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The Role and Performance of Government

Introduction

Public sector reform is one of the five priority programs of the *Kakeega o Tuvalu*, and encompasses improving public administration, public financial management, and public enterprise performance. This Chapter examines developments in the first two areas since 1997, and also the second priority program of restructuring the economy through encouraging export-oriented private investment. The public enterprise sector is discussed in Chapter 4.

The Government System

Tuvalu is a parliamentary democracy operating under the Constitution of 1986 and subsequent amendments. The Government of Tuvalu's (the Government) executive branch includes the British monarch as head of state, represented by a Governor General appointed on the Prime Minister's recommendation, as head of the Government. The Prime Minister and Deputy Prime Minister are elected by and from the members of Parliament. Cabinet is appointed by the Governor General on the recommendation of the Prime Minister and currently includes the Prime Minister and four ministers. The number of ministers may not exceed one third of the members of Parliament.

The Government's legislative branch consists of a unicameral Parliament or House of Assembly (Fale I Fono) with 15 members elected for four-year terms by popular vote of the population aged 18 and over. It should be noted that efficient functioning of Government has been affected adversely between 1997 and 2001 by the failure of elected governments to serve their full terms. Members crossing the floor unseated Prime Ministers in 1997, 1999, and late 2001. In addition, the unfortunate death of the incumbent Prime Minister in late 2000 forced a change of leadership.

The Government's judicial branch consists of the Privy Council (United Kingdom), the Court of Appeal, the High Court, a Magistrate's Court, island courts, lands courts, and the lands courts appeal panel. The High Court consists of a Chief Justice appointed by the head of state acting on Cabinet's advice (and potentially other judges who may be appointed in the same manner), and is expected to sit at least once a year. The Resident Magistrate's Court is scheduled to sit at least once a week, while island courts are scheduled to sit once a month and have their decisions regularly reviewed by the resident magistrate.

The legal system is defined by the Acts of Tuvalu Parliament, some English Acts, common law, and customary law. The Constitution explicitly states that laws are to be relevant to the customs and traditions of the Tuvaluan people, and that the Government's overriding aim is to provide an environment to enable Tuvaluans to live a full, free, and happy life (Pita 1999). A people's lawyer, currently an expatriate volunteer, is appointed to provide legal advice and technical assistance to the public. New legislation is published in the English-language *Tuvalu Gazette*.

Legal affairs and the judiciary are administered by the Office of the Prime Minister (OPM) through the Office of the Attorney General (OAG). The Attorney General is appointed by the head of state on advice from the Public Service Commission after consultation with Cabinet; and at present acts also as the director of public prosecutions. The Constitution provides that salaries and allowances for judges and the

Attorney General are prescribed by specific Acts of Parliament; but the Ministry of Finance and Economic Planning (MFEP) determines the budget for legal and judicial services as part of the national budget preparation process. The judiciary consists of one magistrate paid at level five of the 10-level civil service salary structure, one court registrar, and one clerical officer. The capacity of the judicial machinery is therefore limited. As civil servants, magistrates make much less than comparable professionals in the private sector. There is no annual report from OAG detailing the activities of courts and the time it takes to resolve cases.

The functional areas for which ministers are responsible are broadly defined in a schedule to the Constitution and elaborated in some cases in Acts of Parliament. For example, the functions of the Minister of Finance are explained in the Public Finance Act. However, the organizational structure of Government has changed since 1986, and there is need to redefine ministers' responsibilities.

There is constitutional provision for a neutral and independent civil service, with a Public Service Commission (PSC) advising the Governor General on appointments. There is also constitutional protection for the secretary to government, PSC members, Attorney General, and Auditor General.

Policy-making lacks direction and coordination. Although a Development Coordination Committee (DCC) of secretaries of ministries is to ensure interministerial consultation and meets regularly, it is not always comprehensive in its coverage. There is limited capacity to provide policy advice to the Prime Minister and Cabinet. OPM is primarily an administrative unit that encompasses the personnel and training functions related to the civil service. It includes a public sector reform unit with one staff, and a special service unit staffed by an expatriate advisor. A previous Prime Minister began the practice of appointing special ministerial advisors from those members of Parliament without a portfolio. There is no provision in law for these appointments, and they appear to be politically motivated.

MFEP also has limited capacity to advise on policy, and to review policy priorities and resulting budgetary requirements. A functional review of the needs of OPM, Cabinet, and MFEP would be a first step in strengthening the capacity of OPM and MFEP to provide policy advice, develop a Government agenda, and resolve interministerial differences.

Policies are translated into law by OAG and reviewed by the Chief Justice after a first reading in Parliament. There is no obligation to provide any budgetary, economic, social, or environmental impact analysis for proposed laws, and there appears to be no planned legislative program.

Under the Constitution, the raising and spending of money by the Government (including imposing taxes and raising loans) is subject to authorization and control by Parliament, and is regulated by the Public Finance Act, 1978. Parliament receives reports from the Auditor General after these have been submitted to the speaker of the house. A Public Accounts Committee (PAC) acts as a standing committee of Parliament, with members appointed by the speaker. Since early 2000, PAC membership has consisted of three members of Parliament (from whom the chair is chosen), and three citizens. Previously, membership was confined to parliamentarians, and PAC was inactive: the 1994, 1995, and 1996 Auditor General's reports and Government accounts for 1997, 1998, and 1999 were not considered until 2000 (PAC 2001).

Legislative debate is open to the public, and is broadcast on radio. There is a strong tradition of participation in decision making through the communal meeting house (*maneapa*) system. There is also growing involvement of nongovernment organizations, but limited participation by professional associations such as the Chamber of Commerce.

There are no codes of ethics for Cabinet members or for legislators, and ministers and legislators are not required to declare their assets.

Local government is discussed in Chapter 7.

The Civil Service

The civil service has suffered disruption and uncertainty in recent years. Changes of Government between 1997 and 2001 have led to frequent changes of ministers and movement of senior officials, with inevitable inefficiencies in policy formulation and implementation. In addition, the aging government office building was demolished in 1998, and the civil service scattered around Funafuti in small units of rented accommodation. This has reduced the efficiency of public administration through loss of records during relocation, weakened communication between and within ministries and departments, and lowered morale. There are plans to construct new government offices by 2003.

Related to the issue of office accommodation is the security of the Government's land leases. The original government leases for the airfield and the civil servant housing area (Fakaifou) were for 99 years, the land having been acquired under the Crown Acquisition of Lands Act. The Funafuti landowners were unhappy with the acquisition and the 99-year term, and in 1992 the Government revoked the acquisition order and reduced the lease terms to 25 years. According to some assessments, the 25-year leases commenced from the agreed date of the repeal of the acquisition order (1 September 1992) the exceptions being for the deep sea wharf area (leased for 25 years from 1 March 1979) and Amatuku (leased for 25 years from 1 March 1978). However, this interpretation is disputed by the landowners, who argue that the commencement date is 1978. Whatever the correct interpretation, the Government is operating under an exceptionally short tenure arrangement. Moreover, Funafuti landowners reportedly have indicated in writing their unwillingness to renew leases, prompting the current Government to contemplate splitting the central administration between Funafuti, Vaitupu, and Nukufetau.

Another event affecting administrative capacity was the sustained increase in the number of in-service scholarships granted to civil servants in the late 1990s (Appendix 2, Table A5.1). The desire to upgrade

qualifications of staff is understandable, but the increase in awards seems to have not considered the impact on public administration. And, in the absence of enforcement of the 2-year bonding requirement, many awardees are likely to remain overseas after completing their studies, or to return to Tuvalu for a short time before finding overseas employment.

Tuvalu has a Public Service Act 1979, a Public Service Ordinance 1982, and General Administrative Orders 2000 issued under Section 7 of the 1979 Act. PSC consists of a chairperson and three other members, who are appointed for four-year terms by the head of state on advice from Cabinet. A PSC member cannot be a member of Parliament, a candidate for election to Parliament, the holder of any other office or position established by the Constitution, or in a state service. PSC is responsible for efficiently managing and controlling the civil service, including all personnel matters: appointment and confirmation of appointment, promotion and demotion; transfer from office to office or from place to place (except movement within a common cadre); disciplinary action and suspension; and cessation or termination of employment (except where these occur at the end of the person's regular period of employment as determined by law).

According to regulations and established tradition, civil servants are responsible for helping to formulate and implement policies, evaluate their impact, provide service delivery, and produce certain public goods.

With the exception of the *Code of Professional Conduct* of OAG (GOT 1998), there is no ethics code for civil servants. However, civil service regulations contain a section that covers some ethical areas in public service such as values and gift taking. Breaching of regulations and misappropriation of funds lead to dismissal of the civil servant in question. Senior civil servants come from the ranks and there are no political appointments aside from the special ministerial advisors.

As explained in Chapter 2, the civil establishment in 2001 had 822 positions, of which 636 were filled. A further 201 civil servants were

employed as temporary appointees on contract, effectively making the civil service size 837, or about eight civil servants for every 100 people. There were also 80 casual employees working for the Government. The 268 employees of public enterprises should be added to these numbers to understand the size of the entire public sector, which is large by regional standards. The pay structure is standardized and is based on a 10-level scale.

Advancement in the civil service seems associated more with years of service and seniority than a well-defined career progression program. Numbers in the senior levels are small; and there is an actual executive level of the civil service that meets in DCC.

A striking feature of public administration in Tuvalu is the poor state of record keeping. Key policy and strategy documents are often unavailable. Files have been lost and are not always current. Widespread use of personal computers has encouraged casual practice in record keeping, while simultaneously the capacity to better manage information using computers has not been exploited. Improving efficiency in the public service requires improving such basics.

Public Sector Reform: An Overview

In 1994, the Government funded a public sector review (Baker et. al. 1994) that became the foundation of the public sector reform program presented in the *Kakeega o Tuvalu* (GOT 1995). The program's goal was

To define the set of functions that are best provided by Government and to provide these services in the most efficient and cost-effective way to maximize the contribution of the public sector to community welfare and economic growth.

Civil service downsizing was the first strategy in pursuing the program goal, with the establishment being reduced from 694 to 641

by March 1995, and with an intention of confining further growth in established posts to the rate of population growth. A Public Sector Review Committee consisting of the PSC chairperson, the deputy secretary to Government and the staff development officer was then created to guide the reform process.

Four main components of the program were

- (i) commercializing, corporatizing, and contracting out service provisions;
- (ii) improving public sector performance through corporate planning that encompassed formulating performance indicators, revising job descriptions, and training middle and senior management;
- (iii) introducing output based budgeting to link outputs specified in corporate plans with budget allocations (starting with the 1997 budget); and
- (iv) formulating appropriate pricing policies for Government services.

Technical assistance by an expert in public sector management was provided to the review committee by UNDP between late 1996 and 1998.

Progress in implementing the public sector reform program was slow. Corporatizing the Broadcasting and Information Office and the Tuvalu Maritime School were the only public enterprise reforms, aside from workshops on corporate planning that were run for middle and senior public sector managers. Adopting output based budgeting was delayed.

A 1998 review observed that the governance environment was sound by regional standards, but went on to note that

- (i) the effectiveness of the public sector could be improved;
- (ii) the impetus for public sector reform had waned because of election-induced delays, practical constraints on imple-

- mentation capacity, reconsideration of public enterprise reform, and a lack of capacity for coordinated action; and
- (iii) the future large windfalls of revenue from DotTV could pressure the ethical conduct of politicians and government officials (Mellors 1998).

These three observations applied with greater force in 2002, by which time the civil service had grown well beyond the level targeted in the public sector reform program.

The 1998 review concluded that there was need to upgrade both the capacity to brief Cabinet on technical aspects of cross-ministry submissions, and Cabinet's capacity to monitor and drive implementation of its key decisions and priorities. Also, DCC's functioning and understanding between ministers, permanent secretaries, and special ministerial advisers of their roles and responsibilities both needed improvement—especially in governance issues. The latter concerned basic matters, such as ministries ceasing to prepare annual reports for tabling in Parliament.

The review further concluded that there was need to

- (i) clarify ministers and public servants roles in directing public enterprises;
- (ii) improve procedures for appointing boards and management; and
- (iii) implement public sector reform for promoting private sector development, given that the private sector identified slow decision-making and administrative action in the public service as major concerns.

The 1998 review recommended

- (i) adopting a leadership code;
- (ii) introducing nonstatutory guidelines to standardize current practices for release of public records;

- (iii) agreeing to the annual release of accountable allowances and outstanding imprests for politicians and others;
- (iv) establishing an independent body to review office holders' pay and conditions;
- (v) enacting an Audit Act and introducing a requirement for ministers to report to Cabinet on responses to audit management letters;
- (vi) adopting peer group review of the Audit Office;
- (vii) developing guidelines for preparing annual departmental reports to Parliament;
- (viii) coordinating annual "bids" for overseas travel and approving an annual travel program;
- (ix) disclosing details of individuals' overseas travel expenses;
- (x) running seminars on working with ministers and secretaries; and
- (xi) clarifying and communicating the role and tasks of special ministerial advisors.

In January 1999, Cabinet endorsed all these recommendations and by 2002 an Audit Act was drafted but not passed. Otherwise, there has been no follow-up action. However, output-based budgeting has been attempted, as discussed in the next section.

Public Financial Management and Budgetary Reform

Public financial management is the means by which resources are collected and allocated under society's economic and social choices. It is therefore central to implementing development policy and plans; and considerable effort worldwide has gone into making it a better tool (Premchand 1999). These efforts reached Tuvalu in the mid-to-late 1990s as a performance-oriented technique of output-based budgeting. This Section includes

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- (i) a brief background discussion of budget formulation and implementation, including audit; and
 - (ii) an assessment of the effectiveness to date of budgetary reform.

Note that an important requirement of effective public financial management is employing a medium-term perspective, and this remains largely absent.

Budget Formulation and Approval: As explained in Chapter 2, the budgetary process in Tuvalu focuses on core and noncore programs, and adopts a 1-year time horizon. MFEP's Economic Research and Policy Division projects tax revenue for a forthcoming fiscal year, which is the calendar year. These projections concentrate on underlying revenue, which is assumed to grow at the trend rate of inflation (3.4%) and the population growth rate (1.2%). The plausibility of the assumption appears unquestioned. The addition to underlying revenue of the average automatic distribution from the Tuvalu Trust Fund (TTF) then generates an estimate of core revenue available for funding essential expenditure. This approach to revenue estimation has evolved as an understandable response to the uncertainty of sources of Government revenue other than taxation, and the relative size of these sources. However, the uncertainty should not be overstated and does not alter the need for a multi-year estimation of all revenue if the link between policy and expenditure is to be strengthened.

The tax revenue to GDP ratio has risen from 16% in 1996 to 23% in 2001, which is close to other countries in the region. As noted in Chapter 2, import taxes (duties plus sales tax) are the main source of taxation revenue, accounting for 55% of taxation revenue between 1996 and 2001. Previous analysis indicates that these taxes are mildly regressive, with the most adverse effect on the lowest income earners. This result is inevitable, given that the sales tax applies to all goods, and some basic commodities like clothing and footwear have high tariffs, and some luxury goods have low tariffs (Economic Insights 1997).

A progressive income tax structure tends to offset the regressive import taxes. Income tax is not payable on the first \$2,600 of income, with a rate of 30% applying thereafter.

Historically, the overriding objective in budget formulation has been to maintain essential or core expenditure at a level equal to or less than core revenue. This has underpinned aggregate fiscal discipline, but is not conducive to efficiency in resource allocation or structural adjustment. Planned core expenditure constituted between 33% and 45% of total planned expenditure from 1996 to 2001, and was almost entirely current spending. In 2001, for example, the core program in principle isolated and protected almost 100% of staff costs, all travel and communications costs, 76% of planned maintenance spending, 58% of spending on goods and services, 63% of operating grants and transfers and, confusingly, 4% of special expenditures. Core capital expenditure was just 4% of total planned capital expenditure.

Noncore, domestically-financed expenditure is determined by windfall revenue from external current grants, fishing and telecommunications licenses, DotTV marketing, and so-called surplus TTF distribution. Between 1998 and 2001, this revenue, supplemented by draw-downs of reserves, financed special development expenditure equivalent to 23% of total expenditure. External capital grants financed extra-budgetary (XB) expenditure that accounted for 22% of total expenditure during the same period. A 3-year rolling public sector investment program (PSIP) is presented in the annual budget papers, but this is essentially a shopping list of projects to present to external funding agencies. Most projects are listed in the first year of PSIP, and there is no estimation of maintenance and operating expenses. The lack of integration between current expenditure and investment expenditure programming means that noncore investment projects are undertaken that have implications for core expenditure in later years. The most conspicuous example is the new hospital project for Funafuti, due to begin in late 2002 (Chapter 5). This project was not listed in the PSIP for 2001-2003, and no estimation of the implications for recurrent costs was made during the project planning stage.

Rather than adhere to the established practice of core and noncore budgeting, the Government should consider the alternative of preparing a realistic, unified budget that consistently employs a standardized expenditure classification system. This would allow greater efficiency in resource allocation. Improvements in this area at base require strengthening Cabinet-level and interministerial arrangements, and coordinating current and capital expenditure by line ministries. It would also simplify the presentation of budget papers. These currently include a summary budget framework that excludes XB expenditure, and summary tables at national and ministry levels for core and total expenditure by broad class of expenditure. The presentation is familiar to the initiated, but is not user-friendly. It is important to emphasize that contemplating changes to budget formulation should be part of a general reexamination of public financial management that emphasizes getting the basics right (see Budgetary Reform below).

MFEP presents the budget framework to Cabinet, which approves it and establishes expenditure ceilings that are communicated to line ministries through a budget circular, typically issued in August. Line ministries are invited to prepare their budgets based on the circular's guidelines, which include a requirement to present submissions in an output-based format. A process of negotiation between MFEP and line ministries then occurs, out of which a revised draft budget is prepared for DCC to consider before submitting it to Cabinet. Once endorsed by Cabinet, the budget is sent to the legislature, usually in November, and the Minister of Finance makes a budget speech to the House. Parliamentary approval is normally granted before the beginning of the fiscal year with little, if any, review and discussion.

Budget Execution and Reporting: Systems and procedures are formally in place to ensure compliance with the budget, but there are weaknesses in the cash accounting system arising from a lack of reconciliation of accounts produced separately by MFEP's Treasury and Budget divisions (the divisions having been created by ministerial decision in 1996), and also from occasional failure to ensure transactions are recorded accurately (see the Internal Controls and Audit subsection

below). Systematic comparisons with bank statements are not made, and would be complicated by the Government operating 24 accounts at the National Bank of Tuvalu (NBT). The Commission of Inquiry (2000) noted "the practice of reconciliation or the balancing of accounts by Treasury is no longer used or in practice." Cash management has been a weakness, although efforts were made in 2001 to establish a more effective cash planning function in MFEP. Since privatization of the Government Supplies Store in the early 1990s, ministries have undertaken their own procurement, which is an arrangement that can lead to corrupt practices in a nonregulated environment.

There are many budget amendments during the fiscal year, which are more likely a reflection of poor initial budget preparation than of reasonable operational flexibility. Virements (transfers between line items) are common; and can involve the deliberate running down of essential line items to strengthen the case for a supplementary appropriation. Determining the effect of these virements on the priorities of the budget would require careful investigation. In the first 9 months of 2001, there were 27 supplementary appropriations, and some additional expenditure for which no appropriation had been made (TTF Advisory Committee [TTFAC] 2001). It appears that expenditure ceilings are soft.

The budget reporting system is of limited effectiveness. Managing the implementation of the budget would benefit from more frequent and reliable reports on cash flows and budget execution reports detailing (possibly revised) appropriations and expenditures at each stage of the expenditure cycle (commitment, verification, and payment). An annual appropriation report is not prepared, but the Public Finance Act 1978 specifies that within 6 months of the end of the fiscal year (or longer if approved by Parliament), the Minister of Finance is required to submit to the Auditor General "accounts showing fully the financial position of Tuvalu." The Act specifies that these accounts are to include

- (i) a statement of assets and liabilities;
- (ii) a statement of receipts and payments by heads, and other receipts and payments;

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- (iii) a comparative statement of actual and estimated revenue, by subheads;
 - (iv) a comparative statement of actual and estimated expenditure, by subheads;
 - (v) a statement of special funds' balances, by annual and aggregate receipts and payments;
 - (vi) a statement of other ledger balances;
 - (vii) a statement of balances on the advances account from the Consolidated Fund;
 - (viii) a statement of balances on the advances account from deposits;
 - (ix) a statement of balances on the deposit account;
 - (x) a statement of contingent liabilities;
 - (xi) a statement of investments, showing the funds on behalf of which such investments have been made;
 - (xii) a statement of outstanding loans made from the Consolidated Fund, by annual and aggregate receipts and payments;
 - (xiii) a statement of the public debt;
 - (xiv) a statement of arrears of revenue by subhead;
 - (xv) tabulated summaries of unallocated stores and manufacturing accounts;
 - (xvi) a statement of the balance of the Development Fund account by annual and aggregate receipts and payments;
 - (xvii) a statement of the balances on the clearance account;
 - (xviii) a statement of unauthorized expenditure by subhead and item showing the provision at 31 December, expenditure for the year, and the excess of expenditure over provision; and
 - (xix) a statement of balances on the remittance account.

The Act further specifies that the Auditor General has 3 months after receipt of the accounts in which to audit and certify them and prepare a report to Parliament.

These Public Finance Act requirements have not been complied

with. The 1996 and 1997 Government accounts were presented to the Auditor General, who reported "serious problems" to Parliament and did not issue certificates (TTFAC 2001, p.12). The problems largely involved incomplete and improper recording of numerous assets and liabilities (PAC 2001). The 1998 accounts had not been finalized because of problems with the ledgers and bank reconciliation that were still to be resolved. As a consequence, the 1999, 2000, and 2001 accounts could not be finalized for audit and reporting to Parliament (Tuvalu Audit Office 2001). The Public Accounts Committee has reported that this situation is "absolutely unacceptable" (Pac 2001, p.3). Urgent official action and external technical assistance are needed to deal with this fundamental governance issue. As noted in Chapter 2, accounts for 1996 to 1999 were prepared and submitted to the Auditor General in April 2002, and preparation of the 2000 and 2001 accounts started. In the absence of audited accounts, PAC and the legislature do not appear to conduct hearings to assess whether the budget has been used as approved.

The breakdown in reporting to Parliament encompasses the previously routine annual reports of ministries, which apparently have not been prepared since the mid-1990s; and there is no sign of any reporting that would be expected in an effectively implemented output-based budgeting system. There are no reports on investment/development expenditure that present expenditures by program and project, including estimated costs over the medium term. Even the well-managed TTF has not been exempt: at the May 2000 meeting of the TTF Board of Directors, it was observed that "in recent years an annual report had not been prepared" (TTF 2000, p.1).

Internal Controls Audit: Internal audit is generally considered an integral part of a management control structure to ensure effective operation of the managed entity. However, there is no internal audit function in Tuvalu's government system.

As noted, the Auditor-General fulfills an external audit function with statutory responsibility under Section 172 of the Constitution to audit the public accounts, as elaborated in the Public Finance Act. The

Auditor General is also empowered to audit all Government corporations except NBT, the Tuvalu National Provident Fund (TNPF), and the Tuvalu Media Corporation.

The Audit Office consists of the Auditor General, a deputy Auditor General, two auditors, four assistant auditors, and one clerical officer. The office works under auditing standards published by the International Organization of Supreme Audit Institutions (INTOSAI), but is hampered by inadequate technical qualifications and experience among staff, and staff shortages. During 2000, for example, two assistant auditors were away on training for the whole year, a third was ill from February to June, and a fourth transferred to another department in June. Also, one of the two auditors resigned in December 2000.

Section 171 of the Constitution provides for the independence of the Auditor General from direction or control, but in practice independence is weakened by

- (i) an employment contract that violates the Constitution and auditing standards (Tuvalu Audit Office 2001);
- (ii) a salary classification three levels below the Attorney General's; and
- (iii) an arguably inadequate budget for the Audit Office set by MFEP, rather than statutory expenditure established by PAC.

The last audit report presented to the speaker of Parliament was finalized in May 2001 (Tuvalu Audit Office 2001), and raised concerns over

- (i) the reliability and comprehensiveness of public financial data;
- (ii) the functioning of the accounting system; and
- (iii) the irregularities in the use of public funds.

Some of these concerns are summarized by selected quotations from the audit report (Box 3.1).

Box 3.1: Quotations from the Auditor General's Report 2001

"The Ministry of Finance and Economic Planning has serious problems in its accounting processes."

"It is obvious that Budget and Treasury operate independently of each other and there is no attempt to reconcile accounts."

"There is no reconciliation performed on any of [the Government's 24 bank] accounts other than the general account and that work is not up to date."

"There is no evidence that the current budget has taken these debts [from 2000 and before] into account." (The debts totaled over \$1 million).

"It is my conclusion that the Asset Registers are not complete or accurate..."

"Government is making decisions without knowing the true financial position."

Source: Tuvalu Audit Office 2001.

Audit staff visited ministries and departments to review procedures for expenditure, payroll, assets, and receipting, and unearthed these problems:

- (i) Posting of payments into vote books was incomplete at times and often reconciliation of vote books with treasury records was irregular.
- (ii) Altering carbon copies of receipts in receipt books with ballpoint or ink and without attaching original cancelled receipts was common.

- (iii) In one department the cashier signed blank receipts in advance.
- (iv) In other departments payment vouchers were not completed to follow the Financial Instructions, or were authorized by the person controlling the vote book.
- (v) There were posting errors in the Treasury Department on payroll expenses.

The Audit Office also audited three aid projects, and in two of them there was adequate overall reporting for monitoring and evaluating. The main weakness was a lack of control over the posting of entries to the Government's ledgers: "There was no reconciliation of the projects' disbursements to the disbursements recorded in the Government's ledger. The Government's accounts showed a balance greater than the correct figure in both cases" (Tuvalu Audit Office 2001). The difference was due to duplicate entries to the ledger and postings from other accounts wrongly entered to the project account.

For the third project, which was cross-ministry, each ministry assigned a different name for their segment of the project, which bore no relationship to the project name. In the Treasury accounts, nonproject transactions were recorded. "Overall Audit found it impossible to trace the transactions and records necessary to carry out this audit."

In all three project audits, Audit Office staff were unable to locate original copies of key documents in the Government's filing systems.

Finally, the 2001 Audit Report noted that fraud cases, some involving senior civil servants, had been reported to the Audit Office and passed on to the police. No investigations were complete at the time of the Report.

The Auditor General's summary conclusion was that "The poor state of accounting in Government is largely caused by a lack of qualified accountants." Commenting on the accounts for 1994 to 1999, PAC concluded that "the breakdown of the accounting system contributed enormously to the inefficiency and ineffectiveness of the Treasury

Department...[and that] carelessness was another factor" (PAC 2001, p.2). PAC went on to recommend more formal and on-the-job training in accounting for Treasury staff.

Budgetary Reform: The cash-based, line-item budgeting system is to ensure financial compliance, but is subject to the common criticism that it is input-oriented and therefore does not help link government policy objectives with the budget. Various performance-oriented budgetary reforms to overcome this issue have been attempted in many countries since the 1950s, and have been the center of wide debate. The specific variety of reform introduced to Tuvalu by expatriate consultants in the late 1990s was the most ambitious: output-based budgeting.

The rationale for attempting output-based budgeting was to help link policy and expenditure, and to introduce performance orientation into the civil service. But this best practice technique seems to have been introduced without adequate diagnosis of the existing situation in public financial management, and by erroneously assuming that establishing a performance orientation necessarily required a major change in the budget system. Moreover, costs of introducing the new system were not explicitly weighed against the purported benefits.

Evidence presented above suggests that in the existing situation there was still considerable room for improving basic management information and accounting and reporting systems, and that there was a severe accounting capacity constraint in Government. Put alternatively, there was need for better performance in budgeting as practiced, and an essential element was training in accounting. To attempt output-based budgeting in this context was to strain administrative and technical capacities further, for the "data requirements, methodological difficulties, and demands on implementation and monitoring capacity are vast" (Schiavo-Campo and Tommasi 1999, p.68). There was a risk that the effort would be unsuccessful and even counterproductive, as Hemming (1999, pp.52-53) has suggested in his general evaluation of performance-oriented budgetary reforms in the Pacific:

While some Pacific Island countries...have introduced selected best practices of fiscal management, these may have made excessive demand on local absorptive capacity, with essential good practices having been crowded out in the process [good practices include unified budgets, medium-term budget frameworks, and improved accounting and financial management systems].

There is no guarantee that the adoption of some best practices of fiscal management ensures that...even the most basic requirements of fiscal transparency...are met. Moreover, if these basic requirements are not met on a fairly broad and consistent basis, this could significantly compromise the effectiveness of best practices.

At the outset there also seemed to be logical confusion between the end of improved performance by Tuvalu's civil service and the means of output-based budgeting. Performance in public administration is a complex and contentious issue (Schiavo-Campo and Sundaram 2001, pp.649-671); but it is clear that performance can be improved without adopting performance-based budgeting. Quantitative and qualitative performance indicators can be employed and perhaps used for benchmarking (making comparisons of organizational performance over time or with other organizations). Appropriateness is defined by the criteria of clarity, relevance, economy (data availability at reasonable cost), adequacy as a means of assessing performance, and monitorability (Schiavo-Campo and Sundaram 1999). Where performance indicators are inappropriate, rely on techniques such as open dialogue with management and opinion surveys of consumers of public services. In general, efforts to improve performance should be designed as country-specific based on an understanding of the formal and informal rules of organizational behavior.

Tuvalu's National Budget 2000 was introduced as "the first comprehensive output budget." Staff in the 14 government agencies identified 128 outputs, associated sets of "program activities," and 687 key performance indicators. Costs of outputs were determined by costs of inputs.

This was the first attempt at producing an output budget, and that experience in the few countries that have adopted output budgeting suggests full implementation takes years. In 2000, Samoa was in its fifth year of output budgeting, and an independent review reported that "there is considerably more work to do," especially on reporting and performance evaluation (ADB 2000, p.68). It would therefore be unreasonable to expect that all outputs and their respective performance indicators met the appropriateness criteria mentioned above. The ministries' competencies, and presumably enthusiasm, for the task varied. Table 3.1 presents a few examples where more work would have to be done to produce meaningful and monitorable indicators set at achievable but challenging levels.

A related issue to examine is the risk of adopting indicators that could be counterproductive, especially where the quality of the activity is paramount. For example, using the numbers of in-country and overseas tours and official functions as performance indicators of the Governor General's constitutional functions being strengthened would be widely regarded as bad practice.

Also, it is unclear how much effort went into ensuring that planned inputs were sufficient to produce planned outputs. Anecdotal evidence suggests that early in the budgetary process ministries presented a list of outputs to MFEP with requests for resources that were not (and could not) be met, and with the final, lower budget allocation there was no commensurate adjustment of outputs. It was reported in late 2001 that "there appears to be little ownership by ministries of the budget process" (TTFAC 2001, p.9).

Finally, the monitoring and reporting task was so large for domestic capacity that it is difficult to see how it could be fulfilled. Lack of fulfillment inevitably undermines output budgeting, for there is no

accountability without management reports, variance analyses, and consequences. The risk is that output budgeting could become no more than a ritualistic grafting of an output list onto the traditional line-item budget. So, it is a concern that outputs and program activities in the 2001 and 2002 national budgets were the same as those in 2000, except that the Tuvalu Maritime School no longer appeared because it was corporatized into the Tuvalu Maritime Training Institute (TMTI).

To help formulate a strategic plan for improving public financial management, Tuvaluan authorities should seek external technical assistance for a top-to-bottom assessment of the state of the budgeting and accounting system and of options for the future. In this exercise, it would be essential for the authorities to obtain a range of diverse views, and

Table 3.1: Examples of Performance Indicators in Tuvalu National Budget 2000

Output	Program Activities	Key Performance Indicators
Cabinet transparency and accountability	Cabinet code of conduct	Cabinet makes informed decisions
	Leadership code	Cabinet is more accountable
	Monitoring of Cabinet decisions	Achieve set development objectives
	Greater public awareness	
	Establishment of formal link between Cabinet and DCC	
Inpatient care and supervision	Doctors' consultation;	Reduced inpatient days
	outpatient & clinic; surgery;	Reduced diseases incidence
	obstetrics & gynaecology;	Increased primary & general health care
	medicine & paediatrics;	
	anaesthetics & intensive care; overseas referrals	
Custody of prisoners	Counseling and rehabilitation	Improved citizen upon release

Source: Tuvalu National Budget 2000.

inform themselves of a variety of actual country experiences. It would also be desirable for this to be assessed prior to the completion of new government office buildings and installation of computer systems.

Economic Policy, the Regulatory Environment, and Private Sector Development

Tuvalu's prospects for promoting private sector development (excluding subsistence economic activity) are limited by

- (i) the ultra-smallness of the local market;
- (ii) the extreme geographic and economic remoteness from major markets;
- (iii) the insecurity of property rights; and
- (iv) the generally poor service delivery by the public sector.

Formal private sector activity centers on nontraded goods and services, notably construction, retailing, and transport. Exports are very low and there is little import-replacement production. The *Kakeega's* second priority program of restructuring the economy through encouraging export-oriented private investment therefore confronted severe obstacles. Nonetheless, private sector development can be encouraged if the Government fulfils familiar core functions of

- (i) providing a stable macroeconomic environment;
- (ii) promoting education and technology;
- (iii) investing in physical infrastructure;
- (iv) investing in institutional infrastructure (law and order, property rights, contract and bankruptcy laws, and policies to promote competition and regulate imperfectly competitive markets);
- (v) providing a social safety net, including access to basic health services for vulnerable groups; and
- (vi) preventing environmental degradation.

The Government has progressed with functions (i)-(iii) and (v), with most opportunity for improvement being in functions (iv) and (vi). Function (vi) is discussed in Chapter 6. Here we focus on function (iv).

Past governments have adopted an import-substitution development strategy. In the early 1990s tariff rates of 60% on clothing and 50% on footwear imports were imposed to stimulate local production; but the one business that was established produced for export and so did not benefit from the protection given (Economic Insights 1997). Consumers suffered as a result of higher prices and in 1995 the tariff rates on clothing and footwear were reduced to 30% and 25%, respectively. Local egg and chicken production was also protected by the introduction of a 60% tariff, and further encouraged by loans from the Business Development Advisory Bureau and then the Development Bank of Tuvalu (DBT). The Department of Agriculture imported feed and an aid-funded slaughterhouse was constructed. Consumers again bore the higher prices of chickens and eggs, until production failed because of difficulties with feed supplies and day-old chicks. Subsequently, the tariff was reduced to 20% and a private hatchery started production.

The failure of these attempts at import substitution is local evidence of the relevance of the conclusion that protectionist policy generally is ineffective and costly. Tuvalu's rejection of protectionist policy is inherent in its signing of the Pacific Island Countries Trade Agreement (PICTA) in late 2001. If there were a genuine infant industry argument, production subsidies would be appropriate for encouraging local industry. But it must be noted that global experience shows that infants have a habit of not growing up. The merits of the Government's subsidy to copra producers are discussed in Chapter 6.

While tariff reform is on the Government's agenda, tax policy and administration are still to be reviewed, even though such a review is listed in the budget as an MFEP activity. Presently, company tax is payable by those whose primary source of income is a company and is levied at two rates: 30% for Tuvaluan-owned companies and 40% for foreign-owned companies. The latter rate is high by international standards and reducing it under a one-rate structure should be considered.

Additionally, a review of tax policy should contemplate introducing a tax-free threshold for company tax, just as there is for personal income tax. The absence of such a threshold acts as a disincentive to establishing companies (Economic Insights 1997).

A 1993 report on Tuvalu observed that much had been done to rectify the lack of a cohesive strategy to promote private sector development. Specifically

- (i) the Business Development Assistance Bureau was to be upgraded into DBT to provide finance and business advisory services, including project planning and market intelligence;
- (ii) a commercial center was planned to provide rental accommodation for businesses;
- (iii) a tourism development plan had been adopted; and
- (iv) a timetable for privatization had been prepared.

The report also noted that clear investment guidelines were still needed, and that other requirements included "the need to remove unnecessary regulations and licensing systems, many of which are from the colonial era and are now inappropriate" (Fairbairn 1993, p.23).

Since 1993, DBT has had difficulties (chapters 2 and 6). The commercial center has not eventuated; and the tourism development plan has remained largely unimplemented and without a successor. Progress on public enterprise reform has been limited (Chapter 4). However, a Foreign Investment Act was passed in 1996 and a Foreign Investment Facilitation Board was formed, consisting of the secretary to government, the secretaries of finance and commerce, the Attorney General, and two private sector representatives. In early 2002, revising the Act was to be considered subsequent to a task force that was half-way through formulating a national investment policy. The Government should consider requesting the Foreign Investment Advisory Service to draft guidelines for any amendments to legislation. These guidelines

would include a list of activities reserved for citizens and a list of sectors with restrictions applied (for example, local equity requirements), so that potential foreign investors could know in advance and with certainty what sectors they may invest in and under what, if any, conditions. Regulation then could occur through registration.

In general, the Government has an in-principle commitment to aligning the country's commercial legal environment with modern international practices, to attract foreign investment. It committed to this at the Pacific Islands Forum Economic Ministers' Meeting in Niue in 1999, and was to begin by reviewing all commercial laws and prioritizing areas for reform and external technical assistance. The focus in Tuvalu should be on the Companies Act and business licensing. Other areas could be examined later. These might include

- (i) labor codes for employment in the private sector, which could introduce minimum protections for a safe workplace, dispute resolution mechanisms, and employment agreements that set out the minimum terms and conditions of employment;
- (ii) consumer protection legislation;
- (iii) competition and fair trading legislation; and
- (iv) legislation to regulate persons or organizations marketing financial investment schemes, bonds, and shares.

On the issue of property rights, the *Kakeega* (GOT 1995 p.60) observes

Management of land is currently a source of confusion and uncertainty, for all sectors of the economy, Government, community, and business. The very high value put on land by owners, the customary system of land tenure, the lack of commonly accepted records, and inadequate legal institutions have meant that land disputes are common.

As a result, land is not usually collateral in securing commercial loans and is not easily leased. These constraints substantially inhibit private sector development, particularly the prospects of joint ventures with foreign investors in the export sectors of fisheries and tourism. However, as noted in ADB (1998), land is central to Tuvaluan culture and society and any freeing up of the land market has to be seen as a long-term goal to be approached gradually with what is politically and administratively feasible. The short- to medium-term need is still for the Government to ease leasehold access to such small areas of land as potential domestic and foreign investors might need, and to ensure that such property rights are secure. This will require the Government to promote land surveys, title registrations, and dispute resolution for parts of urban Funafuti.

The range and complexity of issues affecting private sector development should not obscure what the private sector in Tuvalu itself has identified as a major concern: slowness of decision-making and administrative action in the public service. Improving the efficiency of public administration is key to private sector development through reduced transaction costs.

Conclusion

Attempts to improve public administration and public financial management between 1996 and 2001 have paid insufficient attention to domestic administrative and technical capacity. Development fashions have tended to override the need to get the basics right. The mismatch between available and required capacity was exacerbated by the dispersal of the civil service following demolition of the government office building, and the departure of many civil servants to training overseas. Future efforts to improve public sector management, and specifically public financial management, need realistic designing. Developing the private sector requires greater efficiency in public administration.