditure (SDE). This definition of recurrent expenditure refers back to the International agreement which outlines that the TTF would be there to support the recurrent (or what could be deemed to be the ongoing expenditures) of the Tuvaluan Government. For the purposes of this report recurrent expenditure will be categorised into:

- operational expenditure – those expenditures which reflect the costs of running government and direct services, such as education and health;
- grants and subsidies – reflecting those expenditures which reflect the cost of service provision which are provided by parties outside of government, such as the TMTS and scholarships;
- investment – those expenditures which add to the asset base of government; and
- financing – reflecting those expenditures which are servicing debt, both interest and principal repayments.

88. The Tuvaluan Budget projects a record level of expenditure of $72.3 million in 2016. More than doubling the expenditure levels in 2013 of $32.5 million (122 per cent). Domestic revenue only grew by 52 per cent in that same period.

Table 6 – Recurrent Expenditure of Government

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Total Expenditure	$41,390,439	$57,530,856	$72,206,746	$56,530,867	$57,276,862

89. The major components of budgeted recurrent spending in 2016 are:

- $19.977 million in staff costs of ($19.889 million from the recurrent expenditure and $0.088 million from SDE);
- $14.864 million in investment expenditure ($0.073 million from the recurrent expenditure budget and $14.791 million from SDE);
- $5.285 million in goods and services for the operations of Government ($4.990 million from the recurrent expenditure budget and $0.295 million from SDE);
- $5 million to be distributed to the Tuvalu Survival Fund (TSF) (within SDE);
- $4.78 million to be distributed to the TTF (all within recurrent expenditure);
- $5.287 million in scholarships and SELF (all in recurrent expenditure);
- $3.7 million in TMTS costs;
- $2.230 million in maintenance costs ($2.143 million from the recurrent expenditure budget and $0.088 million from SDE); and
- $ 2.331 million in travel and communication costs ($2.191 million from the recurrent expenditure budget and $0.140 million from SDE).

Table 7 – Total Recurrent and SD Expenditure 2014 to 2018

	2014 Actual	2015 Actual	2016 Budget	2017 Projection	2018 Projection
Recurrent Expenditure					
Operational Costs					
Staff	$15,264,940	$16,184,447	19,889,512	20,287,303	20,693,049
Travel/communications	$1,870,030	$2,749,262	2,191,466	2,257,209	2,302,354
Maintenance	$1,789,130	$2,235,663	1,642,851	1,692,136	1,725,979
Deferred Maintenance	$0	$499,842	500,000	500,000	500,000
Goods and services	$4,522,801	$4,797,006	4,990,123	5,139,827	5,242,623
Other Expenses	$399,383	$681,228	333,772	343,785	350,661
Overseas Contributions	$787,851	$913,351	1,210,684	1,210,684	1,210,684
Fuel and Oil	$1,208,795	$1,206,135	1,434,459	1,477,493	1,507,043
Total Operational Costs	**$25,842,930**	**$29,266,932**	**$32,192,866**	**$32,908,436**	**$33,532,391**
Growth on previous year	17%	13%	10%	2%	2%
Grants and Subsidies					
Medical Treatment Schemes	$2,993,034	$3,623,876	3,700,000	3,811,000	3,887,220
Grants and Subsidies	$2,464,773	$7,569,668	$3,485,099	$3,485,099	$3,485,099
Scholarships	$1,798,888	$2,777,933	$4,528,606	$4,664,465	$4,757,754
SELF	$0	$0	$758,624	$311,668	$250,000
Community Service Obligations	$2,904,082	$693,733	$559,729	$576,521	$588,051
Total Grants and Subsidies	**$10,160,778**	**$14,665,210**	**$13,032,059**	**$12,848,753**	**$12,968,124**
Growth on previous year	43%	44%	-11%	-1%	1%
Investment Expenditure	0	0	0	0	0
Capital	$94,880	$92,599	$73,034	$75,225	$76,730
Investment Expenditure	**$94,880**	**$92,599**	**$73,034**	**$75,225**	**$76,730**
Growth on previous year	2%	-2%	-21%	3%	2%
Financing	0	0	0	0	0
Loan Repayment	$74,677	$639,188	$640,281	$640,281	$640,281
Interest Expense	$503,085	$25,854	$56,478	$58,172	$59,336
Total Financing Expenditure	**$577,762**	**$665,042**	**$696,759**	**$698,453**	**$699,617**
Growth on previous year	327%	15%	5%	0%	0%
Total	**$36,676,350**	**$44,689,783**	**$45,994,718**	**$46,530,867**	**$47,276,862**
Growth on previous year	24%	22%	3%	1%	2%
Non Recurrent Expenditure					
Special Development	$4,714,090	$9,841,073	$21,432,028	$10,000,000	$10,000,000
Transfers to the TTF	$0	$3,000,000	$4,780,000	$0	$0
Total	**$4,714,090**	**$12,841,073**	**$26,212,028**	**$10,000,000**	**$10,000,000**
Growth on previous year	59%	172%	104%	-62%	0%

Table 8 - A further breakdown of the Special Development expenditure

	2013 Actual	2014 Actual	2015 Actual	2016 Budget
Operational Costs				
Staff	$52,892	$31,249	$117,392	$87,675
Travel and communications	$0	$63,654	$341,950	$140,000
Maintenance	$0	$100,095	$33,350	$87,513
Deferred Maintenance	$0	$0	$0	$0
Goods and services	$22,973	$493,985	$266,991	$295,234
Other Expenses	$1,244,443	$646,901	$678,971	$6,030,319
Overseas Contributions	$0	$0	$222,197	$0
Fuel and Oil	$0	$318,378	$0	$0
Total Operational Costs	**$1,320,307**	**$1,654,262**	**$1,660,851**	**$6,640,741**
Grants and Subsidies				
TMTS	$0	$178,050	$0	$0
Grants and Subsidies	$155,549	$485,987	$357,931	$0
Scholarships	$0	$0	$0	$0
SELF	$0	$0	$0	$0
Community Service Obligations	$10,000	$0	$650,000	$0
Total Grants and Subsidies	**$165,549**	**$664,037**	**$1,007,931**	**$0**
Investment Expenditure				
Capital	$1,497,468	$2,355,717	$4,784,291	$14,791,287
Investment Expenditure	**$1,497,468**	**$2,355,717**	**$4,784,291**	**$14,791,287**
Financing				
Loan Repayment	$0	$0	$0	$0
Interest Expense	$0	$0	$0	$0
Total Financing Expenditure	**$0**	**$0**	**$0**	**$0**
Total Expenditure	**$2,983,324**	**$4,674,015**	**$7,453,073**	**$21,432,028**

Table 9 – Total Expenditure 2013 to 2016 ($)

	2013 Actual	2014 Actual	2015 Actual	2016 Budget
Recurrent Operational Costs	$22,178,419	$25,842,930	$29,266,932	$32,192,866
SDE Operational Costs	$1,320,307	$1,654,262	$1,660,851	$1,640,741
Total Operational Costs	**$23,498,726**	**$27,497,192**	**$30,927,783**	**$33,833,606**
Growth on previous year		17.0%	12.5%	9.4%
Recurrent Grants and Subsidies	$7,112,248	$10,160,778	$14,665,210	$13,032,059
SDE Grants and Subsidies	$165,549	$664,037	$1,007,931	$0
Total Grants & Subsidies	**$7,277,797**	**$10,824,814**	**$15,673,141**	**$13,032,059**
Growth on previous year		48.7%	44.8%	-16.9%
Recurrent ongoing Costs	$29,290,667	$36,003,708	$43,932,142	$45,224,924
SDE Ongoing Costs	$1,485,856	$2,318,299	$2,668,783	$1,640,741
Total Ongoing Expenditure	**$30,776,523**	**$38,322,006**	**$46,600,924**	**$46,865,665**
Growth on previous year		24.5%	21.6%	0.6%

90. Tables 7, 8 and 9 outline in some detail the reported ongoing expenditure in the budget under recurrent and the ongoing expenditures that have been funded under the SDE. These ongoing expenditures are not specifically provided for in the forward estimates. These expenditures are in the range of around $1 ½ million.

91. Higher levels of ongoing base expenditure were established in the 2015 Budget, the major one being the increase from 2014 in operational costs driven by a $1.911 million increase in the staffing budget and a $1.172 million increase in travel and communications. The 2016 Budget has further increased the ongoing expenditure in these areas. A further 2.714 million in staffing costs being offset by a reduction of $0.850 million in transport and communications.

92. Whilst there appear to be budgetary execution figures, actual operating costs of government have increased by $7.089 million (32 per cent) in the two years from 2013 to 2015. Added to this are the operational costs contained within the SDE expenditure provision.

93. The areas of concern in expenditure where there are patterns of growth that need to be looked at closely are the increasing costs of staffing, TMTS and the scholarships.

94. Currently Tuvalu has a greater portion of wages as an overall proportion of GDP them many other Pacific countries. This reflects the diseconomies of scale which arise with a small nation that has high fixed costs in establishing an institutional bureaucratic base. Increases of five per cent in 2010, followed by a fixed $30 a fortnight (post tax) per employee in 2014 and a two per cent rise in 2015 (also accompanied by a decrease in the income tax threshold) would have raised expectations of ongoing increases which until now have been greater than general price movements in the economy.

95. The large salary bill presents an opportunity cost, for example containing the wage bill may allow for a greater capacity to sustainably fund non-salary type expenditures in areas of service delivery.

96. There is also an aspect of social protection in the employment of many public servants. This universal redistributive approach through public sector staffing is far less efficient than an approach that identifies the needy and assists accordingly.

97. There needs to be a continued emphasis on performance. The obvious risk to the Budget is the increase in salary rates and/or the establishment. The provision of $0.1 million

for the implementation of a payroll system will assist in improving overall pay management and effectiveness.

98. The second area of growth is in the expenditure around scholarships (including the loan scheme). Whilst expenditure in the education sector should be welcomed, there are issues around quality of expenditure to ensure that the investment provides the skills that are required in the Tuvaluan labour market.

99. The growth in expenditures on scholarships and the SELF has seen the $1.8 million expenditure in 2013 growing to $5 million per annum in 2016 onwards.

100. The final area of high growth in recurrent expenditure is the Tuvaluan medical treatment scheme where costs of $3.5 million per annum are improving health outcomes for only a few. Better utilisation of these funds could arise and these have been discussed elsewhere in the report.

2.10 INCREASED INVESTMENT EXPENDITURE

101. The increase in revenue has obviously encouraged greater involvement in decisions on investment spending. Public assets can bring a great economic and social return to the community, but investments don't just happen in the course of one year: a MTFF that allows multi-year decisions to be made will assist in the planning of such investments.

102. Ambitiously, the Government has provided around $14.9 million for investment financing well in excess of the expenditure of $0.1 million that was experienced in 2015. The reported expenditure of $4.7 million in investment spending in 2015 overstates actual activity, as almost $4 million was essentially transferred into the Tuvalu Development Fund (TDF) to continue on with those undertakings, these transfers included:

- Cyclone Pam remediation- $2.070 million;
- School improvement projects - $1.969 million;
- Elisefou office and causeway - $0.089 million;
- Renovation of the government complex - $0.289 million; and
- Vaiaku waterfront project - $0.189 million

103. This approach to carryover appropriated monies from one year to the next undermines resource planning for capital investment. The Government now has $20 million worth of activities to accomplish in 2016; additionally $0.447 million of the $0.5 million in deferred maintenance was also transferred into the TDF.

104. The expenditure detailed in the 2016 budget contains a number of new projects that are assumed to be completed in 2016. These investments, which have been funded from the SDE provision, are significant and are unlikely to be completed in the twelve-month time frame. This would result in a significant amount of this programmed expenditure and the slipping into the following years. The projects that possibly could be delayed include:

- ongoing renovations of the Government complex - $2 million;
- outer island projects - $2.880 million;
- new classrooms for Nanumea and Nukufeteau - $2.625 million; and
- housing for the Pacific Island Forum Leaders Meeting $3.144 million.

105. This situation illustrates an increasing need to provide a multi-year planning process for investment items – i.e. a "capital works programme" that combines planning and budgeting at project level with an aggregate overview of what these individual project

decisions add up to – directly and indirectly. (See paras 10 and 24-30 above, for another example.)

106. Programming of capital works recognises that it is not enough for government to make a robust assessment of projected social and economic benefits and costs of each individual project. Another major consideration is the capacity of the country to support construction/installation and commissioning of capital works is limited – and therefore the timetable and budget (which are often closely related) must be based on a realistic assessment of available capacity. For example, the size and location of project activities will indicate likely demands on local infrastructure and other resources – and demands on the capacity of local leaders to manage any issues that may arise, and on the capacity of local officials, counterparts, suppliers, etc. to contribute as required, when required.

2.11 Recommendations

107. TTFAC recommends that the Government of Tuvalu:

a. ***Commence planning*** to extract higher returns from .TV national asset

b. ***Operationalize*** the Cabinet-approved Contracts Management Unit

c. ***Introduce*** a capital works programme as a tool for the Planning, Budget and Donor Coordination Department of MFED to use to improve the way in which capital projects are planned, budgeted and implemented.

3. Public Sector Management: Progress & Prospects

3.1 Overview

108. Good progress has been made recently in public sector reforms, although it appears some implementation issues are not yet fully resolved, and it is still too early to reach any final conclusions about how successful some of these reforms have been in producing the intended results.

109. The reforms are certainly addressing the main issues that have been raised in recent TTFAC reports. More details are given below on:

- the new payroll accounting module;
- the asset register;
- strengthening linkages between planning, budgeting and results;
- sustaining core public sector operational capacity;
- extending public service good practices into the wider public sector; and
- strengthening governance institutions.

110. Under this "Public Sector Management" heading in our last report, we commented favourably on reforms that are intended to give sector ministries greater freedom to manage but cautioned "These reforms bring good practices into the public sector. They will need time to become thoroughly understood and applied."

111. Our following up on this issue included an investigation into the shipping sector that revealed a number of concerns – but good practices were in fact followed in most of the cases where we investigated apparent lapses. The core procedures appear to be well understood and systematically applied – but, in line with earlier TTFAC findings, the lack of specialist support for Cabinet-level decision-making was revealed as the real problem. At paragraph 159 d below, we highlight proposed progress in resolving this problem. One procedure that possibly is not generally understood and routinely applied is the compulsory process for any "Community Service Obligation". This is discussed at para 29 above.

112. But overall, the integration of public financial management and public sector management has progressed to the point where TTFAC considers it is no longer necessary or helpful to treat PFM as a separate topic area – i.e. it may be **un**helpful if separation sustains/creates an idea that financial management is a narrow technical area that top public sector managers can leave to a lower level manager – e.g. their Accountant. Current training for senior managers and the framing of contracts for PS's are applying good practice by making top managers accountable for managing their budgets.

113. That last point is part of strengthening governance institutions and processes. Very good progress has been made this area, but it needs to be completed by passing the draft legislation and making further legal changes as proposed by the Office of the Auditor General (OAG).

3.2 Reforms Being Implemented

New Payroll Accounting Module

114. TTFAC was informed that a new payroll module fully integrated with ACCPAC software would be effective from next month (May). However some doubts remain:

a. Is this module integrated fully – e.g. is it an ACCPAC product – or is it from another company and is just interfaced? And are there any remaining technical issues that will delay implementation?

b. Does this module meet HR management needs? Does it include controls to ensure that payments are correct, as well as simply making payments – especially: are there process issues about interfacing with records of attendance and leave?

c. The implementation process, including data cleansing which was done by OPM, had not revealed any significant discrepancies between the approved organisational charts and the information on which payroll had been operating. In other words, there were no nasty surprises in terms of false entries ("ghost workers"): the old controls had been effective in preventing anyone from that means of exploiting any weaknesses in the previous arrangements. **BUT**, it appears that, possibly due to integration issues, the process of data cleansing did not make other checks – e.g. were paid leave records checked against attendance records and leave entitlements?

Assets Register

115. MFED's earlier efforts to compile a kind of balance sheet for the public sector have been supplemented by a major assistance effort from the Pacific Regional Infrastructure Facility (PRIF). This is a very welcome move, as it will bring the right mix of specialist knowledge about the status and expected economic life of specific assets plus familiarity with small Pacific Island conditions that can cause additional challenges with maintenance and valuations. The prospective benefits if this initiative is successful include:

- planning and budgeting for ongoing maintenance and replacement of capital items will have a much sounder information base;
- identifying more easily the extra costs of "climate-proofing" Tuvalu's public infrastructure; and
- costing and evaluating options such as insurance.

116. At some stage it may be possible to extend this documentation plus valuation exercise to private assets, especially housing. Donor support for disaster recovery typically extends to repair and/or replacement of these private assets, but increased resilience depends on the actions of owners to do their own "climate-proofing" through building to higher standards and maintaining weather-tightness. There is not much quantified information available about these issues at present, so policy-making is difficult.

Strengthening linkages between planning, budgeting and results

117. Earlier TTFAC reports have welcomed the increased focus on public sector performance management in recent years, and we were pleased to learn

that Secretaries are being trained in negotiating skills to help them in working with their Ministers to translate public expectations and political objectives, especially TK III, into the activities and resources used by core government and the target results that will be achieved. But we still have the same concerns as expressed in earlier TTFAC reports about local capacity to cope with the many upcoming reforms. The TK III proposals present a set of integration and implementation challenges that may be beyond the capacity of the Tuvalu public sector. This issue is discussed more fully in Section 5. Te Kakeega III - 2016-2020 beginning on page 44 below.

Sustaining the Capacity of Core Staff and Systems

118. TTFAC's previous (October 2015) report pointed to the need for improvement in ensuring that core public sector operational capability is sustained, particularly during periods of extra demands as part of the annual planning/operational cycle: e.g. not weakened by decisions on the timing of staff leave and other authorised absences from work – especially extended study leave, overseas missions, etc.

119. We found that a system of workforce planning is currently being rolled out, starting with briefing of Secretaries. This will form part of their performance agreements. It should address the short-term issues identified in the previous TTFAC report. In addition, a Human Resource Development Plan (HRDP) for the whole of government was being finalised in conjunction with a review of all policies and practices relating to scholarships and support for further education generally. That review is due to be available around August this year. The HRDP, in conjunction with the likely reforms of scholarship schemes (see discussion beginning at paragraph 182 below), should address the longer-term issues.

120. Early indications are that the scholarships review will (i) establish a single committee across SELF, and in-service and pre-service scholarships; (ii) limit the number of people on different types of scholarships – taking into account public sector workforce planning and especially recognising the limited number of public service vacancies; and (iii) reallocate funds from liberal arts academic qualifications to technical and vocational and education and training (TVET).

Extending public service good practices

121. In light of the latest developments in public sector management, TTFAC renewed earlier suggestions that some of the government processes for generic management functions like human resource management, performance management and reporting, financial controls, and perhaps project management, procurement, etc. become default procedures for Public Trading Enterprises. All PTE's would be required to adopt them unless they could demonstrate that their own procedures were better. We had also indicated our support for extending performance auditing from core government to PTE's and Kaupule projects and, more generally, for sharing support arrangements, e.g. documentation, training, and a network of peer support, to the Kaupule that decide to adopt these practices.

122. We found that, even if PTEs were not compelled to either surpass or adopt core public service practices, it would be relatively simple for HRM to

obtain contact emails for key people within the wider public sector (i.e. including public enterprises, public utilities/PTEs, and Kaupule), send them publicity material relating to training opportunities, and invite their relevant staff to participate. However some thought and work would have to go into explaining the intentions and promoting greater involvement.

3.3 Strengthening Governance Institutions and Processes

Falekaupule Accounts

123. A practical solution has been found to the problem that TTFAC has noted in the past: Falekaupule accounts could not be properly finalised and audited because of the discrepancies between bank records and bank passbooks held by Falekaupule. These discrepancies were caused mainly by distributions by way of bank transfer, because these were not recorded in the passbooks. The solution was to close all existing passbooks, return them to the bank on Funafuti and issue replacement passbooks with the same closing balance and later updated for transactions to reach the balance as verified by the bank records. The bank was now completing reconciliations going back over many years. The accounts for each year will then be finalised and audited.

124. More training and support will be required to establish good financial management practices, but the package of initiatives from the Office of the Auditor General to improve Falekaupule governance remains on track to deliver the target improvement in the quality of processes – even though the initial estimate of the time required has turned out to be too optimistic.

125. One of the next steps will be to improve the quality of project management. This initiative will need to be supported by the FTF Project Officer who took up her position during our Mission. This is a good opportunity to arrange for a properly qualified project management trainer to train a number of people at the same time – encompassing people from across the wider public sector. Donors such as UNOPS may be able to assist through their access to online project management training courses.

NAFICOT Issues

126. As requested by DFAT, TTFAC reviewed the reports that the Minister of Natural Resources made to Cabinet on the two joint ventures (JVs) under NAFICOT. TTFAC supports the proposed moves to provide better governance processes regarding Tuvalu Tuna FH Co Ltd – (i) reporting to Cabinet that enables effective oversight of this JV under NAFICOT, and (ii) explicit application to these two JVs of the restrictions imposed by the Treasury Instructions 2015.

127. TTFAC also supports consideration being given by Cabinet to exiting the Friendly Tuna Fishing Corporation (FTFC) JV and especially supports the need to move carefully on the basis of advice from an experienced commercial lawyer.

Legislation Relating to the OAG

128. For some time, the Office of the Auditor General (OAG) has had concerns about the limitations of relying on Parliamentary Rules of Procedure to ensure the proper functioning of the Public Accounts Committee (PAC) of Parliament. The work of the PAC can be and has been compromised by the

Speaker of the House withholding funding for the PAC to operate. A number of attempts have been made to introduce separate statutory authority for the PAC activities. Most recently UNDP supported the drafting of a Public Budget, Accounts and Audit Committee Bill that has yet to be considered by Parliament, but appears to meet the need.

129. In addition, the Auditor General has proposed some consequential changes to the Audit Act, plus other clarifications and strengthening of the powers of the OAG – revisions that OAG have been pressing for some time. TTFAC suggests that this is the kind of significant milestone that could be considered for the next policy reform matrix if one is agreed.

3.4 Investigation Into Shipping Services

Domestic Shipping

130. Domestic shipping services in Tuvalu is heavily subsidized. Currently there are six ships operating in Tuvaluan waters for which the Tuvalu government has full or partial responsibility. These are:

- Nivaga III (a new ship, purpose built, received as a gift from Japan late 2015)
- Nivaga II (received from UK as a gift in 1988)
- Manu Folau (received from Japan as a gift 2002)
- Tai Manino (ocean-going landing craft purchased by government 2015)
- Manaui (fishing research vessel received as a gift from Japan in the 1990s)
- Te Mataili (patrol boat received as a gift from Australia)
- Tala Moana (purchased through UNDP NAPA II project in 2015)

131. Four ships fall under the responsibility of the Ministry of Communications and Transport (MCT) (Nivaga III , Nivaga II, Manu Folau and Tai Manino)

132. The Nivaga III and the Manu Folau, are the principle vessels for supply and passenger transport in Tuvalu. The Nivaga II remains in service but MCT plans to sell the ship in June, if a buyer can be found. MCT has little experience of selling ships and limited knowledge of where to sell it. The resale value of the Nivaga II is unknown although there is some expectation that it might fetch between $0.75 and $1.25 million. MCT intends to seek CPU assistance to sell the ship but specialist advice from Fiji, as well as advice from a commercial lawyer, may be necessary.

133. Currently 88 people are employed to crew the four MCT ships. Total 2015 operating budget, including maintenance, was $3.1 million with revenues of $0.4 million, hence an operating deficit of $2.7 million. Similar scale deficits are produced year-on-year and are a consequence of having to subsidize inter-island transport, but periodically, when one or other vessel are in need of major repair or upgrade to meet IMO safety standards, costs escalate significantly. This is partly due to the fact that Tuvalu has no dry dock facility, the nearest being Fiji, but sometimes, for major overhaul, ships have to be sent to New Zealand for repair.

134. The Tala Moana was a surprise purchase made by the NAPA project. Surprise in the sense that few people in government, cabinet included, knew of its existence until its arrival. NAPA II and the fisheries department will share

operating expenses until the end of the NAPA II project, at which point the ship will be sold.

135. Of the other ships, the Te Mataili is the responsibility of the Police department, which shares operating costs with Australia, and the Manaui is an aging research vessel operated by Fisheries.

Shipping Agency

136. In theory, the Marine Department should be able to raise additional revenues through freight and passenger service to and from Fiji. In reality, due to a dispute between MCT and its Fiji agent, revenue figures are unclear, with each party claiming the other for payments withheld. Clouding the dispute is the fact that MCT could not locate, after a year of searching, a copy of its contract.

137. Clearly contract management is not a strong suit of MCT, nor of other line Ministries busy implementing a great many of technical and administrative tasks. TTFAC hopes that the Contract Management Unit will provide the systematic procedures and commercial legal expertise that are needed.

3.5 Recommendations

138. TTFAC recommends that the Government of Tuvalu:

a. ***request*** the next TTFAC mission to review and report on further progress with all of the initiatives itemised in this Section: new payroll accounting module; asset register; strengthening linkages between planning, budgeting and results; sustaining core public sector operational capacity; extending public service good practices into the wider public sector; strengthening governance institutions; and improving management of shipping services; and

b. if a new Policy Reform Matrix is proposed, ***consider suggesting*** that it include the enactment of the Public Budget, Accounts and Audit Committee Act and a new Act making consequential changes to the Audit Act as proposed by the Auditor General, plus other clarifications and strengthening of the powers of the OAG.

4. Private Sector Development Initiatives

4.1 Overview

139. TTFAC has addressed private sector development (PSD) in the past but little progress has been made. Some of the reasons are clearly inadequate infrastructure services – the worst being in the ICT sector. We re-examined the reasons for this and, after consultations including with the President of Tuvalu National Private Sector Organisation (TNPSO), concluded that we may have under-estimated two cultural barriers to progress that tend to reinforce each other, they are a lack of community:

- understanding - especially of how commercial banking works to support private sector initiatives, and how business finances and personal/family finances must be kept separate; and
- acceptance and support for borrowers' obligations to repay money lent to them by a bank.

140. For that reason, we informed key stakeholders of measures taken by other Pacific countries to overcome similar cultural barriers. Those measures generally start with "financial literacy" programmes to create the widespread understanding and support needed so that lenders and borrowers can make agreements that both parties fully understand and accept, and that the borrowers' family, friends, etc. will also understand and accept.

141. Prudential supervision reports have begun under the interim provisions of the Banking Commission Act and Amendment Act. These will highlight current weaknesses and are likely to create pressure for sweeping changes that go far beyond improving access to commercial loans for local businesses.

4.2 Inadequate Infrastructure Services

142. Many aspects of private sector development depend on ICT – so do many TK III public sector initiatives like tele-medicine, distance education, disaster response, etc. – but performance in this sector is worsening, not improving. We were advised that, after an earlier report commissioned by NZ MFAT, a World Bank was following up with a brief visit. During our previous mission (October 2015) we noted with concern that the release of the previous supplier of mobile phone services and contracting another supplier had not been done in ways that best promoted and protected the country's interests.

143. The problem of attracting tourists to the aging premises and limited facilities at the Vaiaku Lagi Hotel is being addressed at last.

4.3 Banking Services & Financial Literacy

144. We once more reiterate our earlier advice that a pressing need is for Government to understand and find solutions to the fundamental problems in both of the local banks, National Bank of Tuvalu (NBT) and the Development Bank of Tuvalu (DBT), face in obtaining adequate security and, in the event of default, recovering the funds owing. These issues are shared by other Pacific nations that have customary systems of land tenure, limited opportunities for long-term employment outside the public sector, and a significant proportion of

informal economic activity including a non-monetised subsistence sector. None of those other countries have made progress without spending years in careful and comprehensive community consultations, with technical experts in a support role rather than designing and driving the agenda. It is not clear that Tuvalu would/should be any different.

145. Since we first gave this advice:

- The government passed legislation (from 21 October 2015) for the Minister of Finance to perform the function and powers of the Banking Commission until the Commission starts operating, and to delegate those functions and powers to the Permanent Secretary of Finance. The banks have started to prepare reports for "prudential supervision" i.e. reveal any weaknesses in their balance sheets and operations.
- The NBT has finished implementing new software for credit assessment and debtor management, and trained staff to use it.
- Nevertheless, the default rates for both NBT and DBT lending remain at levels that cannot be sustained – this exposes the government as owner and de facto guarantor to substantial fiscal risks if called on to recapitalise one or both banks and/or wind up DBT and repay any loans outstanding from its formation; and also could result in a loss of local confidence in the banking system e.g. if it became known that banks had major problems.
- Tuvalu National Provident Fund (TNPF) gave details of a successful commercial loan that is secured by a negotiated four-way agreement between the investor (TNPF), the local Falekaupule, the original land-owners and commercial tenants – by which all parties agree in advance that TPF can evict tenants for non-payment and transfer the sub-leases to a new tenant: making sub-leases an effective security.
- There is increasing acceptance among key local stakeholders of the need to address problems "on the other side of the bank counter" i.e. the need to improve the supply of creditworthy loan applications. For example, both MFED and TNPSO have been working on proposals for borrowers to go through a form of pre-qualification training and support before their loan applications would be considered.
- TTFAC has updated examples of how other Pacific Island nations have dealt with these issues; held meetings and provided briefings for NBT and DBT GMs, MFED Director of Planning, Budget & Aid Coordination, TNPF Manager Corporate Services, etc; and explained the "financial literacy" initiatives that we recommend be part of a package that includes prudential supervision, strengthening banks' processes and targeted support for small and medium enterprises.

146. We recommend below that urgent action be taken on financial literacy.

4.4 Promoting Private Sector Provision of Services

147. Although further specific privatisations are proposed, no response was received to TTFAC's earlier recommendation that there be a new government policy that requires top management of all Ministries, PEs and PTEs (i.e. the

wider public sector) to keep under review all the various options for switching from public to private sector provision of services. We suggest that this be:

a. formalised as a strategy for promoting private sector activity;
b. backed by good practices such as "market testing" and agreed public criteria for private sector participation;
c. integrated with the reformed purchasing policies and procedures;
d. extended to all Public Trading Enterprises and all ministries and departments with trading functions; and
e. made subject to progress reports on reviews of opportunities and rationalisation actions (to be included in every public organisation's annual report.

148. We suggested that the Business Development Office liaise with bodies such as (i) the Tuvalu National Private Sector Organisation (TNPSO) to identify the kind of work that the private sector would like to bid for; (ii) CPU and MEFD and/or OPM/Secretary to Government re application to public sector (e.g. policies re staff whose work was outsourced, instructions to Ministries to conduct market testing at a time of the year that would fit in with the annual cycle, etc.); (iii) PERMU re application to PEs; (iv) Ministry of Education re TVET; etc.

4.5 Local Participation in Government & Donor Purchasing

149. TTFAC suggests that, in parallel with the previous proposal re outsourcing government activities, action be taken to overcome information barriers that may limit local participation in government and donor purchasing:

a. local suppliers, particularly current/potential service-providers, may be unaware of the market opportunities and/or inhibited because of lack of knowledge, skills and experience in bidding for work; and
b. a Business Directory including a registry of people with occupational skills would help the government, donors and the general public to locate local businesses instead of relying on word-of-mouth.

4.6 Recommendations

150. TTFAC recommends that the Government of Tuvalu:

a. ***Give urgent attention*** to improving the inadequate ICT services.
b. ***Support*** the other moves under way or being considered to boost private sector development in Tuvalu.
c. ***Ask MFED***, in consultation with TNPSO, NBT, DBT, TNPF and other stakeholders, to give urgent consideration to existing donor "financial literacy" initiatives as implemented around the Pacific.
d. ***Consider approving*** a policy that all Ministries, PEs and PTEs (i.e. the wider public sector) keep under review all options for switching from public to private sector provision of services.
e. ***Take action*** to overcome information barriers that may limit local participation in government and donor purchasing.

5. Te Kakeega III - 2016-2020

5.1 Current Status of Te Kakeega III

151. The National Strategy for Sustainable Development 2016-2020 – known as Te Kakeega III (TK III) was formally launched with a Prayer Breakfast on 27 April (i.e. during the TTFAC Mission). This followed endorsement and signing by all members of the Government and Opposition at a special session of Parliament.

5.2 Comments on TK III Priorities

152. We understand that it was originally thought that TK III would be approved too late for it to be reflected in 2016 budgets and associated corporate plans, but some 2016 Ministry corporate plans and budgets anticipated those approvals i.e. they included new activities that reflected widely-accepted ideas about the high priority needs in that sector and the best way to meet those needs. In turn, those new activities appeared in the draft and final TK III.

153. That is understandable, but it makes the content of TK III very uneven: (i) specific actions that appear to be taken directly from the 2016 Estimates are listed alongside (ii) broad aspirational goals that lack implementation details, and (iii) strategies that could improve welfare outcomes in key areas but have not yet progressed to costing and budgeting decisions.

154. Consequently, our earlier advice on process still appears relevant, and is reflected in the recommendations below.

5.3 Making Best Use of TK III

155. In our last report, TTFAC used "focus" as the shorthand for the benefits created when the 11-part Integrated reform matrix was extracted from TK II: or, as we put it, "an enormous amount of narrative across very many topics was reduced to a short list of measurable actions".

156. However, as we reported, this also led to a problem of "inflexibility". When TTFAC's April Report recommended agreement between the Government and its donor partners to change some Matrix policy actions – particularly in light of the need to reprioritise and to reflect lessons emerging from responses to cyclone Pam – we found no changes were made, and two reasons given were:

(i) understandable reluctance to reopen major issues that had been resolved through considerable efforts to create acceptable compromises; and

(ii) internal hierarchical hurdles for lower-level staff to initiate even minor changes to agreements that had been ratified at higher levels.

157. Putting together the lessons about focus and inflexibility, we would repeat our earlier advice that it seems prudent for the Government not to rush into implementation plans and donor commitments before being very sure about what results/outcomes are proposed, stakeholders' priorities, technical feasibility, resource availability and realistic timeframes.

158. As part of the TK III process, there had been discussion of options for focusing government resources and activities on the Government's top strategic priorities. Reorganising lower-level structures and budgets (between and within ministries) to align them more closely with TK III's major result areas was considered but rejected. (TTFAC had advised against using TK III to drive massive reorganisations within core government.) Instead, current training/professional development for government's chief executives and top managers emphasises the need to collaborate, avoid "working in silos", etc. In other words, there is little value in conducting massive reorganisations when the inherent problems are lack of communication and failures in collective problem solving.

159. In general terms, we understand that:

a. Ministry of Finance and Economic Development will take the lead in strengthening the linkages between the rest of the public management system and the MTFF, investment decision-making, asset management and donor liaison;

b. the newly-established Project Monitoring Unit within OPM will monitor progress on all projects and report regularly to Cabinet;

c. the newly-established Ministry of Human Resource Management will take the lead in developing the necessary project management and programme management skills and ensuring that Permanent Secretaries' individual performance contracts emphasise what may be <u>the key to all KPIs: more effective **collaboration** between all the Ministries and other public entities</u>; and

d. pursuant to Cabinet's approval to establish a Central Contract Management Unit in the Ministry of Finance, NZ MFAT will assist by providing a full-time commercial lawyer by the end of 2016.

160. However, TTFAC welcomes these promising initiatives, we were unable to meet with and be briefed by the people responsible for the latest initiatives just mentioned – and in particular it was clearly too early to arrange a combined meeting to learn how the different parts planned to collaborate, or to explore how our recommendations on an explicit capital works programme might fit into the new system.

5.4 Recommendations

161. TTFAC recommends that the Government request the next TTFAC mission to evaluate and advise on how well TK III implementation is being managed – with particular emphasis on strengthening a number of core public management functions:

- stronger vertical linkages between plans, budgets and activities;
- better performance reporting and management for the results of these activities – especially regular reliable reporting of non-financial measurements that link Permanent Secretaries' performance to TK III objectives
- stronger horizontal linkages between activities in different ministries that are directed towards the same TK III strategic areas;

- stronger decision-support and long-term management across all of the government's largest spending and revenue decisions – commercial agreements and donor-funded projects would both benefit from Contract Management Support Unit inputs but this will require policy decisions affecting Ministers, PEs and Public Corporations; and
- stronger processes for integrating SDE revenues, activities and (especially) consequential expenditures into the government's planning and budgeting processes.
- care and technical support to ensure that crosscutting issues such as resilience, collaboration, better governance and gender-related practices are properly included throughout all TK III initiatives.

6. Ongoing Sectoral Reforms

6.1 Health Sector Reform Challenges

Reform Strategy

162. Health represents 12% of the Budget. Compared to the previous year the health budget for 2016 has increased by 23% to $8.5 million. This includes SDE expenditure of $0.94 million. Tuvalu's Health Reform Strategy 2016-19 (THRS), launched in February 2016, is the key means to operationalize the TK3 goal of " providing high standards of health care, social opportunity, and social protection free of hardship and gender discrimination". The THRS targets six key result areas consisting (1) Health Reform Agenda (2) Preventative and Primary Care Services (3) Curative and Hospital Health Services (4) Clinical Care Support Services (5) Health Administration and Management, and (6) Strengthening Health Partnerships.

163. The THRS is a comprehensive plan strongly driven by the Minister of Health. The key immediate challenge is to attract and retain well-qualified expatriate specialist staff and to organize newly qualified Tuvaluan doctors to help implement the activities aimed at achieving the Key Result Areas.

164. Currently there are 10 qualified Tuvaluan General Practitioners on the civil list; seven presently working in PMH and three receiving specialist training overseas. A further 10 Cuban-trained Tuvaluan doctors are currently undergoing Hospital Heath Service training in Kiribati and will return to Tuvalu to take up positions in 2016.

165. Prior attempts to recruit specialist doctors were stymied due to unattractive salary packages, especially when compared to conditions offered by DFAT in other parts of the region. Subsequently, Tuvalu increased the level of its packages and contracted two key positions - an anaesthetist, and a general surgeon. Yet to be hired are a paediatrician, a gynaecologist and a physician. On the downside, Tuvalu has lost its two only dentists (husband and wife) to New Zealand via the Pacific Access Category migration scheme.

Tuvalu Medical Treatment Scheme (TMTS)

166. TMTS continues to be a major expense to government. In 2015 total expenditure was $3.6 million representing about 8% of total government expenditure, or 51% of the entire health budget. The initial 2015 TMTS budget of $1.86 million was blown out by 52%, requiring three separate supplementary budgets to accommodate the increase – the latest in April 2016 to pay outstanding 2015 bills. Measured against the TKII Fiscal Ratio of 6% of domestic revenue the TMTS scheme is currently running at 6.77%.

167. Precise details of the number of patients accessing the TMTS are vague, as proper records are not systematically kept, however, in 2015 it is estimated that 90 patients were in receipt of TMTS allowances. This would suggest that the annual average cost per patient approaches $40,000.

168. The total budget for TMTS in 2016 is $3.7 million and accounts to mid April 2016 show expenditure of $1.03 million, close to $300,000 per month. At this rate there would appear to be sufficient resources within the 2016 budget

allocation. However, hidden costs such as the cost of THC and PMH staff administering the scheme and salaries paid to government employees on extended sick leave overseas are additional expenses not captured.

169. The Ministry is seriously trying to curb costs and systems abuse, tackling issues on several fronts. The recruitment of specialist doctors to treat specific health conditions that lead to overseas transferals is important, however, because of the lack of statistics it is unclear which medical conditions give rise to the greater number of referrals.

170. In theory there should be direct correlation between the number of specialist doctors in Tuvalu and the number of overseas referrals. Increasing the former should decrease the latter.

171. With the recruitment of specialists this year we should, in theory, witness a decrease in the number of referrals later in 2016. If this proves to be the case, there is a strong argument to reduce the TMTS 2017 budget and bump up the salary packages for medical specialists, ensuring Tuvalu is competitive in the regional marketplace. For example, if spending an extra $1 million on diagnostic equipment and expatriate doctors results in a $2 million saving on TMTS then clearly this is a decision worth considering. It is unlikely, however, there will ever be a time when there are no overseas referrals, but the number of patients travelling and the length of times spent overseas can be significantly reduced with better in-country care and better management of the scheme.

172. By the end of 2016 there could be as many as 20 qualified Tuvaluan GPs working in the country. In time, some of these doctors could replace the expatriate specialists.

173. Recognizing the importance of bringing the TMTS under tighter control a coordinator has been recruited in Funafuti and a consultant doctor in Suva. In both cases it is important that record management is enforced so that informed decisions can be made. A simple database, or record book, keeping track of the number of patients, type of illness, expenditure made against individual patients broken down into main costs, travel, allowances, caretakers etc., is urgently required.

174. Government has now ended its long-standing relationship with SPH. Instead, patients are treated at the Colonial War Memorial hospital and two private clinics in Suva. Serious cases continued to be referred to India and Malaysia. Whether these changes will result in a more effective service or a cheaper one remains to be seen.

175. Other THRS measures aimed at reducing TMTS costs include:

- procurement and installation of diagnostic equipment;
- TMTS coordinator in Tuvalu and consultant attached to THC Suva;
- SPH contract terminated with referrals switched to more cost effective service providers, CWM, De Asa, Malani;
- enhanced public health (preventative health) programme; and
- a strengthened palliative care programme.

6.2 Recommendations

176. TTFAC recommends that the Government:

a. ***Establish*** a simple database, or record book, keeping track of the number of patients, type of illness, expenditure made against individual patients broken down into main costs, travel, allowances, carers etc. Conduct historical analysis.

b. ***Undertake*** a cost benefit analysis of increased specialist support at PMH and the number of overseas referrals

6.3 Education Sector Reform Issues

Expenditure on education and youth represents 18% of total government expenditure. In the 2016 budget forecast the sector has been allocated $12.7 million, virtually the same as that budgeted in 2015.

177. As expressed in TKIII the goal of the government is to "provide high quality education; equip people with knowledge and skills to develop more self-reliance, and; promote Tuvalu's cultural and spiritual values"

178. This goal is to be realized by undertaking the 21 strategies listed in Annex 7 (TKIII) to be implemented by 2020. As stated in TKIII, these strategies will be implemented retaining the initiatives developed under the 2012 Policy Reform Matrix, rebalancing the distribution of resources more toward basic education, gender access, TVET and school infrastructure.

- strengthened coordination and identification of human resource priorities;
- manage and improve government scholarships;
- realise an inclusive pre-service scholarship scheme for formal and vocational training;
- reduce youth unemployment;
- introduce alcohol and tobacco consumption tax;
- implement national youth policy and sports policy;
- restructure sports Department;
- build outer islands sports facilities;
- build a multi-purpose gym ;
- build a youth recreation centre;
- support local schools and youth in sports initiatives;
- implement the revised DOE structure through the establishment of new staff positions and realignment of functions;
- effective and relevant quality of curriculum, assessment and learning programmes;
- improve monitoring and assessment of learning outcomes and learning programmes;
- development and implementation of ICT;
- improve planning and monitoring;
- improve teaching and learning;
- technical and vocational skills development;
- early childhood care and education;
- inclusive education; and
- improved facilities to store and archive national public records, library books, and other library resources

179. Many of these strategies are in fact standalone activities or statements of intent to be implemented over the planning period. Redefining the 'strategies' into fewer, more targeted outcomes and listing and linking the activities under each desired outcome would make it easier for implementers to monitor and evaluate progress towards achieving goals. It would also simplify the budget process because activities will be more defined and easier to cost.

Broadening the scope of TMTI

180. In recent months there has been little progress made on expanding the scope of the Tuvalu Maritime Training Institute (TMTI). Seafarer training for work on merchant ships has continued albeit at a reduced rate, and some training has been provided for ship observer's, but fishermen training has stalled, pending another attempt in June by PNA ministers to agree a scheme requiring distant water fishing nations (DWFN) to take an increasing percentage of Pacific island fishermen as crew. Last year the scheme was blocked by Kiribati.

181. Currently there are less than 100 seafarers employed overseas and over 300 unemployed trained seafarers in Tuvalu. The latter figure includes the one and only female seafarer ever trained at TMTI. With the steady decline in demand for Tuvaluan seafarers the future of TMTI as a seafaring training institute looks bleak.

Scholarships

182. A scholarship to study abroad is a highly prized commodity in Tuvalu and the award process is keenly studied. In 2016 the total budget for government-funded scholarships (including the SELF scheme) is $5.2 million. Measured against the TKII Fiscal Ratio of 5% of domestic revenue the cost of scholarships is currently running at 9.7%, roughly $2.5 million more than the target. Under guidance of the respective Secretaries in OPM and Education a comprehensive review of manpower planning and the scholarship process is underway. The results of this review are expected in August with new processes adopted ahead of the 2017 budget rounds.

183. Linking training to manpower needs is something that was practiced in the years immediately following independence when the availability of scholarships was confined to study funded by Australia and New Zealand. Then, only the cream of Tuvaluan students were selected and assigned to courses of study determined by the manpower needs of government. Since the 1990s, however, with the introduction of government-funded in-service scholarships and the SELF scheme, the practice of manpower planning seems to have lost its way.

184. There now appears to be renewed interest in manpower planning with attention being given to overhauling all government-funded scholarships schemes. Current thinking is that all streams, i.e. pre-service, in-service and SELF would be better served governed by a central committee and administered by a single government department.

185. It is important that the review take account not only of government needs but also of the wider economy including the private sector. Rather than train large numbers of people in academic subjects, for which there are limited jobs on their return to Tuvalu, more attention and more resources should be given

to skilling and up-skilling people in TVET subjects, creating more employment and boosting the private sector. A smaller, leaner more targeted scholarship programme could free up resources for the establishment of in-country TVET training supported by external partners such as FNU and APTC. Increasing the pool of qualified (and certified) plumbers, carpenters, bricklayers, tile layers and electricians etc. and linking these qualified tradespeople to the proposed small business credit guarantee scheme might be a better use of public funds and a better way of stimulating economic activity. Certainly skilled trades people, compared to undergraduates, have a far greater chance of securing employment not only in Tuvalu but also abroad.

Student Education Loan Fund (SELF)

186. Since commencing in late 2014 a total of 77 scholarships have been awarded. At an average annual cost of $20,000 per annum per scholarship government debt exposure could be as high as $1.5 million. In 2014 $180,000 was spent and in 2015 expenditure is recorded at close to $600,000. A further $750,000 is budgeted for 2016.

187. Although the scheme only started in 2014, already 24 of the 77 scholarships have already been terminated. With little guaranteeing the loans full debt recovery is highly improbable. The scholarships review in August will look again at the procedures governing SELF with attention to cost and expenditure and loan recovery. As SELF recipients are most likely those who cannot secure a funded scholarship a higher failure and dropout rate might be expected. There is evidence to suggest that some funded scholarship holders, whose scholarships are terminated because of poor performance, try again and are granted loans under the SELF scheme.

SDE – Primary School Construction

188. The architectural designs for primary schools on Nukufetau and Nanumea have been modified, strengthening construction to use the schools as community cyclone shelters following the experience of TC Pam. As a result, costs have risen and work delayed. A building contract for the school on Nukufetau is scheduled to be let in June 2016. The redesign work for Nanumea is ongoing. It is doubtful that this project will be completed in 2016.

Fiji Volunteer Teachers Scheme (FVT)

189. The Fiji Volunteers Scheme continues to provide excellent value for money. In 2015 all schools recorded dramatic improvement in the Motofoua entrance exam, with five schools recording 100% pass rates. Much of this success is owed to the FVT which in 2015 placed one teacher in each school. With education policy now requiring students to remain 'on-island' until the end of form 4 additional teachers are required; intentions are to double the number of FVT. There are now five FVT teachers at Motofoua Secondary School, which has also recorded a marked improvement in exam results.

6.4 ***Recommendations***

190. TTFAC recommends that the Government:

a. ***Broaden the scope*** of manpower planning to include the private sector.

b. ***Rebalance*** scholarship awards to boost private sector development.

c. ***Redirect and limit*** the SELF scheme to finance foundation and certificate courses in Tuvalu.

d. ***Explore the possibility*** of expanding the FVT to supply TVET teachers.

Annex: List of People Met by TTFAC

Name	Position
Hon Maatia Toafa	Minister of Finance and Economic Development
Hon Taukelina Finikaso	Minister of Foreign Affairs, Trade, Environment & Labour
Hon Satini Manuella	Minister of Health & President TNPSO
Hon Monise Laafai	Minister of Communication & Transport
Limasene Teatu	Secretary to Government
Letasi Iulai	Secretary for Finance & Economic Planning
Vavau Faatuga	Ag Senior Assistant Secretary, MFED
Tusipese Morikao	Ag Assistant Secretary, MFED
Taukave Poolo	Secretary for Communication & Transport
Fakavae Taomia	Secretary for Human Resource Management
Falasese Tupau	Ag Secretary for Natural Resources
Lily-peti. Faavae	Assistant Secretary for Health
Puaita Etuati	Ag Secretary for Education
Siose Teo	General Manager, NBT
Manraoi Vaaia	General Manager, DBT
Niuatui Niuatui	Director Planning, Budget & Aid Coordination
Taasi Pitoi	Director for Marine
Tepua Aselemo	Ag Director for PERMU
Lototasi Vaguna	Coordinator for Evaluation & Coordination Unit
Sarah Moses	TA for Finance
Nuausala Nuausala	Office of Budget & Planning
Kiatoa Ulika	Financial Manager, TNPF
Samasoni Finikaso	Director, Fisheries
Gary Preston	TA for Fisheries
Natalie Markhoul	TA for Gender
Akerei Maresala Thomson	Programme Mentor, Office of Police
Kate Morioka	TA for Climate Change
Peter Van Dierman	TA for PRM
Rev Kitiona Tausi	CEO, TNPSO
Tony Prcevich	TA for Auditor
Katrina Rajak	TA for Public Sector Reform
Bikenibeu Paeniu	National Project Officer, Pacific Climate Change Migration Program
Penihulo Lopati	Fisheries Officer