Tuvalu

As with most other small Pacific island countries, Tuvalu has a dual economy: a large subsistence sector concentrated on fishing and coconut products coexisting with a monetized economy in which the Government plays the dominant role. Although its land-based and human resources are limited, Tuvalu has a very large exclusive economic zone that it has been able to exploit to good effect through the issuance of fishing licenses. Recurrent budget deficits have generally been avoided, with development expenditure being financed largely from external assistance. Inflows of remittances from workers abroad have been an important element of external earning; and investment revenue from the Tuvalu Trust Fund, established in 1987 by external donors, has not only assisted the balance of payments but has also eased the problem of fiscal management.

Economic growth was high in the early 1990s as the fisheries resource began to be exploited and public expenditure was increased. While there are opportunities for further development of the fisheries resource, much more modest rates of growth can be expected in the future. Although there is limited scope for private sector development, this needs to be encouraged wherever possible.

Recent Trends and Prospects

Economic growth in Tuvalu averaged 9 percent per annum during the four years to 1993, but receded to 2.6 percent in 1994 and further to an estimated 2 percent in 1995. In that year, although fishing license revenue improved, the contraction of both current and capital expenditure by the Government served to check the rate of economic growth.

The Government's fiscal position in 1995 was again less favorable than in the previous year. Recurrent revenue, excluding grants, contracted to 34 percent of GDP in 1995 from 47 percent in 1994. This was largely because of a fall in the contribution made by interest and dividend earnings of the Tuvalu Trust Fund (Figure 2.32). Revenue from fishing licenses increased by 30 percent. Recurrent expenditure also contracted from about 47 percent of GDP in 1994 to 42 percent in 1995. Salary and wage payments were virtually unchanged and most of the expenditure reduction occurred in areas such as maintenance and the purchase of goods and services; expenditure on both declined by nearly 27 percent. The deficit on recurrent operations in 1995 was 7.8 percent of GDP compared with a balance in 1994. Capital and development expenditure showed an even more marked contraction, with the total declining from 69.8 percent of GDP in 1994 to 27.9 percent in 1995. The overall deficit, excluding grants, was thus virtually halved to 35.7 percent of GDP from 69.7 percent in 1994. The major source of finance for these deficits was external grants from a wide range of donors although it was also necessary to draw down cash balances and to draw on balances in the Tuvalu Trust Fund.

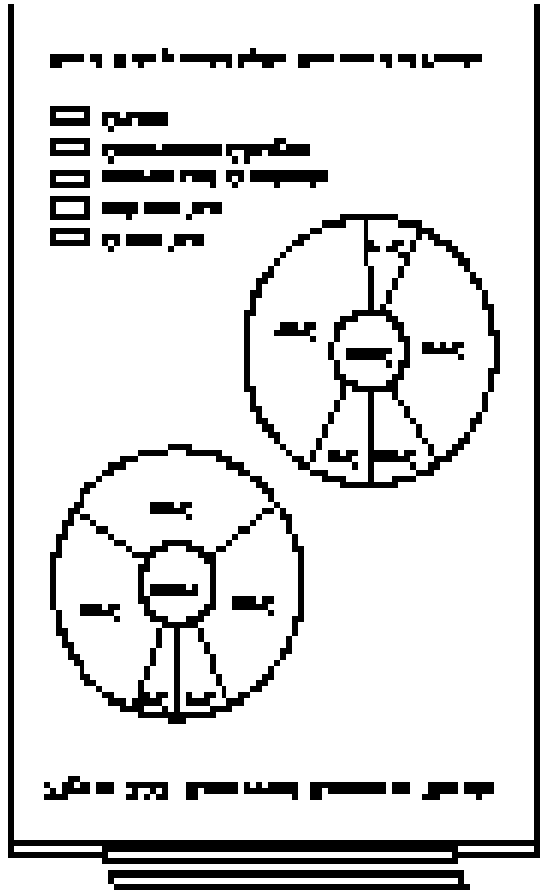
Inflation in Tuvalu is strongly influenced by price movements in Australia, Fiji, and New Zealand, the main sources of imports. Low inflation in these countries over recent years has helped to keep inflation in Tuvalu down to 1.5 percent in both 1993 and 1994;

a similar rate is estimated for 1995. Balance-of-payments data for Tuvalu in 1995 are not available; however, the general features of Tuvalu's external accounts are unlikely to have changed. Commodity export earnings are minimal, amounting to only 3–4 percent of import payments. The trade deficit is typically equal to over 50 percent of GDP. However, income from Tuvalu Trust Fund investments, remittances from overseas workers, and fishing licenses – which rose by some 30 percent in 1995 – along with substantial external grants are usually sufficient to cover the trade deficit, and yield an overall balance-of-payments surplus. External reserves remain fairly comfortable at the equivalent of about nine months of imports.

In the immediate future, the economic outlook for Tuvalu is for continued growth, possibly a little higher than in 1995 at 2.5 percent. The government budget for 1996 provides for very large increases in current revenue and expenditure as well as in capital and development expenditure. Current revenue, excluding grants, is budgeted to rise by 28 percent, with tax revenue up by nearly 50 percent on actual receipts in 1995. Current expenditure is budgeted to increase by 15.1 percent, yielding a recurrent deficit equal to 4.3 percent of GDP, just over half of what it was in 1995. Capital and development expenditure is also budgeted at much higher levels than the outturn for 1995. The total of such expenditure is projected to be Australian dollars (A$) 20.3 million compared with A$4.8 million in 1995, a rise from 27 percent of GDP to over 111 percent, with external assistance providing the necessary finance. However, these estimates of both current and development revenue and expenditure seem unrealistic given the limited absorptive capacity of the Tuvalu economy. Also, in the past there have been substantial differences between budget estimates and actual outcomes. The external accounts of Tuvalu are unlikely to show much change in 1996. The trade deficit will again be largely covered by external grants, services and investment income.

Policy and Development Issues

The achievement of long-run economic growth sufficient to improve per capita incomes in Tuvalu is problematical. The resource base



is limited and the range of options open for development of productive sectors is narrow with further exploitation of its fisheries resource being the only realistic possibility, along with some small-scale commercial agriculture and service activities. Thus, reliance on workers' remittances from abroad, earnings of interest and dividends of the Tuvalu Trust Fund, and especially external assistance to cover the large trade deficit will be necessary for some time to come. Virtually all development expenditure is financed by external assistance. It is important to ensure that projects are properly evaluated on economic terms and do not impose future operational burdens on the public budget which will require levels of taxation that inhibit private sector initiatives. There continues to be a need for considerable strengthening of budgetary management and decision making and for reducing the extent of government involvement in what are essentially commercial activities. Further initiatives to advance this process were provided for in the 1996 budget, along with other measures to promote public sector reform.