



## Concept Paper

---

Project Number: 50377-001  
August 2019

# Proposed Policy-Based Grant Tuvalu: Improved Fiscal and Infrastructure Management Program

This document is being disclosed to the public in accordance with ADB's Access to Information Policy.

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 11 August 2019)

Currency unit – Australian dollar (A\$)

A\$1.00 = \$0.6786

\$1.00 = A\$1.4736

## ABBREVIATIONS

ADB	–	Asian Development Bank
CIF	–	Consolidated Investment Fund
GDP	–	gross domestic product
IMF	–	International Monetary Fund
PFM	–	public financial management
PRM	–	policy reform matrix
TA	–	technical assistance
TTF	–	Tuvalu Trust Fund

## NOTE

In this report, "\$" refers to United States dollars unless otherwise stated

<b>Vice-President</b>	Ahmed M. Saeed, Vice President, Operations 2
<b>Director General</b>	Ma. Carmela Locsin, Pacific Department (PARD)
<b>Regional Director</b>	Masayuki Tachiiri, Pacific Subregional Office, PARD
<b>Team leaders</b>	S. Beatrice Olsson, Country Coordination Officer, PARD
<b>Team members</b>	Ananya Basu, Principal Economist, PARD Lily-Anne Homasi, Senior Economics Officer, PARD Douglas Perkins, Principal Counsel, Office of the General Counsel Leba Sovea, Senior Programs Assistant, PARD
<b>Peer reviewer</b>	Hanif A. Rahemtulla, Governance Thematic Group, Sustainable Development and Climate Change Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

## CONTENTS

	<b>Page</b>
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. PROGRAM AND RATIONALE	1
A. Background and Development Constraints	1
B. Policy Reform and ADB's Value Addition	2
C. Impacts of the Reform	4
D. Development Financing Needs and Budget Support	4
E. Implementation Arrangements	4
III. DUE DILIGENCE REQUIRED	5
IV. PROCESSING PLAN	5
A. Risk Categorization	5
B. Resource Requirements	5
C. Processing Schedule	5
V. KEY ISSUES	5
APPENDIXES	
1. Design and Monitoring Framework	6
2. Problem Tree	8
3. List of Linked Documents	9

## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 50377-001	
<b>Project Name</b>	Improved Fiscal and Infrastructure Management Program	<b>Department /Division</b>	PARD/SPSO
<b>Country</b>	Tuvalu	<b>Executing Agency</b>	Ministry of Finance and Economic Development
<b>Borrower</b>	Ministry of Finance		
<b>Country Economic Indicators</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=50377-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=50377-001-CEI</a>		
<b>Portfolio at a Glance</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=50377-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=50377-001-PortAtaGlance</a>		
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ <b>Public sector management</b>	<b>Subsector(s)</b> Public expenditure and fiscal management		4.00
		<b>Total</b>	<b>4.00</b>
<b>3. Operational Priorities</b>		<b>Climate Change Information</b>	
✓ Addressing remaining poverty and reducing inequalities		Climate Change impact on the Project	Low
✓ Strengthening governance and institutional capacity			
<b>Sustainable Development Goals</b>		<b>Gender Equity and Mainstreaming</b>	
SDG 1.a		No gender elements (NGE)	✓
SDG 9.1			
		<b>Poverty Targeting</b>	
		General Intervention on Poverty	✓
<b>4. Risk Categorization:</b> Low			
<b>5. Safeguard Categorization</b>		<b>Environment: C Involuntary Resettlement: C Indigenous Peoples: C</b>	
<b>6. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>4.00</b>	
Sovereign Program grant: Asian Development Fund		4.00	
<b>Cofinancing</b>		<b>10.60</b>	
European Union - Program grant (Not ADB Administered)		1.50	
Government of Australia - Program grant (Not ADB Administered)		1.00	
Government of New Zealand - Program grant (Not ADB Administered)		0.60	
World Bank - Program grant (Not ADB Administered)		7.50	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>14.60</b>	
<b>Currency of ADB Financing:</b> US Dollar			

## I. THE PROPOSAL

1. The Government of Tuvalu has requested financial assistance from the Asian Development Bank (ADB) for the proposed Improved Fiscal and Infrastructure Management Program to support reform efforts prioritized in the government's policy reform matrix (PRM).<sup>1</sup> The program will contribute to improved management of public finances and national infrastructure in Tuvalu.<sup>2</sup> A single-tranche, stand-alone, policy-based grant of \$4.0 million to be financed from ADB's Asian Development Fund grant resources is proposed.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

2. **Development context.** Categorized by ADB as a fragile state, Tuvalu is one of the smallest, most remote, most climate-change-vulnerable countries in the world. The public sector is the main employer and driver of economic activity, accounting for about two-thirds of gross domestic product (GDP). The private sector is small and undeveloped and has struggled to grow. With negligible exports, Tuvalu is heavily dependent on imports. The use of the Australian dollar and the lack of a central bank means that fiscal policy is Tuvalu's only tool for macroeconomic management. Achieving fiscal sustainability requires prudent management of volatile external revenue sources, including fishing-license fees, licensing royalties for the commercial use of the "dot.tv" internet domain name, and development assistance grants. To help reduce revenue volatility, the government created the Tuvalu Trust Fund (TTF) in 1987. Statutory provisions governing the fund provide for an automatic transfer of funds above the maintained value of the TTF to its associated buffer fund—the Consolidated Investment Fund (CIF). The CIF provides a source of funding for the budget and acts as a fiscal buffer when TTF earnings are low or when unexpected financing gaps arise.<sup>3</sup>

3. **Economic and fiscal performance.** From a low annual average of 0.8% during 2011–2014, economic growth accelerated to 4.9% on average during 2015–2018 through higher government expenditures underpinned by substantial increases in fishing-license revenues and a series of large infrastructure projects. Growth is projected to remain strong—above 4.0% in 2019 and 2020, buoyed by continued construction of major infrastructure projects. The fiscal surplus expanded from 13.6% of GDP in 2017 to 33.9% of GDP in 2018 because of another sharp rise in fishing-license revenues (from 49.6% of GDP in 2017 to 85.3% of GDP in 2018). Estimated external public debt was equivalent to 27.6% of GDP in 2018, and the International Monetary Fund (IMF) continues to classify Tuvalu's risk of debt distress as high.

4. **Risks to macroeconomic and fiscal framework.** While the medium-term outlook is broadly positive, there are downside risks that can reduce the government's ability to meet operational expenditures and debt repayments. External economic shocks could reduce remittance flows, diminish employment opportunities abroad, and adversely impact returns to the TTF. An unexpected decline in receipts from fisheries or donor grants would strain Tuvalu's fiscal position. The Pacific Catastrophe Risk Assessment and Financing Initiative assessment in 2015 estimated that, on average, Tuvalu should expect annualized disaster-related losses and damages of 0.6% of

---

<sup>1</sup> Government of Tuvalu. *Policy Reform Matrix: 2012–2019*. Funafuti.

<sup>2</sup> The proposed program is included in ADB. 2018. *Eleven (11) Small Pacific Island Countries: Country Operations Business Plan, 2019–2021*. Manila. It is aligned with ADB. 2016. *Pacific Approach, 2016–2020*. Manila. An initial draft of the design and monitoring framework is in Appendix 1.

<sup>3</sup> As of 30 March 2019, the market value of TTF Investments was \$122.3 million, while the maintained value was \$123.7 million, so investments were lower by \$1.4 million. The CIF targets a minimum balance of 16% of the TTF's maintained value; at \$22.8 million as of 30 March 2019, the CIF exceeded the minimum balance requirement by \$3 million.

GDP.<sup>4</sup>The government, through its Climate Change Policy, 2012–2021, is undertaking reforms to improve the country’s resilience to shocks, but costs associated with physical adaptation, disaster risk reduction, and disaster response are large and may necessitate higher levels of development assistance.<sup>5</sup> In 2016, the government established the Tuvalu Survival Fund to help the country prepare and respond to climate change impacts; this fund is now valued at \$6.2 million. Such efforts by the government align with the IMF’s 2018 Article IV Consultation, which calls for a stronger fiscal framework by building fiscal buffers and improving climate change risk management.<sup>6</sup>

5. **Public financial management.** Tuvalu’s public financial management (PFM) environment has improved through its commitment to implementing fiscal prudence in line with the Public Financial Management Roadmap, 2015–2018, which has led to greater macroeconomic stability and improved quality of public expenditures.<sup>7</sup> The government still needs to address weak fiscal management and slow implementation of PFM reforms and is aiming to update the PFM Roadmap to (a) improve the medium-term fiscal framework and credibility of the budget; (b) review financial legislation and subsidiary guidelines; (c) improve the capability and usage of the government Financial Management and Information System; and (d) build PFM capacity and service delivery.<sup>8</sup> The government has also recognized that procurement reforms implemented since 2012 can benefit PFM if noncompliance issues and lack of enforcement are tackled.<sup>9</sup> The government’s fiscal vulnerabilities are associated with the questionable credibility of the government financial system—this is partly because of discrepancies associated with using both cash accounting and partial accrual accounting, which needs to be addressed.

6. **Physical infrastructure assets.** Infrastructure management in Tuvalu is challenging because of a lack of economies of scale, high transport costs, and a harsh climate. When not managed and maintained properly, physical infrastructure assets pose fiscal risks, impact the quality of public service delivery, and compromise public health and safety. The harsh climate causes physical infrastructure assets to corrode and age quickly. Contractors typically do not build infrastructure assets to appropriate standards and often fail to take climate projections into account. Technical capacity for asset management is weak and institutional memory is missing, resulting in many assets being poorly constructed and maintained.

## B. Policy Reform and ADB’s Value Addition

7. **Government vision.** The proposed program is aligned with the objective of Tuvalu’s National Strategy for Sustainable Development (Te Kakeega III), 2016–2020 for a more protected, secure, and prosperous nation through sound macroeconomic management and policy and efficient, high-quality, and resilient infrastructure and support services. ADB’s Strategy 2030 operational priorities of addressing poverty and reducing inequalities (operational priority 1), making cities more livable (operational priority 4), and strengthening governance and institutional capacity (operational priority 6), are applicable.<sup>10</sup> Since 2012, ADB, Australia, New Zealand, the European Union, and

<sup>4</sup> World Bank et al. 2015. *Advancing Disaster Risk Financing and Insurance in the Pacific: Regional Summary Note and Options for Consideration*. Washington, DC. Average annual loss data were compared to 2016 GDP. The replacement cost of exposed assets in Tuvalu—including all buildings as well as infrastructure (ports, airports, roads, bridges)—was estimated at \$268 million.

<sup>5</sup> Government of Tuvalu. 2012. *Climate Change Policy, 2012–2021*. Funafuti.

<sup>6</sup> International Monetary Fund. 2018. Tuvalu: Article IV Consultation. Washington DC.

<sup>7</sup> Government of Tuvalu. 2015. *Public Financial Management Roadmap, 2015–2018*. Funafuti.

<sup>8</sup> The reforms in the new roadmap draw from the Government of Tuvalu’s 2015 *Public Expenditure and Financial Accountability self-assessment*.

<sup>9</sup> ADB has supported public procurement reforms in Tuvalu since 2012, including the development of the 2012 National Procurement Policy, the Public Procurement Act 2013, and the Public Procurement Regulations 2014. The government established a central procurement unit in 2015 to oversee procurement and developed standard bidding documents.

<sup>10</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*, Manila; Government of Tuvalu. 2015. *National Strategy for Sustainable Development, 2016–2020*. Funafuti.

the World Bank have supported the government's use of the PRM as a tool to strengthen public sector management. These development partners offered long-standing policy engagement, technical assistance, and a coordinated program of budget support and reforms from 2012 to 2018. Support focused on PFM, fiscal policy, public administration, public enterprise performance and rationalization, health, and education reforms. Progress in these areas has resulted in ADB and other development partners providing \$27 million in budget support. ADB policy-based operations in 2012 and 2015 totaled \$4.3 million and supported PRM reform actions supporting PFM, public enterprise rationalization, private sector development, and fiscal policy.

8. **Reform areas.** This will be ADB's third program in support of the rolling government–development partner PRM and will facilitate reforms specific to (i) improving PFM and (ii) improving infrastructure management.<sup>11</sup> ADB will also develop a post-program monitoring framework to support implementation of longer-term reforms and ongoing policy engagement. The indicative policy actions for the proposed program are:

(i) **Improving policies and processes for public financial management.** The Cabinet will develop and endorse the PFM Reform Strategy, 2019–2021 to strengthen the foundations of PFM practices and overall fiscal discipline.<sup>12</sup> The cabinet will also develop and endorse a “Note to Adopt Full Accrual Accounting System,” including a road map to upgrade PFM processes and systems, and will revise the Public Finance Act to ensure Tuvalu's compliance with accrual accounting according to Generally Accepted Accounting Principles. The cabinet will also develop and endorse a public procurement manual, a procurement complaints and appeals procedure, and a procurement suspension and debarment procedure to strengthen procurement compliance and put in place processes to respond to noncompliance.

(ii) **Improving institutional and legal frameworks for national infrastructure management.** The cabinet will endorse the Tuvalu Asset Management Framework, which identifies the maintenance requirements and investment needs of public sector infrastructure assets, ensuring that they deliver their intended functions with economic efficiency throughout their service life.<sup>13</sup> Parliament will draft and pass a Building Act and the implementing ministry will endorse the draft building code and commit to completing national consultations to finalize the building code by December 2019. The building code and associated legislation will ensure that construction adheres to acceptable standards of structural sufficiency, safety, and amenities for the public.

9. **ADB value addition and lessons learned.** The proposed program will draw on lessons from previous policy-based operations in Tuvalu and other Pacific island countries as well as the 2015 evaluation of the PRM, financed by the Government of Australia. These lessons relate to building strong political consensus, limiting reforms to a few substantive actions, institutionalizing joint government–development partner coordination mechanisms, and recognizing that deep institutional and structural change requires time to take root.<sup>14</sup> The design of the program is based

<sup>11</sup> Government of Tuvalu. *Policy Reform Matrix: 2012–2019*. Funafuti. ADB technical assistance is supporting implementation of these reforms.

<sup>12</sup> The PFM Reform Strategy, 2019–2021 replaces the PFM Roadmap, 2015–2018.

<sup>13</sup> The Asset Management Framework is linked to the Tuvalu Infrastructure Strategy and Investment Plan, 2016–2025, which prioritizes infrastructure investments in Tuvalu over 10 years. As the custodian of all major infrastructure assets, the Ministry of Public Utilities and Infrastructure Implementation will commence implementation of the Asset Management Framework. Incremental implementation supported by technical assistance from development partners is recommended for this framework because of the varying capacities of different ministries.

<sup>14</sup> ADB. 2017. *Completion Report: Strengthened Fiscal Sustainability Program in Tuvalu*. Manila; ADB. 2014. *Completion Report: Strengthened Public Financial Management Program in Tuvalu*. Manila; Independent Evaluation Department, ADB. 2015. *Corporate Evaluation Study: ADB Support to Small Pacific Island Countries*. Manila. Government of Tuvalu. 2015. *Evaluation of the Policy Reform Matrix, 2012–2015*. Funafuti; and ADB. 2011. *Policy Brief: Policy-Based Programs for the Pacific Islands*. Manila.

on a small number of critical government-led reforms, incentivized by coordinated development partner budget support. ADB's strong relationship with the government and development partners has proved invaluable, enabling frank conversations on complex and politically sensitive reforms. Given Tuvalu's weak administrative capacity and high exposure to external shocks, reform-targeted technical assistance and flexibility to adjust reform triggers are essential to ensuring that policy reform programs remain relevant. Development partner engagement has been vital in supporting the government to clarify and sequence reforms, and will continue to be key in maintaining the government's reform momentum.

### C. Impacts of the Reform

10. The program's intended impact contributes to the Te Kakeega III (footnote 8) objectives of sound macroeconomic management and efficient, high-quality, and resilient infrastructure and support services. The intended effect of the reform is improved management of public finances and national infrastructure. The program will incentivize efforts in two reform areas (i) stronger policies and processes to improve PFM and (ii) institutional and legal frameworks to improve the management of national infrastructure.

### D. Development Financing Needs and Budget Support

11. The government has requested a grant of \$4.0 million from Asian Development Fund resources to help meet its projected budget financing needs, inclusive of the estimated costs of designing and implementing the reform program. With fishing-license revenues in 2019 projected to fall back to \$21.4 million—about the same level as in 2017—or \$16.9 million lower than the seasonal windfall recorded in 2018, the budget financing gap for 2019 is projected to be \$20.9 million.<sup>15</sup> Although the government's cash reserves in the CIF can accommodate key budget priorities for the next 3–5 years, this will require financial support. The proposed ADB grant and parallel collaborative partner cofinancing are indicated in Table 1.

**Table 1: Financing Plan**

Source	Amount (\$ million)	Share of Total <sup>a</sup> (%)
Asian Development Bank (grant)	4.00	27.0
European Union (grant)	1.50	10.0
Government of Australia (grant)	1.02	7.0
Government of New Zealand (grant)	0.40	4.0
World Bank (grant)	7.50	51.0
<b>Total</b>	<b>14.42</b>	<b>100.0</b>

<sup>a</sup> Numbers may not sum precisely because of rounding.  
Source: Asian Development Bank.

### E. Implementation Arrangements

12. The Ministry of Finance and Economic Development will be the executing agency for the program. It will oversee the implementation of agreed policy actions, as well as be responsible for program administration, disbursements, and maintaining all records. The Ministry of Finance and Economic Development and the Ministry of Public Utilities and Infrastructure will be the implementing agencies for the program. Technical assistance (TA) from ADB and other development partners is supporting the implementation of the program policy matrix.<sup>16</sup> The program will be implemented from July 2018 to December 2019. The government will review Tuvalu's reform efforts and progress against this program's design and monitoring framework in close coordination with ADB and in the context of the annual review of the policy matrix. ADB will monitor the

<sup>15</sup> Government of Tuvalu. 2019. *National Budget*. Funafuti. The 2019 budget projects total domestic revenues to be \$38.9 million (A\$55.7 million) with planned expenditures to be \$59.7 million (A\$85.6 million).

<sup>16</sup> ADB. 2017. *Tuvalu: Supporting Reforms to Strengthen Fiscal Resilience and Improve Public Service Delivery*. Manila.



implementation of reforms according to the post-program monitoring framework. The proceeds of the policy-based grant will be withdrawn in accordance with ADB's Loan Disbursement Handbook (2017, as amended from time to time).

### III. DUE DILIGENCE REQUIRED

13. Due diligence for the program, to be prepared in close collaboration with development partners, will include a risk assessment and risk management plan. The program is expected to be category C for environment, involuntary resettlement, and indigenous peoples. The IMF will provide a macroeconomic assessment letter. The initial poverty and social analysis is included in the list of linked documents. The Tuvalu Trust Fund Advisory Committee—including representatives of the governments of Tuvalu, Australia, and New Zealand—is tasked with monitoring risks and provides an independent assessment of PRM implementation progress and management measures.

14. The program is classified *no gender elements*. While improved management of public finances and national infrastructure will benefit all, the program contains no proactive gender design features. Gender design features, including gender responsive procurement and gender actions relating to the implementation of the Building Act and draft building code, will be explored in ADB's subsequent programs.

### IV. PROCESSING PLAN

#### A. Risk Categorization

15. The program is categorized low risk as (i) the grant amount does not exceed \$50 million, (ii) ADB has a sound record of engagement in public sector management since 2009, (iii) the executing agency has reasonable capacity in externally financed project administration, and (iv) the program is not expected to be rated category A for any safeguard category.

#### B. Resource Requirements

16. ADB estimates that the program will require 5 person-months of ADB staff time. Other development partners, including the governments of Australia and New Zealand, the European Union, and the World Bank Group, are providing TA to help implement PFM reforms.

#### C. Processing Schedule

**Table 2: Proposed Processing Schedule**

<b>Milestones</b>	<b>Expected Completion Date</b>
Fact finding mission	25–27 July 2019
Management Review Meeting	3 September 2019
Grant negotiations	13 September 2019
Board consideration	31 October 2019
Grant effectiveness	15 November 2019

Source: Asian Development Bank.

### V. KEY ISSUES

17. ADB will pay particular attention during processing and implementation to (i) maintaining the government's reform commitment and monitoring the political economy, (ii) ensuring timely TA to provide technical expertise or supplement government capacity; and (iii) ensuring close collaboration with development partners.



	1.4 Public procurement manual, procurement complaints and appeals procedure, and procurement suspension and debarment procedure developed and endorsed by cabinet (2018 baseline: 47% of major procurement [by value] undergoes competitive procurement process; 2012-2018: 50% or more)		
<b>2. Institutional and legal framework for national infrastructure management improved</b>	<p>2.1 Tuvalu Asset Management Governance Framework developed and endorsed by cabinet (Baseline: No framework; improved maintenance of public infrastructure)</p> <p>2.2 Building Act 2019 drafted and passed by parliament and draft building code developed and endorsed by implementing Ministry. (Baseline: Building code developed in 1990 but had no enabling legal framework for its implementation; more public infrastructure meeting a higher level of safety standards)</p>		
<p><b>Budget support</b></p> <p>Asian Development Bank: \$4.00 million grant by Q4 2019</p> <p>Government of Australia: \$1.02 million (A\$1.5 million) grant by Q3 2019</p> <p>Government of New Zealand: \$0.40 million (NZ\$1.0 million) grant by Q3 2019</p> <p>European Union: \$1.50 million (€1.3 million) by Q3 2019</p> <p>World Bank: \$7.50 million grant by Q4 2019</p>			

PEFA = Public Expenditure and Financial Accountability, PFM = public financial management, Q = quarter, TA = technical assistance.

Source: Asian Development Bank.

<sup>a</sup> PEFA indicators: PI-17 recording and management of cash management balances, debt and guarantees; PI-19 transparency, competition, and complaints mechanism in procurement; PI-20 effectiveness of internal controls for non-salary expenditure; PI-22 timeliness and regularity of accounts reconciliation; PI-25 quality and timeliness of annual financial statements.

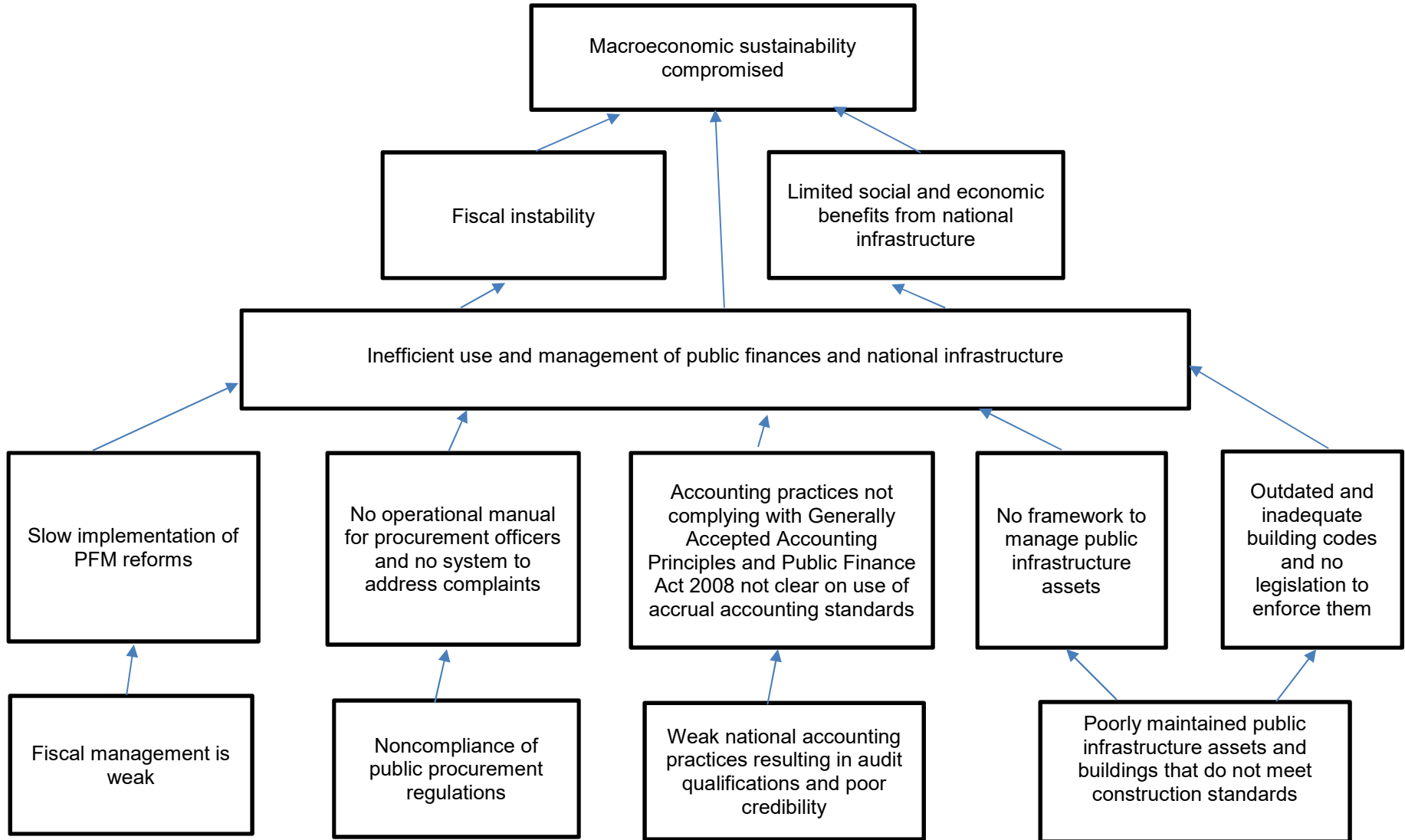
<sup>b</sup> The policy actions (and the data sources and reporting mechanisms) listed are indicative, and will be further refined and revised during program processing and appraisal.

**PROBLEM TREE**

EFFECTS

CORE PROBLEM

CAUSES



**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=50377-001-ConceptPaper>

1. Initial Poverty and Social Analysis