



TUVALU TRUST FUND

20th Anniversary Profile

1987 – 2007



TUVALU TRUST FUND BOARD

Vaiaku, Funafuti, Tuvalu

Preface

I have the greatest honour of presenting the 20th Anniversary Profile of the Tuvalu Trust Fund, which is a testimony in itself of the Fund's success after Twenty years of operation.

Tuvalu has managed to demonstrate comfortably that a Trust Fund set up can have significant positive impacts on national budget and the economy as a whole. Although the Fund is not specifically tied to line expenditure items, it is fair to say that real per capita income (on average) and physical infrastructure of Tuvalu have been substantially improved partly due to the Fund's revenues.

The Tuvalu Trust Fund has been used as a successful model for similar funds in other least developed countries and it could not have come this far without the continuous support and dedication of Tuvalu's traditional donor partners, most notably New Zealand and Australia and I am grateful for that.

Furthermore, the Fund has also been seen as an excellent alternate mechanism for delivering untied development aid to a developing country, and one that also promotes donor harmonisation due to the way it operates. The Government therefore invites further contributions from donors into the Fund in its attempt to continue growing the Fund's capital.

In conclusion I pay my personal tribute to those who were involved in the initial formulation and setting up of this Fund which has grown into a vital cornerstone of the country's financial base.

Tuvalu Mo Te Atua.

Lotoala Metia

Minister of Finance and Economic Planning

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Executive Summary

The International Trust Fund Agreement (The Agreement) was signed on 16 June 1987 by Tuvalu, New Zealand, Australia and the United Kingdom as the original parties. Since its establishment other contributors have been Japan and South Korea.

After twenty years the Fund has clearly made a huge difference to the Government's financial position and so to economic stability and national self confidence. It has given Tuvalu a level of financial security not thought possible at Independence. It has provided an additional source of government revenue that underpins the Budget and so the whole economy.

The Fund was set up to enable Tuvalu to help finance chronic budget deficits, underpin economic development and achieve greater financial autonomy. Initial contributions amounted to \$27.1 million. The Agreement provides a mechanism for these and subsequent contributions to be held in trust for the benefit of current and future generations of Tuvaluans.

The key features of the Fund's performance have been:

- a structure for governance of the Fund that gave the original donors the confidence to invest, and has stood the test of twelve years' operations and growth.
- use of the distributed revenue to allow real increases in government expenditure particularly in the areas of education, health and island development.
- the setting aside of distributed revenue as Government savings, to build a buffer fund to provide budget support in years when the Fund itself yields a reduced investment income.
- re-investment of distributed income back into the Fund to enable larger distributions in future. Tuvalu is now the largest contributor to the Fund.

In the first twenty years of operation the Fund has grown to \$106.6 million in Market Value as at 30 June 2007. The real rate of return on the Fund has averaged 6.2 percent per annum providing \$65.7 million in revenue to Tuvalu. Of this \$24.1 million has been used to help fund budget deficits, \$29.2 million has been reinvested in the Fund and \$12.4 million is held in the CIF awaiting drawdown as at 30 June 2007.

The Government's subsequent reinvestments back into the Fund since inception raises Tuvalu's contributions to the Fund to \$29.8 million including the initial contribution of \$1.6 million. It makes Tuvalu the major contributor to the Fund, which is evidence of Tuvalu's commitment to the long term sustainability of the Fund.

The core purpose of the Fund set out by the architects was “to assist the Government to achieve greater financial autonomy in the management of its recurrent budget”. This has not been achieved due to the increased level of aid funding from donor partners particularly on capital expenditures. Despite that, the increased revenue flows from the Fund has enabled the Government to finance some of its own development projects through the establishment of the Special Development Expenditure pool in the 1998 National Budget.

Tuvalu can now face the future in the knowledge that it has a Fund which is soundly based, and well managed, advised and structured.

1. How the Fund Started

When Tuvalu achieved independence in 1978 the Government finances were difficult and continued to deteriorate. Unlike Kiribati, Tuvalu did not inherit any financial reserves from the Gilbert and Ellice islands Colony. In 1982, a preliminary approach was made to the United Kingdom to provide a “once and for all” payment in lieu of continuing direct budget support. This was turned down. A similar approach was made to Australia and New Zealand for “one-off” assistance to reduce the overdraft (estimated at \$1.5 million in 1981). This request was also declined and the Government was faced with the prospect of managing the emerging economy on ever reducing finances.

By 1984, the Government of Tuvalu had developed the concept of a “Reserve Fund”, to which Australia, New Zealand and the United Kingdom might contribute and from which revenues would be used for recurrent expenditure. In January 1985, Tuvalu presented a preliminary paper seeking comments on the concept now described a “special budget fund”. This was followed by a further paper, which was discussed with potential donors in Suva in May 1985, that outlined a proposal for a “Special Budget” or “Trust Fund”.

In October 1985, Tuvalu provided a more comprehensive submission for the proposed “Tuvalu Trust Fund” and this was discussed with various possible donor Governments. Tuvalu’s then Deputy Prime Minister and Minister of Finance visited Australia, New Zealand and the United Kingdom to press the case for the establishment of the Fund. At the meeting with the Prime Minister of New Zealand it was announced that New Zealand had agreed in principle to support the Fund, and would set aside NZ\$500,000 in its 1986-87 development assistance budget to be held in reserve pending establishment of the Fund. New Zealand also indicated that it was to consider providing a further NZ\$7,500,000 towards the Fund should other donors (particularly Australia and the United Kingdom) be prepared also to contribute.

This was a turning point in the consideration of the proposed Trust Fund. During 1986, New Zealand and the United Kingdom with the support of the United Nations Development Program (UNDP) began to refine the proposal further - identifying with greater precision the necessary size of the Fund along with the potential legal and other requirements. Australia also undertook its own investigations of possible other alternatives for meeting Tuvalu’s budget difficulties.

By mid-1986 regular meetings were being held between Tuvalu Government officials and potential donors with the need to develop a legally binding international agreement. As by now Australia had agreed to support the Fund, having set aside funding with in its 1986-87 bilateral allocation to Tuvalu, it was important that the negotiations be concluded by June 1987.

The agreement establishing the Fund was signed in Suva on 16 June 1987.

2. Key Features of the Agreement

Purpose and Objectives of the Fund

The purpose of the Fund (as stated in the International Agreement that established the fund) is to contribute to the long-term financial viability of Tuvalu by providing an additional source of revenue for recurrent expenses of the Government of Tuvalu in order to:

- (a) assist the Government to achieve greater financial authority in the management of its recurrent budget;
- (b) enable the Government to maintain and if possible improve existing levels of social infrastructure and services;

Box 1
Capital Contributions to the Tuvalu Trust Fund

The initial value of the Fund was A\$27.1 million contributed by:

Tuvalu	A\$1.6 million
Australia	A\$8.0 million
New Zealand	A\$8.3 million
United Kingdom	A\$8.5 million
Japan	A\$0.7 million
South Korea	A\$31,000

Since establishment there have been additional contributions of A\$38.6 million:

Tuvalu	A\$28.2 million
Australia	A\$6.4 million
New Zealand	A\$3.2 million
South Korea	A\$37,821

- (c) enhance the capacity of the Government to receive and effectively utilise external capital development and technical assistance;
- (d) enable the Government to meet long-term maintenance and operating costs of social and economic infrastructure and services; and
- (e) assist the Government to develop the economy of Tuvalu.

In recent years the objectives set by the Board for the fund managers has been to provide a real annual return of 4.5% on the capital while reinvesting any surpluses to build the capital of the fund to \$100 million.

Two notable features of the Fund's objectives and operating arrangements are:

- they do not tie the government use of income from the Fund to any specific type of recurrent expenditure; and
- with the limited exception of Article 20 of the International Agreement, they contain no binding fiscal principles or rules aimed at influencing the government conduct of its fiscal policy.

Article 20 of the International Agreement commits the government to, amongst other things:

- "treat all moneys received by it from the Fund as public moneys of Tuvalu and as such subject to Parliamentary appropriation and scrutiny"; and
- "maintain its practice of prudent financial management, control of expenditure and the utilisation of all reasonable opportunities for mobilising additional revenue."

Fund Management and Administration

The International Agreement for the Tuvalu Trust Fund has provided a system of governance that has served Tuvalu extremely well. There are a number of key aspects that have contributed to the excellent performance of the fund including:

- Accountability through a Board of (originally) four directors with Tuvalu in the chair and the other original parties (Australia, New Zealand and UK) providing members. Following a review of its regional programme in the Pacific, the UK withdrew from the Board in 2004. There is provision for further directors to join the Board and represent any new contributing donors. Japan, Korea ADB and EU have observer status to date.
- The Fund is managed by professional fund managers currently based in Australia. The managers are guided by a set of objectives and guidelines established by the Board in accordance with the Articles of the Agreement. At inception the Fund was invested wholly with one "balanced" Fund Manager. In 1993 the Fund was divided equally among two balanced Fund managers due to diversification considerations. In 2002, coinciding with the appointment of a new Fund Monitor, the Fund undertook a major restructuring by engaging with "specialist" Fund Managers and at 31st March 2007, the Fund was invested in 10 different asset-class specialist funds.

- Monitoring of fund performance is carried out by The Fund Monitor, currently Watson Wyatt Australia Pty Ltd (consultant actuaries), whose brief is to regularly review the investment performance of the fund managers against that of other fund managers and report to the Board on a three monthly basis. In 2005, by a resolution of the Board, an Investment Committee was established to review in detail the reports of the Fund Monitor and make recommendations to the Board on practical steps to be taken.
- Auditing of the fund is undertaken by international auditors – presently Ernst and Young.
- An Advisory Committee - which regularly evaluates and monitors the impact of the Fund on Tuvalu and provides economic reports to the Government and the Board. The committee meets bi-annually in Tuvalu for about 10 days. It reviews the Government's budget and provides advice on macro and micro economic issues in a similar way to an IMF Article 4 mission. Members of the Advisory Committee originally represented the original contributors to the Fund with one member each nominated by Australia, New Zealand, United Kingdom and Tuvalu. In 2003 following its regional aid review, the United Kingdom's representation on the TTFAC was ended.



- A Secretariat - which provides administration services to the Board. This role was played by the Secretary of Finance up until 2004 when a fulltime officer was recruited by the Board.

The structure of the TTF International Agreement offers a unique partnership between Tuvalu and donor Governments with Tuvalu benefiting in many ways. Tuvalu gains access to very experienced and highly qualified people at almost zero opportunity cost on a regular basis. These include fund managers, board directors and financial and economic advisors on the TTFAC.

The TTF

The capital of the Fund is held in the TTF. This is invested primarily in Australia in a diversified portfolio of assets (through specialised products) reflecting the requirements of the Fund to:

- maintain the real purchasing power of the Fund; and
- provide a regular stream of income to the Government of Tuvalu.

The fund managers have certain discretion as to the asset allocation of the Fund to meet the objectives and manage the risk of the various asset classes. Assets range from high return, high risk growth assets such as shares to low return, low risk defensive assets such as cash and fixed interest.

From inception until September 1996, the Fund's the asset allocation was 45 percent growth and 55 percent defensive. Since then the asset allocation has changed a number of times and as at 31 December 2006, this allocation was 65 percent growth and 35 percent defensive. This move to a stronger growth orientation follows the successful establishment of the Consolidated Investment Fund (CIF) formerly known as the B Account, to act as a buffer to smooth out investment value fluctuations. With the comfort provided by the CIF the TTF could be restructured towards more volatile, but higher yielding long term investments.

The following chart shows the TTF allowable investment ranges and benchmarks for the asset allocation as at 31 December 2006 as agreed between the Board of Directors of the Fund and the fund managers.

TTF Asset Allocation (%)
as at 30 June 2007

Asset Class	Minimum	Maximum	Benchmark
Australian Equities	13.0	21.0	17.0
International Equities (hedged)	11.5	19.5	15.5
International Equities (unhedged)	11.5	19.5	15.5
Property	3.0	11.0	7.0
Hedge Funds	6.0	14.0	10.0
Total Growth Assets	45.0	69.0	65.0
Australian Fixed Interest	16.0	24.0	20.0
International Fixed Interest	3.5	11.5	7.5
Australian ILB	3.5	11.5	7.5
Total Defensive Assets	23.0	47.0	35.0

Central to the operation of the fund is the requirement that the capital of the fund be maintained in real terms for inflation. Only in very exceptional circumstances would the capital of the fund be considered to be drawn down by the Government of Tuvalu. In the 20 years that the Fund has been operating this has never happened. At the end of each financial year on 30 September, the Advisory Committee calculates the maintained value of the fund based on the Australian Consumer Price Index (CPI). If the market value of the fund is greater than the maintained value, then the difference is automatically distributed to the Tuvalu Government and placed in the CIF. This income is referred to as the automatic distribution from the Fund. If the value of the Fund falls below the Maintained Value then no distribution is made until the Fund once more exceeds its Maintained Value

The Consolidated Investment Fund (CIF)

From the beginning of the operation of the Fund it became clear that there was a need to provide a mechanism for holding distributions from the TTF until they were required to be drawn down into the budget. In 1991, the CIF was formally established for this purpose.

The CIF funds are managed by the Fund Managers. Firstly this was as cash deposits, but subsequently using the same asset allocation as the A Account. In the September quarter, 1996, restructuring of the asset allocation the CIF was moved back to cash based assets only from the 45 percent growth and 55 percent defensive assets used for some years. As at 31 March 2007, the CIF is invested in a Barclays Global Investors Managed Cash Fund.

The CIF was originally known as the B Account (with the TTF referred to as the A Account) and from 1996 this has been referred to in the Government's Budget as the Consolidated Investment Fund to identify it more closely as belonging to the Government of Tuvalu. This distinction is important as although the TTF belongs to the people of Tuvalu it is held in trust and is therefore subject to the terms of the Trust Fund Agreement. The Agreement protects the principal of the Fund, and secures the distributable income from the Fund for the use of the Government. On the other hand the CIF, consisting of unspent distributions, can be used by the Government as it sees fit, subject to Parliamentary appropriation.

Box 2 Administration Costs

Expenditure including Secretariat charges, bank charges, audit fees and the Management fee amount to 0.8 percent of the net assets of the Fund.

Uses of the Fund

In the period since the Fund began to 30 June 2007, \$65.7 million has been made available to the Government which allocated it as follows:

Recurrent Budget expenditure	\$24.1 million
Re-invested in the TTF	\$29.2 million
Held as a buffer in the B Account	\$12.4 million

Funds drawn down from the CIF into the Government budget are fungible as there is no specific allocation of this revenue to particular classes of expenditure. Unspent balances in the CIF represent Government savings, and may be re-invested in the Fund by returning them to the Fund, or carried forward to the next fiscal year.

Winding Up Provisions

The Agreement allows for the winding up of the Fund under certain circumstances.

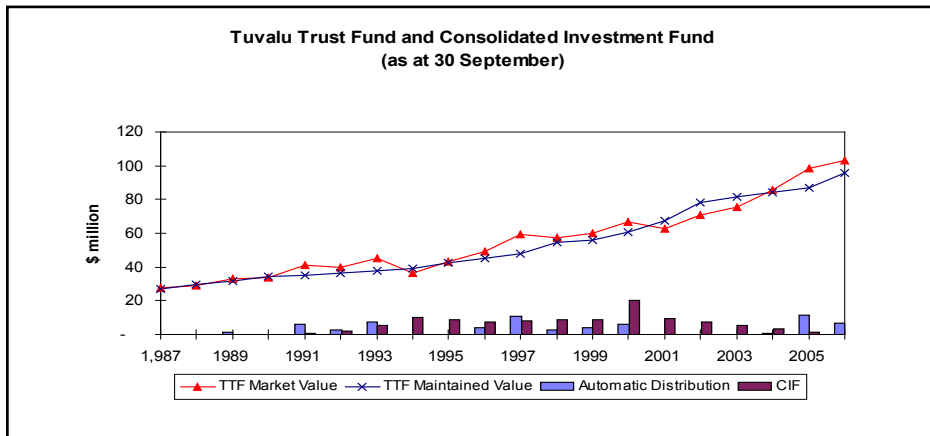
The size of the CIF balance has been the subject of considerable debate because of the conflicting objectives of maximising the drawdowns into the Budget and maintaining a smooth flow of revenue for the Budget over time. A number of different formulas have been used by the Government in the past to work out a Target Minimum Balance of the CIF. Recently the Government has adopted a formula based on 4 times the Fund's return objective of 4% p.a. above CPI (i.e. 16% of the TTF's maintained value of the TTF, which is \$15.4 million for 2007). This would allow the CIF to provide the equivalent of 4% of the TTF's maintained value a year for a period of four years.

3. Fund Performance

Growth of the Fund

Over the twenty year history of the Fund, it has achieved an average rate of return of 9.3 percent per annum. Over the same period the Australian Consumer Price Index has risen by 3.1 percent per annum. Thus the average real rate of return on the Fund to date is 6.2 percent per annum. This has, on average, been comfortably in excess of the target rate of return of CPI plus 4.5%.

The chart below shows the growth of the market value and maintained value of the Fund since 1987 (the lines) plus the amounts distributed to the Government and the balances of the CIF (the columns). This chart illustrates the volatile nature of the market value of the Fund relative to the steady rise in the Maintained (real) Value. Over the period there have been only ten years in which the market value has significantly exceeded the maintained value thus enabling a sizeable distribution to be made. In contrast there were five years in which the market value was actually below the maintained value and thus no distribution was possible. The chart also illustrates how the Government has built up the CIF to act as a buffer against years when there was no distribution. This is particularly seen in the years 2000 through 2004 when the impact of the collapse of the dotcom boom and the events of 9/11 caused global capital markets, and the returns on the Fund, to decline



¹ Note that the distributions from the TTF shown in the chart are lagged by one year as this is when they are reflected in the Budget.

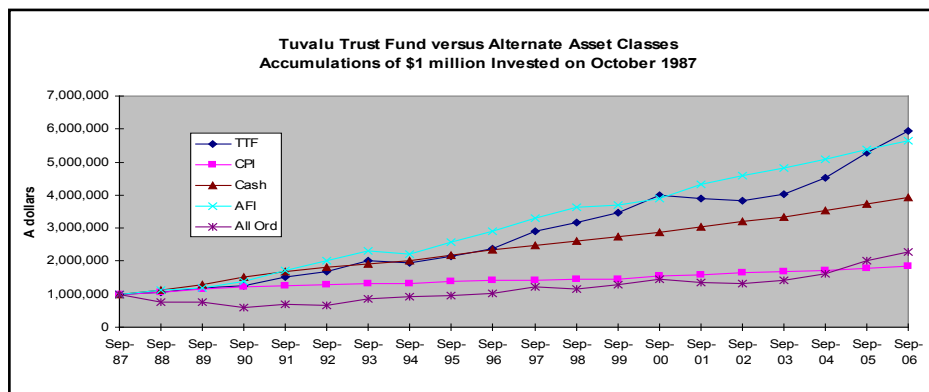
² The relatively small number of births, and very much smaller number of deaths, mean that there may be wide fluctuations in year to year ratios.

The prime objective of maintaining the real capital value of the fund has been comfortably achieved and significant distributions have been made to the GoT. One of the Fund's objective when it was first set up was to reach a value of A\$100 million. The Fund's market value reached this target in September 2006. As at 30 June 2007, the TTF's Market Value was A\$106.6 million¹ and its Maintained Value estimated at A\$99 million.

While the average annual distribution over 20 years has been \$3.3 million, in 1988, 1990, 1994 and 2001 - 2003, there was no distribution as the market value was less than the maintained value. On the other hand, the largest distribution was in 2005 at \$11.4 million. These large fluctuations highlight the importance of the CIF as a mechanism to even out distributions¹.

Comparative Returns

It is difficult to compare the returns on the Fund to other funds because of the unique objectives and resulting asset allocations of the Fund. It is possible, however, to compare the returns from the Fund to returns from particular asset classes. The chart below compares the A Account with alternative asset classes based on accumulations of \$1 million invested on 1 October 1987.



One million dollars invested in:

the TTF yields	\$5.9 million
Australian Fixed Interest (AFI)	\$5.7 million
Cash	\$3.9 million
Australian shares (All Ord)	\$2.3 million
Consumer Price Index (CPI)	\$1.9 million

These relative returns illustrate a number of features of investment risk and return.

The first point is that the Australian share market collapsed within days of the formation of the Trust (the October 1987 share crash) thus wiping \$406,600 off the nominal \$1 million. Because of the unfortunate timing of the start of the Fund the cumulative returns from the share component of the portfolio only surpassed inflation in early 1996.

Secondly, these returns illustrate the investment adage that the past is not a reliable indicator of the expected absolute level of returns in the future. For example, the chances are low for a sharemarket crash being followed by high fixed interest returns in the next ten years. Because of these uncertainties in market performance it is prudent to take a conservative approach to budgeting on the performance of the Fund.

³ Recurrent Revenue excludes TTF Distributions

4. Tuvalu's Economic Performance

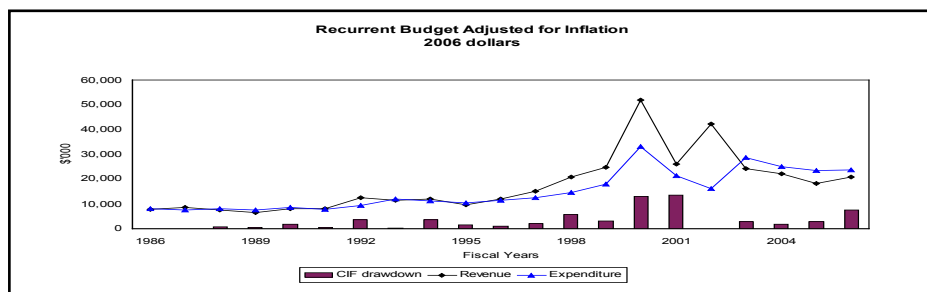
Fiscal Management

In the years prior to the formation of the Fund Tuvalu faced an increasingly difficult financial environment. In 1983 Tuvalu and the United Kingdom agreed that the phasing out of budgetary support over a 16 year period would begin in 1987. Without an alternative source of financial support Tuvalu faced a bleak future. At independence Tuvalu inherited negligible financial reserves. The country had a very narrow economic base and relied heavily on the British Government's budgetary support to maintain a minimal level of services.

In 1986, the year prior to the formation of the Fund, the Government's Recurrent Revenue² amounted to \$3.8 million. Twenty years later (2006) the Revised Estimate for Recurrent Revenue, excluding grants and distribution from the TTF, was \$20.8 million an increase of \$17.0 million or roughly 550%. After allowing for inflation this means revenue increased by 230.4%.

Over the same period the Government's Expenditure has risen from \$4.1 million to an estimated \$23.8 million. After adjusting for inflation this amounts to a real increase of 255.5 percent.

The chart below shows the progress that has been made in the recurrent budget, with all values in 2006 dollars. Revenue excludes the automatic distribution from the TTF.



During the period 1986 to 1997, recurrent expenditure remained around A\$10 million in 2006 dollars. Over the same period revenues almost traced the expenditure trend. In 1998 the Government experienced a significant increase in recurrent revenue as a result of high fisheries license fees. In the years 1999 to 2002, revenue continued to be substantially higher than average as a result of higher revenues from both fisheries and dot.tv.

Higher recurrent revenue, on top of higher distributions from the TTF, contributed to the significant rise in recurrent expenditures in the late 1990's and early 2000's. When recurrent revenue declined to more sustainable levels in 2003 to 2006, recurrent expenditure did not decline at the same rate, resulting in *recurrent* budget deficits over the same period.

In the first twenty years of the Fund's operation the average annual contribution from the Fund to the budget was \$3.3 million, in 2006 dollars, which represents an average of 21 per cent of total Government recurrent expenditure.

Development Budget

Records obtained from the Aid Management Department of the Ministry of Finance only reflect projects funded by donors and administered through the department but exclude a significant amount of major projects administered by the donors themselves. Major projects funded through developmental budget have included: sealing of the airport runway and new terminal; port reconstruction at Vaitupu; high school redevelopment at Vaitupu; earth satellite communications for outer islands; new classrooms on six islands including the capital, the Government's new office building, new hospital and powerhouse on the capital.



While donors' support has continued over the years, the increased revenue available from the Fund has enabled the Government to begin funding its own development projects. This was unthinkable at the time the fund was established



but it shows how quickly Tuvalu has moved in terms of its financial strength. In 1998 the government established the Special Development Fund (more commonly known as the Special Development Expenditure (SDE) pool) in the National Budget. This

has enabled Tuvalu to become a major contributor to its national development programme. The most notable projects that were funded under the SDE pools over the years includes FTF contributions of \$8.9 million (paid between 2000 and 2005), the Electrification of Outer-Islands (\$1 million), road and runway reconstruction on the capital (\$9.5 million), counterpart contribution to DBT's loan from EIB (\$300K), and the upgrading of TTC (\$1.2 million). The Government was able to meet those expenditures from the consolidated fund which was fed by general revenues, grants and transfers from the Tuvalu Trust Fund.

Falekaupule Trust Fund and Outer island development

A key obstacle that has stood in the way of island development has been the small amount of money under the direct control of island Governments. Through the success of the TTF the Government has been able to allocate considerable resources to the setting up of a fund specifically for island development.

The Government, after consulting widely with island leaders, implemented a devolution programme with the longer-term financial and technical support to come from the Falekaupule Trust Fund (FTF). While similar to the TTF in some ways a big difference is that the island communities will control the FTF. This fund is for the exclusive benefit of the island communities and for the exclusive purpose of island development. Another important difference is that the TTF was set up to fund the recurrent budget while the FTF is designed to fund development in a broad sense including maintenance and local training.

In the FTF recurrent expenditure is excluded except for these two areas. The success of the TTF has allowed it to fund development, although this was never expected by the designers.

As at 30 June 2007, the FTF's market value stood at \$25.3 million. After eight years of operation, the FTF has made three distributions totalling to \$4.7 million. A Reserve Account was established in 2005 having the exact same purpose as the CIF, which is to smooth out the stream of revenue from the main investment. At 30 June 2007, the FTF's Reserve Account was \$1.4 million.

Social and Economic Indicators

GDP

In the 14 year period from 1988 to 2002 GDP at Factor Cost grew at 8 per cent per annum in real terms.

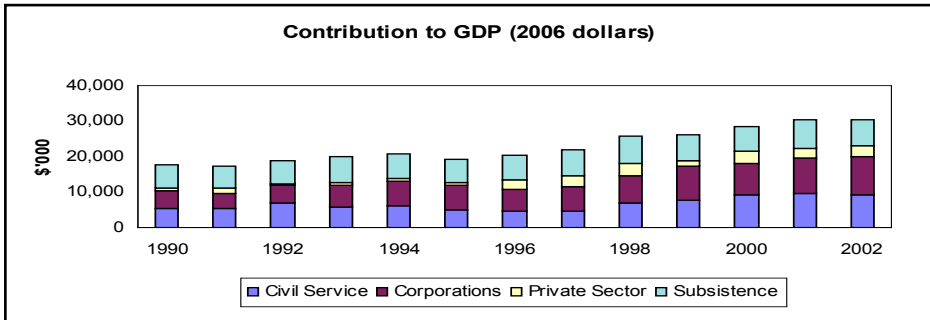
Over the shorter period from 1990 to 2002 GDP grew at a real rate of 6.1 per

cent per annum in aggregate. Within this the contribution to GDP by the Public Corporations grew by 10.0 per cent while the Civil Service contribution grew at 5.8 per cent in real terms. The Private Sector grew by 17.2 per cent and Subsistence by 1.5 per cent (see chart).

The Private Sector posted the highest growth over this period, although its contribution remains relatively smaller compared to other sectors.

CPI

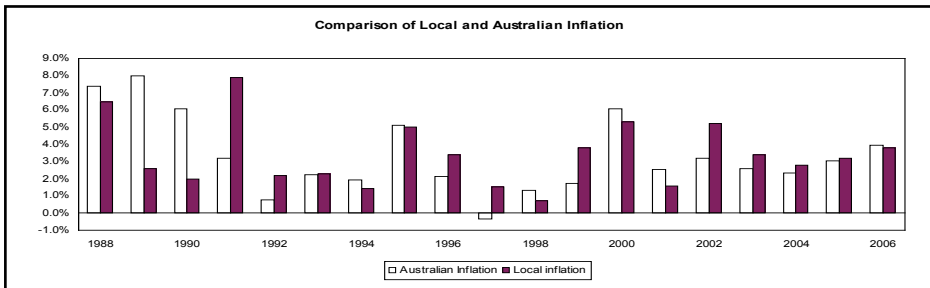
Most goods and services in the cash economy are sourced from Australia and thus price changes are largely determined by changes in the prices of imports from this source. The chart below shows the annual percentage change in local



inflation compared with the Australian Consumer Price Index (CPI). Over the period from 1988 to 2006, the average annual increase in prices in Tuvalu was slightly less than in Australia at 3.1 per cent compared with 3.8 per cent.

Population and Environment

Population growth of Tuvalu residents from 1991 to 2002, excluding Tuvalu residents temporarily overseas (de facto), was about 0.5 per cent per annum which is significantly lower than many other Pacific Island countries but is not greatly out of line with many industrialised countries.



Over the same period the population density increased from 353 to 373 people per square kilometre, although it varied from island to island with Funafuti being the highest at 1,610 people per kilometre. The 2002 census showed that while the Funafuti population had increased by 17%, outer islands population had decreased by 2.6%.

The dependency ratio of Tuvalu's resident population rose from 80 in 1991 to 82 in 2002. This means that there were more young people (0-14 years old) and old people (60+) compared to those in the working age (15-59). Furthermore, the dependency ratios of the Outer Islands were considerably higher than those of Funafuti. These figures therefore suggest



that more and more people of the working age are moving to the capital or overseas in search of paid jobs. Halting or reversing the absolute declines in the populations of many outer islands, together with the increasing dependency ratios of those remaining, are key policy targets for the Falaekaupule Trust Fund and the government's overall development policies.

The Kakeega II recognizes that one of the key issues and challenges for Outer Islands development is the decline in outer islands economic activity while for Funafuti the major issues are related to rising population and deteriorating environment. The Kakeega II calls for the creation of more employment opportunities and generally making the Outer Islands more attractive places for young people to live by improving standard of services available. The proposed installation of internet facilities in the Outer Islands in 2007 is one such activity.

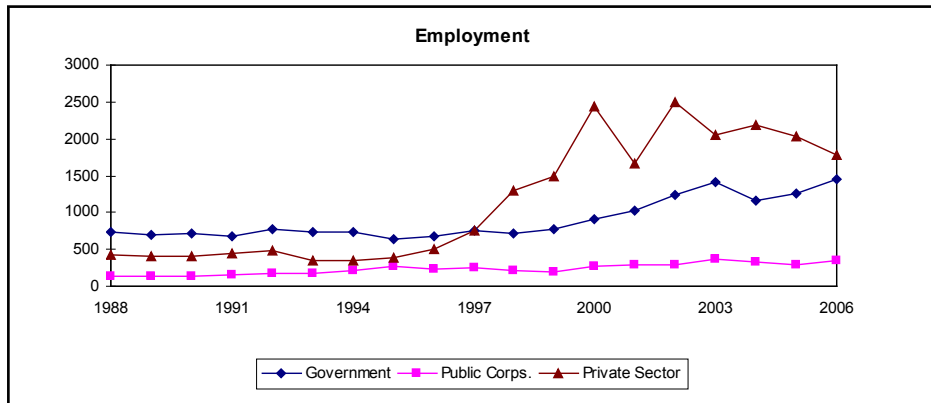
Employment

Using Tuvalu National Provident Fund members as an indicator, total number of paid jobs in Tuvalu remained static in the period 1988 to 1996 at around 1300. However the level of employment began to increase rapidly in 1997 and in 2002 it peaked at 4,031. In the eighteen years to 2006, total employment rose by an average of 7 % per annum, however most of this growth took place in the period 1996 to 2005 where the average rate of growth was 11.6% pa.

Records obtained from seafarers recruiting agencies showed that the average number of seafarers working on ships at any one time was 474 in 2001 and 413 in 2004 but fell sharply in 2006 as a result of discipline problems. Seafarers do not make compulsory contributions to TNPF therefore their non-consistent voluntary contributions results in the fluctuations in the Private Sector's share

of the labour market from 1999 onwards. It is also important to note that TNPF records shows that voluntary contributions from seafarers significantly increased between 1997 and 2000 which directly impacted the increased Private Sector's share of labour market during that period onward. In 2006, Private Sector accounted for 50% of total employment, leaving the Government's and Public Corporations shares behind at 40.3% and 9.9% respectively. It should also be noted that a number of large Government projects have been implemented in recent years, which contributed to the higher share of Private Sector construction employment.

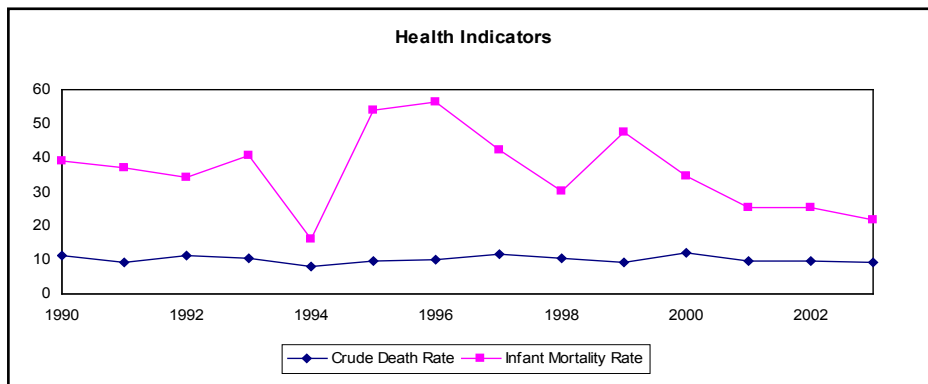
Both Government and Public Corporations employment rose at steady rates of 4.5 and 6.3 per cent per annum respectively between 1988 and 2006.



Health

Primary health care, including the promotion of family health (maternal and child care), family planning, immunisation, sanitation, nutrition and basic curative services are provided by government down to the community level. These services are delivered by a network of clinics on the outer islands and the central referral hospital on Funafuti. Government services are backed up by Non Government Organisations (NGOs) such as the Red Cross and the Tuvalu Family Health Association.

High priority goals such as universal immunisation have been achieved. The crude death rate remained relatively low from 1990 to 2003, averaging 10.1 persons per thousand per annum. Over the same period, infant mortality rates have been brought down to average 36 per thousand live births³.



Education

The national education system comprises 12 primary schools, two secondary schools, nine community training centres and a marine/technical training institute. There are also 13 pre-schools, managed by local communities and the University of the South Pacific (USP) Extension Centre. Government primary schools are free. Most post-secondary education is carried out in New Zealand, Australia and Fiji. Tuvalu recognises that developing the education system is a long process, but there are many short to medium term strategies that can yield significant benefits that improve education. The Kakeega II strategies are aiming to achieve better managed, maintained, equipped and resourced schools which can very quickly lead to higher teacher and pupil motivation, and consequently improved quality of education.

Enrolments at primary schools have risen from 1,004 in 1986 to 2,010 in 2005 an increase of 100 percent. At the same time the Government has managed to significantly reduce the teacher ratio from 25.5 in 1986 to 19.5 in 2005.

Secondary enrolments have risen from 280 in 1986 to 593 in 2005 an increase of 112 percent. In addition, many students are selected to go to Fiji for their upper secondary education. At the secondary level the aim is to have full participation in the first four years of secondary education (years 7 to 10) plus expanded, but selective access to senior secondary school (years 11 and 12).



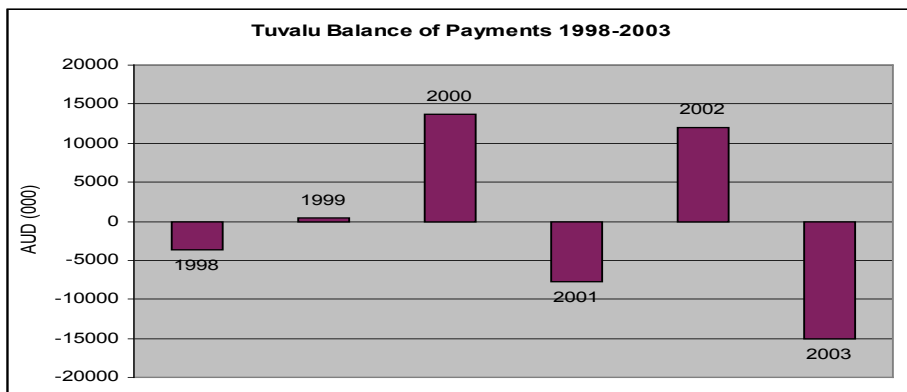
The augmented foundation, which is a bridging programme to Tertiary education (equivalent of Form 7 or Year 13) was introduced in 2004 and has since continued with great success. Secondary School leavers are given the opportunity to enter this bridging course, providing them with a better foundation to compete for a Government/AusAID/NZAID tertiary level funded scholarship.

Balance of Payments

BoP estimates for 1998-2003 indicate that Tuvalu has had an overall balance in its current account, however wide fluctuations have been recorded year-to-year. Annual balances have ranged between a deficit of A\$14.9 million and a surplus of A\$13.0 million. For the six-years to 2003 the average annual balance was in deficit by A\$0.05 million.

Fish license revenues and 'dot.tv' internet licensing and other opportunistic or so-called 'sovereignty rentals' continue to be an important source of revenue for the country representing 46% of estimated total foreign receipts. International Aid is estimated at 23% of receipts, with income earned from overseas employment (seafarers) and TTF transfers estimated at 6.5% and 8.8% respectively. Total TTF transfers to the CIF between 1998-2003 amounted to A\$19.95m.

Despite the importance placed on developing export markets, particularly in fisheries, Tuvalu has yet to see any return for the effort spent. Total exports in the period 1998-2003 represent less than 0.1% of total foreign receipts. In contrast, revenues generated through International licensing agreements are substantial but frameworks to monitor such agreements and to explore and exploit new ventures are limited. Closer monitoring of external contracts would not only alert government to any shortfall in contract performance but may provide line Ministry negotiators with information crucial for contract management, negotiation and re-negotiation.



Infrastructure

The importance of reliable infrastructure for sustainable development remains high on Tuvalu's agenda. Significant sums of aid funds have been spent on infrastructure. In recent years, EU, UK, Japan and Taiwan have been the sponsors of major infrastructure development projects. These have included the provision of a second inter-island ferry (MV Manufolau), upgrading of Motufoua Secondary School buildings, new Outer Islands Primary School buildings, new Princess Margaret Hospital II, the new Government Office Building and the new Power House for Funafuti.

Tuvalu has also contributed directly to the improvement of infrastructure by financing from its own resources the reconstruction of roads and runway in Funafuti, the electrification of Outer Islands and upgrading TTC equipment. The provision of internet services in the Outer Islands in 2007 will result in a marked improvement to communications between islands as well as between Outer Islands and the rest of the world. The existence of the Fund has also enabled Tuvalu to allocate adequate resources to maintain the numerous infrastructure developments made possible through aid funds.



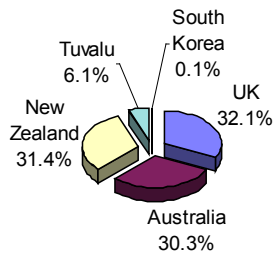
5. Commitment of Donors

Capital Contributions (Australian Dollars)							
Date	UK	Australia	NZ	Tuvalu	Japan	South Korea	Total
Opening	8,449,980	8,000,000	8,281,791	1,600,000		31,000	26,362,771
Sep-88					694,830		694,830
Jun-91			382,350				382,350
Jul-91						37,821	37,821
Apr-92				500,000			500,000
May-92		600,000					600,000
Jun-92				1,049,750			1,049,750
Mar-95				1,000,000			1,000,000
Jun-95		700,000					700,000
Mar-96				1,000,000			1,000,000
May-96				438,082			438,082
Dec-96			86,805				86,805
Jun-97				3,000,000			3,000,000
Dec-97			134,818				134,818
Jan-98				6,000,000			6,000,000
Jun-99			23,453				23,453
Dec-99				1,200,000			1,200,000
Dec-00				5,000,000			5,000,000
Feb-02				2,799,970			2,799,970
May-02				5,000,000			5,000,000
Jun-02		610,955					610,955
Jul-02			664,795				664,795
Jun-03		585,822					585,822
Jul-03			709,993				709,993
Jun-04		593,847					593,847
Jul-04			134,835				134,835
Jun-05			736,610				736,610
Nov-05		1,367,543					1,367,543
Jan-06		80,862					80,862
Jun-06		1,785,000					1,785,000
Jul-06			318,010				318,010
Aug-06				1,233,009			1,233,009
Jun-07		1,648,628.00	253,376				1,902,004
Additional Contributions	-	7,972,657	3,445,045	28,220,811	694,830	37,821	40,371,164
Total	8,449,980	15,972,657	11,726,836	29,820,811	694,830	68,821	64,831,931

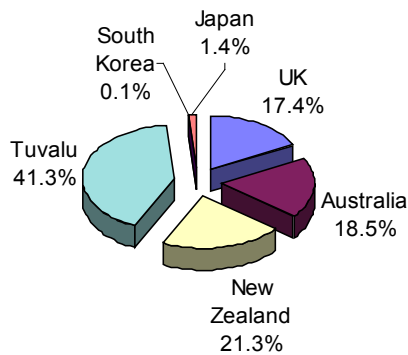
Since the initial contributions to the Fund a further \$40.4 million has been contributed until June 2007. Of this amount, \$5.7 million was made possible through counterpart matching of EU DSP funds channelled to support Government's budget over recent years Tuvalu's share of the Fund's underlying capital now amounts to 41.3 percent compared with the starting capital where the share was 6.1 percent. Reinvestment is one of Tuvalu's undertakings as set out in the agreement. The major source of Tuvalu's capital has been the reinvestment of distributions from the Fund.

The pie charts below highlight how the Fund has grown and how the shares of the various contributors have changed over the first twenty years of the Fund.

Opening Fund Contributors



Fund Contributors 2007



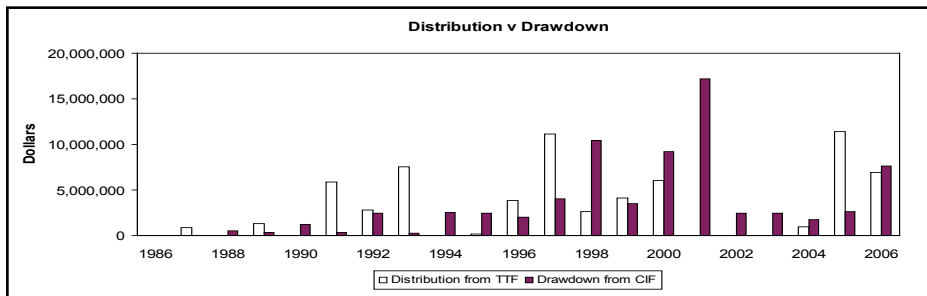
While Tuvalu has become the major contributor to the fund after 20 years, both Australia and New Zealand continued to make available additional contributions to the Fund in recent years. This is an indication that the Fund has been seen by donors as an excellent vehicle for aid delivery.

6. Tuvalu Strategy

Setting up the Buffer Account

Recognition by the Government of the need to provide a more stable flow of revenue from the Fund led to the establishment of the CIF. The objective of the CIF was to build up a buffer fund that could be drawn on to even out Government income from the automatic distributions from the Fund and highly uncertain fisheries license revenue.

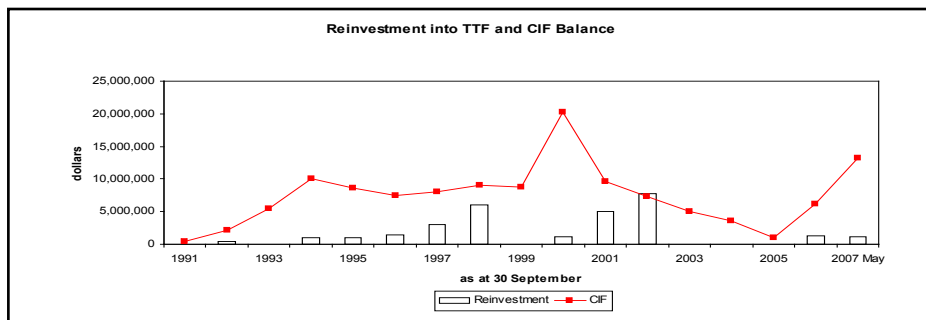
The chart below shows that the amount distributed from the Fund to the Government versus the amount actually drawdown into the Budget. The difference between the distribution and the drawdown remains in the buffer account. It should be noted that the amount to be distributed from the Fund is calculated as at 30 September each year and placed in the CIF. The drawdown from the CIF takes place over the following fiscal year (commencing 1 January). For example, in 1990 there was no distribution from the Fund. However, the drawdown into the Budget of \$1.2 million was based on the distribution from the A Account of \$1.353 million in the previous year.



Size of the CIF

When the CIF was set up in 1991 the intention was to build it up to \$10 million as this was seen by the Government of the time as an adequate buffer. By September 1994 this goal was reached as is shown on the chart below. Subsequently the buffer target was reviewed and it was decided that a lower amount may be more appropriate. In the late 1990's, a target balance was set based on the sum of the inflation adjusted drawdowns from the CIF over the previous four years, plus \$1.5 million because of uncertainty in major sources of income such as fisheries licences. The formula's deficiencies were uncovered when the CIF's actual balance became very low in 2003 to 2004 which meant the Government was only drawing down what was available. but this does not mean it was sufficient to cover Government's requirements.

In 2004, the Government adopted a new formula for the CIF's Target Minimum Balance which was set as the equivalent of 16 per cent of the TTF's maintained value. This was based on the intention that CIF's size would be sufficient to pay up to four years of "target" distributions from the TTF. As the TTF's return objective for distributions to government in any given year is targeted to be 4% of the maintained value of the TTF, the target size of the CIF should therefore be 16% of the maintained value (4% x 4 years).



Based on the TTF's maintained value at 30 September 2006 of \$96.0 million, the CIF's Target Minimum Balance for 2007 is \$15.4 million. At 30 April 2007, the CIF's balance was \$13.3 million.

7. Issues

Growing the Fund's Capital

A joint review of the Fund carried out by member countries in 2005 concluded that while the Fund provided on average 17% of Government's annual recurrent revenue from 1988 to 2004, the onset in the 1990s of recurrent budget support by way of EU and RoC grants, and substantial 'windfall' revenue from other sources meant that revenue from the TTF has represented a declining percentage of the long-term trend in total revenue and grants.

Recognising this issue, the Government is looking into inviting more additional contributions from member countries and the rest of its donor partners in an attempt to grow the Fund's size. The larger the real size of the Fund, the lower the average annual real return on the Fund that is required to generate any given level of average revenue from the Fund. This would also translate into the Fund having to assume less risk, which will result in more stable and predictable flow of distributions.

Board's composition

Following the withdrawal of the UK in 2003, the withdrawal of a second original party to the Agreement would certainly raise significant governance issues in terms of the viability of the remaining TTF Board in particular. Although none of the remaining parties to the Agreement has expressed any intention to withdraw from the Fund, the Board is nevertheless working to at least maintain the structure of decision-making and the policy advising capacity established by the Agreement.

8. The Future

Tuvalu the Major Contributor

Tuvalu's commitment to reinvest in the Fund whenever possible and to maintain the real value of the Fund per capita has resulted in Tuvalu becoming the largest contributor to the Fund after twenty years of the Fund's operation. This signals both to Tuvaluans and to the international community the confidence that Tuvalu has in, and its commitment to the Fund's longevity and to the undoubted social and economic benefits that will flow to future generations of Tuvalu.

Budget Stabilisation

The TTF has demonstrated that the Trust Fund concept for support to a national budget can have very positive benefits for a small state that lacks the resources and capacity to develop the economy by itself. An important success factor with the TTF has been the prudent approach shown by the government in its financial affairs. This is demonstrated by a discipline to produce balanced or surplus budgets year on year. In its 2007 National Budget, the Government has introduced a TTF Budget Stabilization item in its Multi Year Budget Framework, which is pitched at 4% of the TTF's maintained value at 30th September of the previous year. This is a major development in the Government's fiscal management strategies, which to some extent controls the level of drawdowns from the CIF in any given year to a much more sustainable level. The present government is also committed to building the CIF's capital to reach its Target Minimum Balance (the equivalent of 16% of the TTF's maintained value) within the next four years. This will ensure the CIF has sufficient capital to provide the sustainable level of buffer to the annual Budget for a period of up to four years. The government has also agreed with key development partners a set of fiscal benchmarks that will be closely monitored to ensure long-term sustainability in the budget and overall fiscal management. And will thus help to secure the role of the TTF in Tuvalu's long term viability and progress towards fiscal self reliance.

Tuvalu Trust Fund Directory

Board Directors

Tuvalu (Chairman)

Mr Lotoala Metia (2006 to date)
Mr Bikenibeu Paeniu (2003 – 2006)
Mr Saufatu Sopoaga (2002 – 2003)
Mr Lagitupu Tuilimu (1997 - 2001)
Dr Alesana Seluka (1989 - 1993, 1996 - 1997)
Mr Koloa Talake (1994 -1996)
Mr Kitseni Lopati (1987 - 1989)

Australia

Mr James Sweeting (2006 to date)
Ms Stephanie Copus-Campbell (2004-2006)
Dr Andrew Pope (2003 - 2004)
Mr Peter Waddell (2000 – 2003)
Mr John Davidson (1998 – 2000)
Mr Dereck Rooker-Smith (1994 to 1997)
Mr Richard Harman, acting (1993)
Mr Michael Commins (1993 - 1995)
Mr Rodney Irwin (1987 - 1993)

New Zealand

Mr Brian Bell (2003 – to date)
Dr. Patrick Caragata (1998 – 2002)
Mr Terry O'Donnell (1995 - to 1997)
Mr Brian Bell, ad interim (1993-1994, 1997)
Mr Graham Ebbett (1987-1992)

United Kingdom

Mr Lionel Yee (2003)
Mr Eroni Mavoia ad interim (2002)
Mr Savenaca Siwatibau (2000 – 2002)
Ms Valenie Hunnam, ad interim (1999)
Mr Glyn Lewis-Jones (1996 to 1999)
Mr Graham Teskey, ad interim (1993 - 1996)
H.E. Timothy David (1993-1995)
Ms Pamela Wilkinson (1991 -1992)
Mr John Hodges (1987 - 1991)

Secretariat

Mr Talavai Iona (2004 to date)
Mr Seve Paeniu (2003)
Mr Solofa Uota (2001 – 2002)
Mr Aunese Simati (2000 - 2001)
Mr Afelee Pita (1999 – 2000)
Mr Lutelu Favae (1998)
Mr Tine Leuelu (1997 to 1997)
Mr Mose Saitala (1993 - 1994)
Mr Panapasi Nelesone (1987-1992)

Fund Managers

Michael Triguboff (2006 to date)
MIR Investment Management Ltd

Angela Coady (2006 to date)
JF Capital Partners Ltd

Nick Hamilton (2006 to date)
Bell Asset Management Ltd

Mr. Richard Keary (2004 to date)
BT Financial Group Ltd

Ms. Jenny Ju (2003 to date)
Credit Suisse Asset Management Ltd

Ms. Liz Chisholm (2003 to date)
Wellington International Management Company Pte Ltd

Mr. Glen Giddings (2003 to date)
Barclays Global Investors Ltd

Mr. Mark Calder (2001 to 2004)
INVESCO Australia Ltd.

Mr. Ian Webber (2001 to 2006)
Citigroup Asset Management Australia Limited

Mr Chris Andrews (1996 to 1998)
J P Morgan Investment Australia

Mr Phillip Cormack (1992 to 1994)
Mr Lindsay Gibson (1987 to 1992)
Westpac Investment Pty Limited

Mr Mark Calder (1993 to 2000)
County NatWest Australia Investment Management Ltd

Fund Monitors

Ms Anne Whittaker (1987 to 2002)
William M Mercer Pty Ltd

Mr Sean Henaghan (2002 to 2005)
Watson Wyatt Australia Pty Ltd

Mr Dan Simpson (2006 to date)
Watson Wyatt Australia Pty Ltd

Auditor

Ernst & Young (1987 to date)

Advisory Committee

Government of Tuvalu

Mr Malcolm Ponton (2005 – 2006)
Ms Esita Morikao (2004)
Mr Talavai Iona (2003 – 2004)
Ms Sunema Simati (2001)
Mr Simeona Sione (2001)
Mr Petaia Meauna (2001)
Mr Malie Lototele (1999 – 2000; 2002)
Mr Letasi Iulai (1998)
Mr Mose Saitala (1997 to 1998)
Mr Elisaia Malua (1993 to 1997)
Mr James Conway (1996)
Mr Aunese Simati (1991 - 1996)
Mr Tine Leuelu (1994 - 1995)
Mr Stephen Boland (1994 - 1995)
Mr Tuafafa Latasi (1991 - 1992)
Mr Seve Paeniu (1989 - 1993)
Mr Garry Wiseman (1987 - 1988)

Australia

Mr Michael Hyndman (2003 to date)
Mr Garry Wiseman (1995 to 2003)
Mr Michael Grey (1994)
Mr Lindsay Shepherd (1988 - 1993)

New Zealand

David Abbott (2004 to date)
Mr Michael Hyndman (2002 – 2003)
Mr Brian Bell (1987 - 2002)

United Kingdom

Mr Tony Hughes (1997 to 2003)
Mr Stephen Pollard (1993 - 1996)
Ms Susan Jones (1993)
Mr Jeremy Clarke (1990 - 1992)
Mr David Donaldson (1987 - 1989)

Investment Committee

Mr Brian Bell (2006 to date)
Mr Tim Hennaghan (2006 to date)

Negotiators

Tuvalu

Mr Henry Naisaliw

Australia

Mr John Piper

New Zealand

Mr Rod Gates

United Kingdom

Mr Roger Baltrop

UNDP

Mr Ross Mountain

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