



Vanuatu Economic Report 2009

ACCELERATING REFORM



Australian Government

AusAID

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Abbreviations

ADB	Asian Development Bank
AusAID	Australian Agency for International Development
BPS	budget policy statement
CEDAW	Convention for the Elimination of All Forms of Discrimination Against Women
CNFC	China National Fisheries Corporation
CPI	consumer price index
CRP	comprehensive reform program
DEMCC	Department of Environmental Management and Conservation
DGMWR	Department of Geology, Mines and Water Resources
DPH	Department of Ports and Harbors
DTIS	Diagnostic Trade Integration Study
EIA	environmental impact assessment
EMC	Environmental Management and Conservation
ERC	Expenditure Review Committee
EU	European Union
FDI	foreign direct investment
GACAP	Governance and Anticorruption Action Plan
GDP	gross domestic product
GEF	Global Environment Facility
GFG	Governance for Growth
HDI	human development index
HIES	Household Income and Expenditure Survey
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
LDC	least developed country
LSF	Land Sector Framework
MAQFF	Ministry of Agriculture, Quarantine, Forestry and Fisheries
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goal
MFEM	Ministry of Finance and Economic Management
MIPU	Ministry of Infrastructure and Public Utilities
MOE	Ministry of Education
MOH	Ministry of Health
NBV	National Bank of Vanuatu
NGO	nongovernment organization
NZAID	New Zealand Agency for International Development
OAG	Office of the Auditor General
PAA	Priorities and Action Agenda
PEA	preliminary environmental assessment
PEFA	Public Expenditure and Financial Accountability
PFEM	Public Finance and Expenditure Management Act
PFM	public financial management
PFTAC	Pacific Financial Technical Assistance Centre
PGI	poverty gap index
PPA	physical planning area

PPP	purchasing power parity
PRAI	Pacific Regional Audit Initiative
PSC	Public Service Commission
PWD	Public Works Department
RBV	Reserve Bank of Vanuatu
SOE	state-owned enterprise
SRD	statutory reserve deposit
TA	technical assistance
TVET	technical and vocational education and training
TVL	Telecom Vanuatu Limited
UGMS	Urban Growth Management Strategy
UN	United Nations
UNDP	United Nations Development Programme
UNELCO	Union Électrique du Vanuatu Limited
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNICEF	United Nations Children's Fund
URA	Utilities Regulatory Authority
US	United States
VADB	Vanuatu Agriculture Development Bank
VARTC	Vanuatu Agricultural Research and Training Center
VAT	value-added tax
VCMB	Vanuatu Commodities Marketing Board
VESAP	Vanuatu Education Support Action Plan
VESS	Vanuatu Education Sector Strategy
VIT	Vanuatu Institute of Technology
VNPF	Vanuatu National Provident Fund
VTAP	Vanuatu Tourism Action Plan
VTSSP	Vanuatu Transport Sector Support Program
WHO	World Health Organization
WTO	World Trade Organization

Currency Equivalents

(As of 30 June 2009)

Currency Unit–vatu (Vt)

Vt1.00 = \$0.009438

\$1.00 = Vt105.96

In this report, “\$” refers to US dollars unless otherwise stated.

NOTE: This report contains information available as of 30 June 2009.

FOREWORD

Vanuatu has made significant economic and social gains since 2003, with the rate of economic growth averaging 6% from 2003 through 2008. Construction activity, tourism, services, and a robust real estate sector were the main drivers of this growth. The achievement of strong economic growth has occurred on the back of improved economic policy and effective fiscal management. Greater political stability has also been important, bringing with it improved investor confidence, better policy outcomes, and stronger development partner support. Continued efforts to improve the enabling environment for private sector development will ensure sound economic and social outcomes as the nation continues to develop.

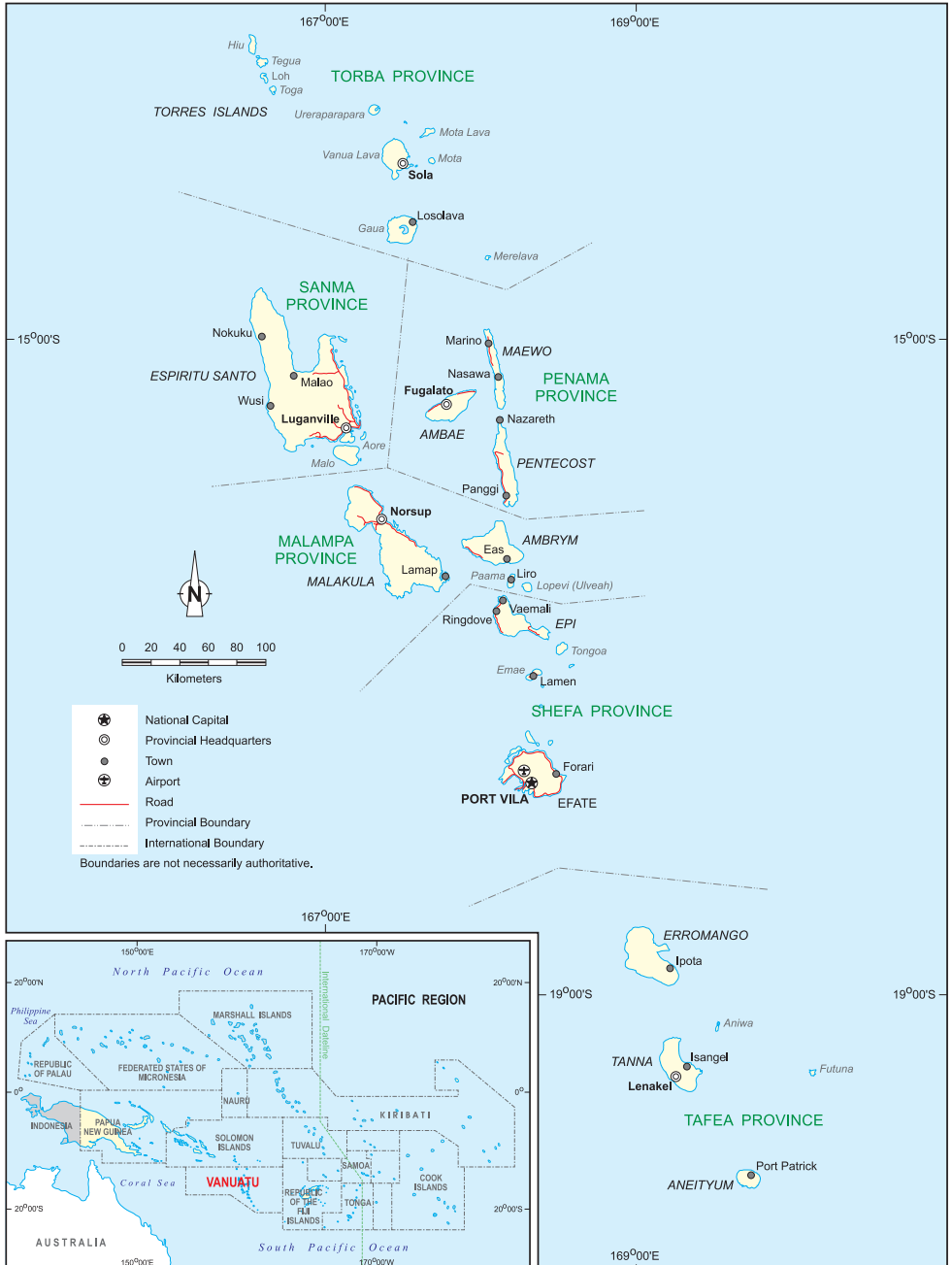
While recent gains have been impressive, more remains to be done to sustain growth, reduce poverty, and ensure the benefits are distributed throughout the nation. More than three-quarters of the population resides in rural areas, and providing services to this widely dispersed population remains a crucial challenge for the government and its development partners. Employment and revenue reform, improved governance, and the need to give greater attention to the management of the natural environment, which underpins agriculture and tourism, are among key development priorities. Quality improvements in the delivery of education services present special challenges, as does the delivery of health services. Transport and urban infrastructure are also important areas requiring urgent attention.

The *Vanuatu Economic Report 2009* outlines the state of economic and social development in the country and presents a road map for addressing key development challenges. It identifies the principal development constraints and opportunities in public sector performance, private sector and social development, and governance. The publication, a part of the Pacific Studies Series, is made possible through regional technical assistance for Pacific economic analysis

and policy development, jointly funded by the Asian Development Bank (ADB) and the Australian Agency for International Development (AusAID). The report was prepared by a team comprising Kevin Carr, Derrin Davis, David Hill, and Sally Rynveld, and benefited from peer reviews by development partners and valuable contributions by ADB staff, including Jeremy Cleaver, Elvira Rustamova, and Eugene Zhukov. The team is grateful for the assistance and cooperation provided by the Government of Vanuatu, in particular by the Ministry of Finance and Economic Management.

S. Hafeez Rahman
Director General
Pacific Department
Asian Development Bank

Map 1: Vanuatu



Source: ADB.

OVERVIEW

Introduction

Vanuatu has made significant economic and social gains in recent years. Construction activity, tourism, and services are the main drivers of its economic growth, which is underpinned by improved economic policy and effective fiscal management. But the distribution of the benefits of development, which do not reach most of the 80% of the population that lives in rural areas, remains a cause for concern.

The rate of population growth is estimated at 2.4% annually; 50% of ni-Vanuatu are under age 20.¹ Finding employment for and providing services to a rapidly increasing population will present major challenges. The urban centers of Port Vila and Luganville are experiencing high growth rates as a result of continued rural–urban migration. The provision of infrastructure and other services in urban areas is a pressing need.

Poverty of opportunity is prevalent in rural areas where health, education, and transportation facilities are limited, standards of governance are poor, employment opportunities lacking, and income and expenditure restricted. Urban incomes are higher than rural incomes, although a new class of urban poor—particularly in the peri-urban areas—is developing.

Economic and Social Setting

Vanuatu's natural resources support tourism, agriculture, fisheries, and some forestry. Subsistence agriculture is critically important as 80% of the population lives in rural areas and about 98% of rural households engage in agriculture. In rural areas, the main economic activity of 50% of the heads of households is subsistence agriculture.

1 The term “ni-Vanuatu” is used throughout this report to refer to citizens of Vanuatu, regardless of their ethnicity.

Despite improvements in its human development index (HDI) and HDI rank, increased life expectancy, and recent strong growth in gross domestic product (GDP) per capita, Vanuatu appears likely to achieve only two of the Millennium Development Goals (MDGs)—reduced maternal mortality and the reversal of major diseases—by the target date of 2015.

The issues that raise the most concern include the inequality of income distribution, the poverty of opportunity confronted by much of the population, the lack of formal employment and income-generating opportunities for school leavers given rapid population growth, and the limited access to high-quality education.

Vanuatu's economic performance, driven by tourism, real estate, construction, and assistance from development partners, has been robust since 2003. Fiscal management has been sound and some reforms introduced. Future performance depends on private sector investment. However, inadequate physical infrastructure, poor governance, an outdated legal and regulatory environment for private sector investment, corruption, and government involvement in inefficient enterprises that crowd out the private sector pose impediments to private sector development.

Sustaining Growth

Over the past 6 years, Vanuatu has achieved its macroeconomic targets for sustained economic growth, balanced budgets, sustainable external balances, and prudent debt management. Inflation exceeded the target threshold of 4% in 2007 and 2008, but is expected to fall to 3%–4% in 2009. The goal of establishing a broad revenue base presents special challenges, however, and there is a pressing need to review the taxation system, which currently relies very heavily on import duties and the value-added tax (VAT).

The economy is dominated by the services sector, which contributes more than two-thirds of GDP. Investment in economic services and in infrastructure for land development and tourism-related activities has led the way for continued growth in the sector. Agriculture is the mainstay of livelihoods for the 80% of the population living in rural areas. Commercial agriculture accounted for 16.1% of GDP in 2007; customary and traditional agriculture constituted 9.4% of the economy. But commercial agriculture is underperforming and in overall decline.

The current account deficit and the merchandise trade deficit expanded significantly from 2003 to 2008 as a result of increased construction activity, expanded transportation services, and increased private credit and consumption. Weak total merchandise export earnings underlie the current account deficit, which averaged 6% of GDP during 2004–2008. Tourism earnings and official grants have offset the declining balance on traded goods. The combi-

nation of increasing services income, official grants, private capital inflows, and the importation of project goods has resulted in a positive net balance of payments since 2002. However, increasing imports and net income outflows are expected to offset increases in tourism earnings in the short to medium term, with the current account deficit likely to widen.

The legal minimum wage is significantly above the equilibrium level, reducing employment. Given the large number of new job seekers each year, there will be continued downward pressure on wages without substantial productivity gains. Wages and salaries absorb more than 76% of the goods and services bill of the government and account for more than 60% of recurrent expenditures, so funding for operational activities and public investment is limited. Amendments to the Employment Act, passed in late 2008, will have a significant negative effect on the economy, and it is recommended that they be repealed as soon as possible.²

Vanuatu is making substantial progress in reforming many of the key areas affecting the private sector. It has made great strides in deregulating international air access, opening up telecommunications to competition, and embarking on commercial and legal reforms. However, a range of factors, such as high electricity tariffs, limited transport and other infrastructure, costly and inefficient port operations, the high transaction costs of establishing and operating businesses, and an ineffective land leasing system continue to hinder the business environment in Vanuatu. State-owned enterprises (SOEs) also crowd out private sector activity.

Private sector credit, mainly for housing, land purchases, and personal consumption, expanded rapidly from 2006 to 2008. Growth in lending was particularly strong in 2008 because a fourth commercial bank opened—leading banks to attempt to maintain market share—and because of the ongoing real estate boom. There was a consequent liquidity shortage in the second half of 2008, resulting in the Reserve Bank of Vanuatu (RBV) reducing the statutory reserve deposit (SRD) level. The Vanuatu National Provident Fund (VNPF) also has a substantial role, contributing about 40% of the liquidity in the market through term deposits with local banks. Given continued growth in the economy, it seems unlikely that further liquidity difficulties will be experienced in the foreseeable future.

Interest rate spreads are generally high in Vanuatu, perhaps reflecting the commercial banks' views on risk levels. Rural enterprises and small businesses find it difficult to obtain credit. Microfinance schemes will address this issue to some extent, and the improving telecommunications system will support wider credit availability. The recently introduced Personal Property Securities Act is an important positive step in support of private sector investment. Still,

2 Recent media reports suggest that the Government of Vanuatu endorsed the Employment (Amendment) Act in September 2009, which has slightly improved the situation.

most of the population's access to credit remains severely limited; continued efforts will be required to enhance credit availability and use across the nation. Financial sector supervision should be further enhanced by improving the oversight of commercial banks and supervision of the newly established Vanuatu Agriculture Development Bank (VADB) and the VNPF.

Fiscal discipline and economic growth have enabled Vanuatu to achieve a sustainable fiscal position in relation to external debt. The country could use concessional loan financing for investments with rates of return well in excess of the costs of borrowing. This may be a way to address needs such as improved urban infrastructure. As the global economy improves, judicious use of loan financing in critical development areas can bring long-term benefits to the nation. However, the uncertainties associated with the global financial crisis compel caution in taking on significant additional debt at this time.

To support continued growth and development, in the near term, Vanuatu should review its taxation system, including duty exemptions and poor compliance in many areas; review and streamline the government expenditure system; repeal the 2008 amendments to the Employment Law; replace trade and price controls and other regulation with a competition policy; continue efforts to provide credit to rural areas; and bring the VADB under RBV's jurisdiction.

Social Challenges

Rapid population growth, geographic isolation, and widely scattered settlements pose major challenges for the delivery of basic services in Vanuatu. More than 50% of the rapidly growing population is under 20, indicating future increases in population growth. At the same time, improvements in health have resulted in longer life expectancy, bringing a new set of challenges in health service delivery. There is a strong argument for the government to develop a national population policy.

Recent gains in health indicators include reduced infant and maternal mortality rates, improved immunization coverage, and prevention of major diseases like malaria and tuberculosis, but lifestyle changes are increasing the incidence of noncommunicable diseases such as diabetes, high blood pressure, and heart disease. Rapid urbanization is leading to overcrowding, poor housing, and lack of clean water and sanitation in many urban and peri-urban areas, especially in Port Vila, exposing urban residents to major health risks.

Health

While there have been improvements in some health indicators, service quality in rural areas is poor, mainly because of extremely weak institutional capacity at the provincial, district, and area levels. In the short term, the state will not be able

to expand the quality of services at the local level or improve them significantly. It is recommended that increased use be made of nongovernment organizations (NGOs), churches, civil society organizations, and networks to deliver primary health care. This outsourcing needs to be accompanied by capacity building and effective monitoring to ensure services meet required standards.

Increased attention must also be given to the health needs of the burgeoning urban population, particularly those living in overcrowded, unsanitary conditions in informal and squatter settlements. Lack of access to clean water, sanitation, drainage, and proper waste disposal increases their vulnerability to gastrointestinal disease, malaria, skin problems, and a range of other water- and hygiene-related illnesses.

Targeting the youth is important for the delivery of health messages related to sexually transmissible infections (STIs), drug and alcohol abuse, and unplanned pregnancy, especially in urban areas. Some NGOs are already playing a valuable role in this area, and further support needs to be directed to these groups to ensure that young people have the means to make informed choices and protect their own and others' health.

Education

The wide dispersion of the student population makes provision of education services difficult. The quality of education, particularly of teaching, demands urgent attention. Many teachers at primary and secondary levels lack any training or qualifications, and school enrollment rates are among the lowest in the Pacific. The costs of education are one reason for non-enrollment. Parents are required to pay school fees, which is a major impediment to access. The government recently announced that primary school fees are to be abolished, which may increase enrollments, but will not eliminate deficiencies in other resources, such as education materials and infrastructure.

The national curriculum requires major revision, school infrastructure and facilities must be improved, and a national education language policy must be developed.

Vanuatu's continuing low rates of adult literacy and numeracy, especially among youth and school leavers, are likely to have a significant effect on the nation's ability to take advantage of future economic opportunities. The government should therefore consider a national adult literacy campaign.

Finally, reform of the education system must reflect future human resource requirements. Technical vocational education and training (TVET) courses need to be better targeted to the demands of public administration and the productive sector. To this end, the government needs to prepare an overall national human resources development strategy, and education policies and programs should be realigned to support this strategy.

Good progress has been made in the education sector by the government and development partners in recent years. The Ministry of Education (MOE) finalized the Vanuatu Education Sector Strategy 2007–2016 (V ESS) in December 2006, which identifies investments and policy reforms throughout the education system. It provides the foundation for education sector development for the next decade, and emphasizes the need for improvements in quality, efficiency, equity, and relevance to develop a system that meets national needs and that is financially sustainable in the long term.

In addition, in 2008, the MOE and its development partners—particularly the Australian Agency for International Development (AusAID), the European Commission, and the New Zealand Agency for International Development (NZ AID)—prepared the Vanuatu Education Support Action Plan (VESAP), which outlines a sector-wide approach for support to education including resourcing, capacity building, teacher training, and refurbishment of schools. VESAP will facilitate a move from traditional project financing to on-budget support for education. External financing will be integrated with funds from the national budget appropriation and fully managed by the MOE. This will, however, require substantial strengthening of the MOE’s administrative capacity.

Employment and Livelihoods

Skills shortages currently impede economic development and limit employment prospects. The most urgent task is to prepare a comprehensive national human resource development strategy to define current and future human resource requirements. A key area for investigation will be how to ensure that education and training services are closely integrated with the country’s human resource needs, including those in the informal sector.

Youth employment must be a primary concern, with youth training programs targeted to match job opportunities. Given the rapid rate of urban growth, investment in targeted training in sectors suffering from acute shortages of skilled or semiskilled workers in the urban centers must also be a high priority for the government. Strategies to support the creation of jobs for youth, possibly including apprenticeship schemes and vocational placements, should be an important focus of the national human resource development strategy.

Private Sector and Productive Sectors

Private Sector

Vanuatu is establishing a foundation for sustained economic growth. The government has signaled its intention to make Vanuatu a more business-friendly environment for private sector development, with sound macroeconomic management and improved policies toward the private sector. Key improvements include:

- **Competition in the airline industry.** Vanuatu recently opened its air transport market to international airlines, creating competition that has resulted in significantly lower airfares and higher tourism arrivals. Recent figures illustrate the extent of this increase: international tourist arrivals were nearly 30% higher in January 2009 than in January 2008. These results reinforce the wisdom of opening the country to additional foreign airlines, and demonstrate the benefits of greater competition. In another positive step, the government is also considering options for restructuring Air Vanuatu.
- **Competition in the telecommunications sector.** The government issued a license to a foreign mobile telecommunications operator to provide services in competition with Telecom Vanuatu, the state-owned telecommunications company. This has led to a significant increase in coverage and a decrease in prices.
- **Strengthened regulation of existing monopolies.** The Utilities Regulatory Authority Act was passed recently. This act establishes a new regulatory authority to monitor the power and water concessions.³
- **Some divestiture.** The government has reduced the state's holdings in the abattoirs and indicated interest in further state-owned enterprise (SOE) reform.
- **An extensive commercial legal reform program.** The government has passed a new personal property securities law and has put a supporting electronic registry in place. It is engaged in extensive reform of the laws governing business, including the Companies Act, the Trustee Act, and the bankruptcy framework. Once completed, these initiatives will result in Vanuatu having a modern commercial legal framework that is tailored to the needs of the country and the structure of business transactions.

Vanuatu's small but robust private sector could expand significantly and make a substantially greater contribution to employment and overall economic development if the environment for private sector investment were further strengthened. The following are the principal constraints on private sector development:

- Infrastructure services are low in quality, high in cost, or both.
- Weak governance and intrusive interventions by the state, including through the operation of SOEs, reduce productivity.
- Inefficient and expensive monopolies under state ownership.
- The commercial legal framework is complex, costly to access, and out-dated in many areas.
- Access to financing is limited, particularly for small and rural businesses,

3 The Government of Vanuatu established the authority on 11 February 2008 under the Utilities Regulatory Authority Act No.11 of 2007.

although some progress is being made through microfinance initiatives and passage of the Personal Property Securities Act.

- Land access and tenure issues have pervaded development efforts and continue to present difficulties for investors.
- The government has a propensity to regulate rather than facilitate business investment.

Tourism

Tourism is the leading export industry, marked by continual growth since 2004. From 2002 to 2008, visitor numbers doubled and the average stay of multiple-day visitors increased from 8.2 to 10 days. Strong growth continued in 2009; substitution effects have been important as tourists choose Vanuatu for their holidays rather than destinations such as Thailand and Fiji. In the short to medium term, growth in visitor numbers might be limited by accommodation shortages on Efate, and the number of tourists arriving by air may plateau in 2009 or 2010 because of these shortages. Over time, the sector will need to diversify, particularly into emerging Asian markets.

The success of tourism depends on political and social stability. To make the country an easier place to visit, the government must implement economic reform, increase public investment in physical and social infrastructure, and pay careful attention to environmental management to preserve natural assets. Land issues also affect investment in the tourism industry. All these factors require the government to set the policy context and operating environment and allow the private sector to drive investment and employment. A robust enabling environment for investment and greater clarity in government policy is critical for tourism development.

The Vanuatu Tourism Action Plan (VTAP) provides a blueprint for the further development of tourism in a manner that best meets the needs of Vanuatu.⁴ It should be given high priority by the government, the business sector, and donors to ensure the further development of the country's most critical sector for economic growth and employment.

Agriculture

Agriculture is the backbone of the economy, involving all but a small percentage of the population, and is fundamental to the traditional and cash economies. It is the second largest contributor to GDP, provides commodity exports, and meets the subsistence needs of most of the population.

But the agriculture sector lacks leadership and vision, and the performance of commercial agriculture has been poor and declining. The government urgently needs to formulate and implement a national agriculture policy that

4 Government of Vanuatu, National Tourism Development Office. 2009. *Vanuatu Tourism Action Program*. Port Vila.

focuses on its core roles in regulation, extension, and research rather than market intervention and involvement in commercial activities. Donors have clearly signaled support for agriculture development activities if the government takes the lead, indicates a vision for the sector, and actively seeks such support.

While a national agriculture policy is the most pressing need, it is recommended that immediate action be taken to develop, fund, and implement a program for the revitalization of extension services in the Ministry of Agriculture, Quarantine, Forestry, and Fisheries (MAQFF). The 2008 report of the NZAID-funded review of extension services provides a sound basis on which to revive those services.

Fisheries

The core functions of the Department of Fisheries are the development of rural fisheries, sustainable management of fisheries resources, and licensing and surveillance of commercial fisheries and the sport-fishing charter boat industry. The department has prepared a number of management plans for domestic fisheries, but its ability to assist the development of domestic fisheries and its enforcement powers are limited by a lack of resources. It has, however, provided guidance for the establishment of more than 70 fishermen's cooperative associations, principally for the marketing of domestic catches.

In 2008, more than Vt144 million was collected from licensing and registration fees for offshore commercial fisheries. The department has been very successful in increasing revenues from this source, yet seeks to appropriate a greater share of resource rentals on behalf of the government by supporting onshore processing. Again, it has been successful in this initiative, with processing plants under development in Port Vila Bay and at nearby Mele Bay. The Port Vila Bay development is subject to preparation of an environmental impact assessment (EIA), while the Mele Bay plant, to be operated by the China National Fisheries Corporation (CNFC), is awaiting the outcome of an independent review of the preliminary environmental assessment (PEA) for the development but is expected to commence operations in late 2009 or early 2010.

The location of the plants, with potential for creating adverse effects on the tourism industry, vessel and wharf overcrowding, and increased pollution in Port Vila Bay and Mele Bay, has engendered concern. If a plant commences operations, it is critical that robust environmental monitoring and management plans are in place and that adequate resources are allocated for monitoring and management. The government should also consider the use of performance bonds for these and other developments that have the potential to affect the environment.

Infrastructure

Infrastructure plays a vital role in generating economic growth. For many years, Vanuatu has suffered from inadequate physical infrastructure as a result of insufficient government investment. Costs for electricity, water, and port services in Vanuatu are among the highest of all Pacific island countries. The state of infrastructure and provision of associated services in Vanuatu is mixed, although in some areas policy reform and private sector participation have reduced costs and increased efficiency through competition. The government has recently been increasing its focus on its core roles of regulation—for example, through the Utilities Regulatory Authority—and promotion of private sector provision of services, with significant positive outcomes in telecommunications and air services. It has also listed strategies for increasing the reliability, accessibility, and quality of infrastructure services in a planning matrix entitled *Planning Long, Acting Short*.⁵

Economic Infrastructure

The establishment and maintenance of transportation infrastructure is vitally important to economic growth, however challenging it may be in island nations. The three main types of transportation infrastructure required to support growth are (i) roads, wharves, ports, and jetties to anchor shipping services and link rural areas to the two major urban centers; (ii) interisland transport; and (iii) international air transport.

Vanuatu's road network is inadequate and poorly maintained. Low expenditures on maintenance have accelerated the deterioration of the roads. The Public Works Department (PWD)⁶ estimates that maintenance expenditures have historically been less than 10% of the total amount needed.⁷ The Millennium Challenge Corporation (MCC) and AusAID's Transport Sector Support Program have recently started to upgrade the road network and build the PWD's capacity to maintain it.

In the shipping sector, the domestic wharves at Port Vila and Luganville require major rehabilitation. A master plan for port and harbor development in Port Vila is urgently needed, the rural wharf network should be prioritized for rehabilitation and extension, and the institutional arrangements for management of the sector require review and reform. The government is developing a strategy for improved interisland shipping services that covers these areas (with assistance from ADB and NZAID), and is considering the potential method to subsidize uneconomic routes, through a bidding process.

5 Government of Vanuatu. 2009. *Planning Long, Acting Short 2009–2012*. Port Vila.

6 The Ministry of Infrastructure and Public Utilities (MIPU) is the main government agency responsible for providing and maintaining transportation infrastructure. PWD is one of the main departments of MIPU.

7 The annual maintenance requirement for the road network is estimated by the PWD to be Vt1.2 billion (\$11.3 million), but the allocation in 2006 was less than Vt0.1 billion (\$0.9 million).

The open skies policy and reform of the institutional arrangements for managing the air transportation sector have brought significant benefits. Continued planning for rural airport maintenance is required, and the preparation of a master plan for the upgrading of Bauerfield Airport should be given high priority.

The electricity sector is functioning well in the urban and peri-urban areas, but coverage in rural areas is poor. The Utilities Regulatory Authority (URA) should monitor the performance of Union Électrique du Vanuatu Limited (UNELCO) and pass on any cost savings to consumers. Implementation of the rural electrification plan is a priority.

All water supply infrastructure assets in Vanuatu are owned by the state.⁸ In 1994, the government entered into a contract with UNELCO to supply water to Port Vila for 40 years. The Utilities Regulatory Act regulates UNELCO and its service delivery. In rural areas, water supply is the responsibility of the Department of Geology, Mines and Water Resources. The current National Rural Water Supply Program is intended to provide potable water to the entire rural population, based on community access to water rather than individual household connections. Despite government commitment to this program, however, many rural communities still lack an adequate water supply. The Vanuatu National Water Strategy 2008–2018, prepared under NZAID funding, was recently released and endorsed by the government, but is now waiting for additional funding.

Urban Planning

Urban areas, particularly Port Vila, suffer from poor planning and development control and inadequate or outdated infrastructure. Living standards in many parts of Port Vila are under pressure from overcrowding and poor sanitary conditions, while increasing pollution of groundwater, lagoons, and nearshore areas exposes urban residents to major health risks. There is a pressing need to tackle the issues arising from rapid urban growth, to make urban areas more habitable, and to invest in urban services and infrastructure. The recently concluded planning process for Luganville was an important initiative and a first step to improved urban planning and development. A similar process will soon begin for Port Vila.

The institutional capacity of government and municipal authorities for urban planning and management, including urban development, infrastructure works, and provision of services, is extremely limited. The various roles, responsibilities, and operations of different government departments and the different levels of government—national, provincial, and municipal—are poorly coordinated. National urbanization policy and planning guidelines are needed, along with a national task force that is responsible for developing and

8 ADB. 2003. *Vanuatu: A Private Sector Assessment—Issues, Challenges, and Policy Options*. Manila.

implementing a national urban strategy. It should consist of representatives from national and local government, communities, key donors, and NGOs. There is an acute shortage of trained urban planning and management professionals, and short- to medium-term donor support is needed for institutional capacity building and technical support.

Sanitation management is a substantial and growing environmental and public health issue. There is no comprehensive sanitation infrastructure in the urban areas of Port Vila or Luganville. Both municipalities lack sewage and wastewater treatment systems. Waste is generally disposed of by illegal storm water connections, direct discharge into waterways, or poorly designed and maintained septic systems that leach contaminants into groundwater. Sanitation is, therefore, an issue that must be addressed in the very near future. Findings from the previous ADB-funded sanitation master plan should be reviewed in conjunction with any proposed new urban master plan. ADB, in partnership with AusAID and other donors, will provide assistance through the Pacific Regional Infrastructure Facility for urban planning and the provision of affordable, sustainable, and effective sanitation and drainage services to residents.

Governance

Public Sector Effectiveness

Effective and transparent governance is a fundamental requirement for successful economic and social development. Parliament and government offices, such as those of the auditor general and the ombudsman, play a central role in ensuring good governance. Budget processes and fiscal management are among the key roles of government that affect development outcomes. The relationships between the national government, provincial governments, and the municipal administrations of Port Vila and Luganville are also important. The National Council of Chiefs has a special consultative role on matters of custom and tradition under the Constitution. The National Council of Chiefs and each island council of chiefs are responsible for promoting and encouraging sustainable social and economic development in their respective islands or urban areas.

The budget process is robust, although the opportunity for public comment remains limited. In 2008, the Prime Minister's office, in collaboration with the Ministry of Finance and Economic Management (MFEM), began to prepare the budget policy statement (BPS) early in April. The aim is to ensure that government policy priorities are effectively translated into the budget process. These changes reflect the strengthening of the budget process that has been occurring in recent years. The budget for 2010 will integrate the development budget with national policy priorities. In this way, the government can align aid expenditures with its policy priorities by considering the resources of its development partners during the budget preparation cycle.

The government is committed to the principles of fiscal responsibility, and the MFEM applies the Public Finance and Expenditure Management Act (PFEM) rigorously to ensure good governance in relation to fiscal targets. As a result, the country has achieved a budget surplus in each of the past 5 years.

Tax compliance has been improved, resulting in an increased surplus in recent years, but tax and duty exemptions continue to be a drain on revenue. The country remains dependent on a narrow base for its revenue, and the government appears to have no plans for extending that base. Under these circumstances, taxation arrangements should be reviewed, particularly in light of an expected decrease in import duty receipts once various trade agreements come into force.

More than half of the recurrent budget is spent on the public sector wage bill, crowding out expenditures in the areas that could help improve the productive capacity of the economy. Most development expenditures are currently financed by aid inflows. While aid inflows are projected to remain strong over the next few years, the government should restructure expenditures to increase development spending in priority areas.

The formal accountability institutions, such as Parliament and offices of the auditor general and the ombudsman, need further strengthening. Vanuatu already is moving to strengthen the capacity of the Office of the Auditor General (OAG) and general support is being provided to strengthen law enforcement. In terms of accountability, many SOEs and statutory bodies have not submitted their accounts for a number of years. Through the Priorities and Action Agenda 2006–2015,⁹ the government has identified good governance and public sector reform as a reform focus and is working to promote such reforms with donor support, particularly from the AusAID-supported Governance for Growth (GFG) Public Financial Management subprogram.¹⁰

Land and Land Management

Under the Constitution, the rules of *kastom* (traditional culture) form the basis of land ownership and use.¹¹ Land is closely linked with heritage, power, and spirituality. It is central to all development activities whether in the public or the private sector, and it is the foundation for economic reform. But landown-

9 Government of Vanuatu, Ministry of Finance and Economic Management. 2006. *Priorities and Action Agenda 2006–2015: An Educated, Healthy and Wealthy Vanuatu*. Port Vila.

10 GFG (2006–2015) was established as a partnership between AusAID and the Government of Vanuatu with the aim of generating economic growth and improving service delivery through good governance. It is a 10-year program, allowing time for reforms to be carried out and for capacity to be effectively built. GFG supports broad-based economic reforms to benefit the majority of the population in Vanuatu and makes sensible use of technical assistance, using it selectively to support, advise, and build long-term capacity within the government. Finally, it supports capacity building to strengthen core systems of governance, particularly Vanuatu's own policy and financial management processes.

11 Under the Constitution of Vanuatu of 1980, Act 10, Article 73, all land in Vanuatu belongs to the indigenous owners and their descendants.

ers are often disadvantaged by current leasing arrangements. Investors often find that land access is a stumbling block to investment, and disputes regularly occur among landowners and between landowners and lessees.

The recently implemented Land Sector Framework was developed to provide an enabling environment for multistakeholder participation in the effective use, management, and stewardship of the nation's land resources. It provides a roadmap for land sector development over a 10-year period, based on effective oversight of land policy development, planning, and resource allocation.

State-Owned Enterprises

About 20 state-owned enterprises (SOEs) are engaged in commercial activities or the provision of public services. Many are not viable; they are inefficient and lack transparency, accountability, and a framework for monitoring performance. However, most of those involved in regulatory service provision, such as the Reserve Bank of Vanuatu (RBV), the URA, and the Vanuatu Financial Services Commission, have core roles in governance and financial and economic management.

SOEs should be restructured through the establishment of a new legal framework for SOEs and improved oversight. Reform of corporate governance arrangements is urgently needed, and as many SOEs as possible should be prepared for divestiture. It is specifically recommended that the Vanuatu Commodities Marketing Board (VCMB) be abolished.

The Environment—Vital to Livelihoods and the Economy

Vanuatu's natural environment is critical to livelihoods and is the basis of the nation's principal export industries, particularly tourism and agriculture. Yet little more than lip service is paid to environmental sustainability. Political commitment to the environment is lacking, the budget allocation to it is tiny, and the requirements of the Environmental Management and Conservation Act of 2002 are not followed. The Department of Environmental Management and Conservation (DEMC), which is mandated by the act, has not yet been established, while the Environment Unit has insufficient resources.

Population growth, rural–urban migration, real estate and tourism development, deforestation, invasive species, imported energy and transportation goods, waste disposal, runoff into bays and lagoons, and increasing numbers of tourists all cause environmental change. Environmental management should be mainstreamed in government activities and accorded strong standing in all planning and development activities, whether public or private.

The first priority is to establish the DEMC and position it in the government structure, possibly in the Office of the Prime Minister. In addition, the government should seek donor technical assistance to (i) examine sustainable environmental financing through fees, charges, and performance bonds; (ii) undertake a strategic environmental assessment; and (iii) develop a system for examining policies, plans, and programs for their environmental outcomes before their approval. Furthermore, the establishment of a National Council on Sustainable Development and the convocation of a national environment summit are recommended.

DEVELOPMENT PERFORMANCE, ISSUES, AND POLICIES

An Overview of Human Development

“An educated, healthy, and wealthy Vanuatu” is the national vision, as spelled out in the Priorities and Action Agenda 2006–2015 (PAA) (footnote 9). Significant economic and social gains have been made in recent years. Real annual economic growth averaged 6.0% from 2003 to 2008, resulting in per capita income gains and improving social welfare.¹² Construction activity, tourism, and agriculture have been the main drivers of this growth. While economic and social gains have been realized, the distribution of those benefits remains a cause of concern. Distribution issues arise at least partly because of the wide geographic spread of the islands that make up the nation. Increasing division between the agriculture and services sectors and rural–urban drift are important issues to be addressed.

Vanuatu has a population of 235,000, with an annual growth rate of about 2.4% (Appendix Table A.1). However, uncertainty remains about the true rate of population growth. The recent Vanuatu Diagnostic Trade Integration Study (DTIS) reported it as 2.9%.¹³ The 2007 Agriculture Census gave a growth rate of 2.3% for rural residents.¹⁴ This report cites a rate of 2.4% (see

12 The per capita gains were largely absorbed by substantial “catch-up” pay increases for government employees in 2007 and 2008.

13 Government of Vanuatu, Department of Trade, Industry and Development. 2008. *Vanuatu: Diagnostic Trade Integration Study*. Port Vila.

14 National Statistics Office. 2008. *Census of Agriculture 2007—Vanuatu*. Port Vila.

sections on Economic Growth, Demographic Profile, and Health). According to the Agriculture Census, there were 175,051 people in agricultural households—about 80% of the national population. Census results also show that 50% of the national population is under age 20, indicating that it is likely to continue growing at a relatively high rate. A national census was undertaken in late 2009, bringing population and other data up to date and supporting improved planning and policy analysis, particularly of service delivery.

Rapid rural–urban migration, particularly to Port Vila and Luganville, is changing the degree of urbanization. According to the DTIS, these two centers are growing at 4.0% annually, suggesting that the population of Port Vila could reach 60,000 by 2020, with many residents being young and unemployed. The strain on infrastructure and services is already evident in Port Vila. Urbanization and urban infrastructure must, therefore, be addressed with some urgency.

Disparities in incomes between urban and rural areas, coupled with better access to services in urban areas, are likely to be important incentives to internal migration. As indicated in data from the 2006 Household Income and Expenditure Survey (HIES),¹⁵ rural incomes are generally well below those for urban areas. But living costs are higher in urban areas, particularly Port Vila, with a greater proportion of urban residents below the basic needs poverty line than that of rural dwellers (see section on Development Issues).

Income and expenditures are important indicators of well-being. But “poverty of opportunity”—lack of access to basic health and education services, employment opportunities, standards of good governance, and equal opportunity across gender and age—is now considered just as important in defining the extent of poverty and hardship in a society. As the HIES data show, households in the more remote parts of the country, away from urban amenities, or in the informal settlements in Port Vila and Luganville, may lack access to basic services such as water and sanitation, or health, education, and transportation facilities.

Vanuatu has made significant gains in human development over the past decade. In 1998, its human development index (HDI) was 0.425 and its global HDI rank was 140 out of 174 countries.¹⁶ The nation’s HDI was 0.674 in 2005 for a rank of 120 out of 177 countries, placing it in the middle range of the medium human development category.¹⁷ Life expectancy increased from 65.7 years in 1995 to 70.0 years in 2008; combined gross educational

15 ADB, National Statistics Office, and United Nations Development Program. 2008. *Analysis of the 2006 Household Income and Expenditure Survey: A Report on the Estimation of Basic Needs Poverty Lines and the Incidence and Characteristics of Poverty in Vanuatu*. Port Vila.

16 An HDI below 0.5 is considered to represent “low development.” An HDI of 0.8 or more is considered to represent “high development.” United Nations Development Programme. 1999. *Pacific Human Development Report: Creating Opportunities*. New York.

17 United Nations Development Programme. 2008. *Human Development Report 2007/2008: Fighting Climate Change: Human Solidarity in a Divided World*. New York.

enrollment (primary, secondary, and tertiary levels) increased from 57.4% to 63.4%. Vanuatu's human poverty index for 2005 was 24.6%, ranking 56th of 108 developing countries.

These gains might indicate that Vanuatu is progressing well in achieving the United Nations Millennium Development Goals (MDGs). However, in its 2008 Pacific Economic Survey, AusAID suggested that Vanuatu is "off track" on the MDGs. Of all seven indicators, AusAID judged that only goals 5 and 6—reduced maternal mortality and the reversal of major diseases—are likely to be achieved by the target date of 2015.

Vanuatu's recent economic and social progress can be attributed to various factors. First, economic growth has been high by both international and regional standards. The real annual growth rate accelerated from an average of under 1.5% during 1995–2003 to an average of 6.0% during 2003–2008. Despite the high rate of population growth, economic growth since 2004 has translated into a significant increase in per capita income of close to 4.0% annually.

Second, there has been substantial real estate investment and construction activity since 2003, supported mainly by foreign direct investment (FDI) and aid flows. From 2003 through 2007, construction activity grew at a real average rate of 11.6%; in 2007 the growth rate exceeded 18%.¹⁸ This increase has been complemented by high levels of growth in the service industries, particularly those related to tourism, such as hotels and restaurants. AusAID noted that strong growth has resulted from aid-funded construction (although private sector construction activity has also been strong), tourism expansion, and growth in agricultural exports.¹⁹

Third, public spending on education has been high, averaging 9.6% of gross domestic product (GDP) from 2002 to 2005, and reaching 26.7% of total government expenditures during this period (footnote 17). These are among the highest spending levels on public education as a proportion of GDP and government expenditures in the world. However, the effectiveness of these outlays is a cause for concern (see section on Education), with little if any improvement in access to or quality of education.

Fiscal responsibility and an environment conducive to reform also appear to have underpinned development, resulting in increased support from all major donors in recent years. Net current transfers in the financial accounts are dominated by official grants. Official development assistance increased from Vt720 million in 2002 to Vt980 million in 2007, and sharply in 2008 to Vt4 billion, partly because of road building funded by the Millennium Challenge Corporation of the United States. Aid has been an important source for Vanuatu's relatively stable income, allowing for balanced national budgets and offsetting its vulnerability to natural disasters and fluctuations in world markets.

18 Government of Vanuatu, Ministry of Finance and Economic Management. 2007. *National Accounts of Vanuatu 2007*. Port Vila.

19 AusAID. 2008. *Pacific Economic Survey 2008: Connecting the Region*. Canberra.

Finally, subsistence agriculture activity is significant. As shown in the 2006 HIES and the 2007 Agriculture Census, around 80% of the population lives in rural areas and about 98% of rural households engage in agriculture. In rural areas, the main economic activity of 50% of the heads of households is subsistence agriculture, while the most important consumption category across all households is home-produced food. According to the 2007 Agriculture Census, most rural households still concentrate solely on household production. HIES data also show that subsistence production is important for urban households, although increasingly, inhabitants of Port Vila and Luganville are selling their production.

Development Issues

Despite a recent general rise in the level of human development in Vanuatu, a number of concerns remain, mostly related to the division of the economy between agriculture and services. These include inequality of income distribution; poverty of opportunity, particularly in rural areas; rapid population growth; lack of formal employment and income-generating opportunities for school leavers; declining school enrollments in the face of an increasing population;²⁰ limited access to high-quality education; and rapid but unplanned urbanization in Port Vila and Luganville as a result of accelerating rural–urban migration.

Inequality is analyzed in various ways, including through the measurement of poverty, derivation of Gini coefficients, and comparison of levels of household expenditures in different parts of the country. In an analysis of 2006 HIES data, the National Statistics Office found that overall poverty was relatively low in Pacific terms, with a national poverty gap index (PGI) of 5.6, compared with PGIs of 7.5 for Solomon Islands, 11.2 for the Fiji Islands, and 12.8 for the Federated States of Micronesia.²¹ However, the PGI for Port Vila, at 10.6, was higher than for the rest of Vanuatu, indicating a large difference between the better off and the poor. The PGI indicates that the average expenditure levels of households in poverty are much lower than the poverty line.

Similarly, the Gini coefficients calculated by the National Statistics Office indicate that income inequality is greater in Port Vila than in other parts of the nation (Table 1). The national average Gini coefficient of 0.41 is relatively low for a medium-human-development country, reflecting that income inequality is not particularly high in Vanuatu. Again, however, the figure of 0.46 for Port Vila indicates a greater level of inequality, most likely due to rural–urban drift and the increased number of settlers in the peri-urban

20 Government of Vanuatu, Ministry of Education and Youth Development and Training. 2009. *Annual Report 2008*. Port Vila.

21 The PGI is a measure of the depth of poverty being experienced by households that are below the basic needs poverty line. It indicates just how poor the poor actually are. For the method of computation of the PGI, please refer to <http://mdgs.un.org/unsd/mdg/Metadata.aspx?IndicatorId=2>

area. Increased urbanization and growth of the formal urban economy will, based on regional and international experience, result in increased inequality of income distribution (for example, Samoa experienced increased income inequality as the economy of the capital, Apia, grew).

Table 1: Gini Coefficients in Vanuatu

	National Average	Rural	Luganville	Port Vila
Gini Coefficient	0.41	0.40	0.41	0.46

Note: 0 = perfect equality.

Source: ADB, National Statistics Office, and United Nations Development Programme. 2008. *Analysis of the 2006 Household Income and Expenditure Survey: A Report on the Estimation of Basic Needs Poverty Lines and the Incidence and Characteristics of Poverty in Vanuatu*. Port Vila.

Poverty of opportunity, as previously noted, refers to the poor's access to basic services, employment opportunities, and good governance. The government is focused on improving services to rural areas, yet governance at the provincial, municipal, and local levels is hampered by capacity limitations. The provision of infrastructure services will also be important in overcoming poverty of opportunity.

Poverty occurs at different levels in different locations. For example, the cost of food and non food basic needs tends to be higher in urban areas. The per capita poverty lines, calculated from the 2006 HIES, are shown in Table 2. Based on the HIES, 6.0% of households, representing 7.4% of the population, do not spend enough to meet basic food needs as defined by the food poverty line of Vt3,064 per person per month. Nationally, an estimated 12.9% of households, representing 15.9% of the population, spent less than that needed to meet the basic needs poverty line of Vt4,716. Again, Port Vila exceeds the national average, with 27.2% of households below the basic needs poverty line, suggesting the existence of a population of "working poor." Continued drift from rural to urban areas will increasingly present challenges to policy makers who seek to address the problems faced by the urban poor.

The creation of formal employment opportunities for the rapidly growing population and increasing numbers of school leavers are also formidable challenges. Jobs will have to come predominantly from the private sector.²² The international financial crisis had had little impact on Vanuatu by early 2009. However, a lag can be expected, particularly in construction activity. If construction and tourism, which accounted for 18% of employment in 2005, both slow significantly, this will have a substantial impact on employment (footnote 19). The short- to medium-term challenges may be serious.

Table 2: Monthly Adult Equivalent Per Capita Poverty Lines (Vatu)

	Category	National Average	Rural	Luganville	Port Vila
a.	Food poverty line	3,064	2,589	3,594	5,034
b.	Estimated non-food expenditure	1,651	777	2,516	6,041
a+b.	Basic needs poverty line	4,715	3,366	6,110	11,075

Source: Government of Vanuatu, National Statistics Office. 2008. *Vanuatu: Analysis of the 2006 Household Income and Expenditure Survey: A Report on the Estimation of Basic Needs Poverty Lines and the Incidence and Characteristics of Poverty in Vanuatu*. Port Vila.

Vanuatu does not have the advantage of the high emigration rates and large remittance flows found elsewhere in the Pacific. Seasonal work programs in New Zealand, and potentially some in Australia, will contribute significantly to job creation and could eventually employ up to 3,000 ni-Vanuatu. Nonetheless, the reality is that growth in private sector employment will have to be extremely high to absorb new entrants into the workforce. This requirement is even more acute in the face of formal employment rates that are already low; according to HIES data, 75.8% of all heads of households in Port Vila are in some form of full- or part-time employment, but in the rest of the country only 15.4% of heads of households are employed. The recent amendments to the Employment Law will also present a major impediment to employment growth unless they are repealed.

With Vanuatu's high rate of population growth, there is also likely to have been an increase in underemployment; labor would be absorbed into the subsistence sector and people would work fewer hours at lower levels of productivity. The private sector must be the source of jobs for the several thousand school leavers and dropouts entering the workforce each year, as the days of public sector expansion have passed.²³

The major challenges in education are ensuring that all children of school age actually attend school and improving the quality of primary and secondary education. Education quality is compromised by resource limitations, particularly the undersupply of trained teachers (see section on Education). Official estimates put the literacy rate for people age 15–24 at around 87.0% in 1999 (the latest figure) and adult literacy rate at 78.0% in 2006, although the actual figures are likely to be much lower given enrollment and primary school completion rates. The rate of net primary school enrollment rose from 74.5% in 1989 to 78.2% in 1999 and then to 93.0% in 2004, but has since fallen to 85.4% in 2007. The proportion of pupils that complete a primary

23 No estimate is available of the number of school leavers and dropouts, although it is thought to be more than 5,000 each year.

education fell from 90.0% in 1991 to 72.0% in 2004.²⁴ But the government, with funding agencies' support, has made progress on education quality in recent years, while the Vanuatu Education Support Program will underwrite future improvements.

Challenges and Opportunities

Vanuatu has opportunities to grow its domestic economy, but it confronts impediments—some immutable and some that can be eased or removed. The principal impediments include isolation from international markets; few, if any, economies of scale; inequality of income, opportunity, and access to services; limited competition to provide services and market goods; rapid population growth that maintains pressure on service delivery; weak institutions; poor and limited infrastructure; and poor regulatory and governance arrangements.

The geographic dispersion of the nation and its population, distributed over some 80 scattered islands, presents particular challenges for internal transport and public service delivery. Because infrastructure remains generally poor, access to these services is difficult, particularly in rural areas and more isolated islands, although telecommunications access improved substantially with the arrival of a second network provider in 2008.

Like most other Pacific island economies, Vanuatu is remote from major trade and commerce centers. This puts it at a disadvantage in its attempts to use international trade to overcome the inherent limitations of its small domestic market. Shipping costs are high, not only because of the long distances between ports of call, but also because of the small and imbalanced cargo flows associated with a high merchandise trade deficit.²⁵ Vanuatu relies heavily on oil imports and its smallness imposes diseconomies of scale. The quality of public administration is also a cause for concern; skilled personnel are thinly spread across 13 ministries and a large number of departments, and many are lost to the private sector. Limited institutional capacity is also a constraint on the effective absorption of aid flows.

Like other Pacific island countries, Vanuatu may become more vulnerable to natural disasters as a result of climate change. The coastal fringe areas could experience increased erosion, storm surges, and inundation as the sea level rises, and the intensity of cyclones could well increase (footnote 25). In this event, disaster mitigation measures will become paramount.

Weaknesses in the legal and regulatory environment within which business operates, inefficiencies in the state-owned enterprise (SOE) sector (including state-owned utilities), and physical infrastructure limitations create hindrances to private sector development that could be eased. Capacity

24 UNDP. 2009. *United Nations Millennium Development Goals (Pacific) Summary Data*. Suva.

25 AusAID. 2004. *Pacific Regional Transport Study*. Canberra.

constraints also remain throughout the public service, particularly in policy analysis and development.

In contrast, the natural resource endowment constitutes a solid asset base for agriculture, fisheries, and tourism development. The nation contains significant agricultural land of proven productivity, yet the commercial agriculture sector is underperforming and has made few gains in the past 2 decades or more (see sections on Economic Growth and Agriculture). On the other hand, subsistence agricultural output has broadly increased in line with population growth. Commercial agriculture can make a greater contribution to growth, development, and employment than it does now. To do so, however, requires that it be revitalized through the development of appropriate policies, and by investment from donors and the private sector.

There are also opportunities in the tourism industry, which has proven to be robust and has expanded rapidly in recent years with significant private investment. Tourists now have greater access with the entry of Virgin Blue, and the political unrest in the Fiji Islands may have also stimulated travel to Vanuatu. Cruise ship arrivals are set to increase in the short to medium term, and infrastructure development will further support tourism growth. Public security, which is important to continued tourism development, is also generally sound. In addition, despite concerns about the development of coastal land for real estate, Vanuatu's general support for FDI has recently resulted in significant real estate development.

The social and cultural customs of Vanuatu—an attachment to custom land, to villages, to chiefs and religious leaders, and to ceremony—are a strength that underpins a level of resilience of livelihoods. The extended family system provides a high degree of food security and opportunities to subsist.

Development Policies

The Comprehensive Reform Program (CRP), commenced in 1997, was a major development initiative in response to fiscal fragility, political instability, economic stagnation, inefficient public administration, and poor social service delivery in the mid to late 1990s. The CRP was funded through a \$20 million loan from ADB, supported by technical assistance—the third and final phase of which was completed in 2005.²⁶ The CRP was designed to redefine the role of government, enhance service delivery, increase the productivity and growth of the private sector, and improve social indicators. It was an important catalyst for reform, yet it was too ambitious, particularly because Vanuatu's weak institutional capacity was underestimated, affecting its sustainability, capacity building, and the local control and ownership of reforms.

26 ADB. 2002. *Project Completion Report: Comprehensive Reform Program (Vanuatu)*. Manila.

The need for real and effective reform highlighted by the CRP remains. Public sector institutions are still confronted by capacity limitations. Inefficient and costly state-owned enterprises (SOEs) continue to operate outside the two main urban centers. Infrastructure is limited, and service delivery is little improved. A recent response to the need for meaningful reform has been the AusAID-funded Governance for Growth (GFG) program, launched in 2007. The GFG was designed and implemented with the view that “Vanuatu’s overarching development challenge is to ensure that economic performance is translated into broad-based economic opportunities and improved service delivery.”²⁷ The governance objectives under the GFG, which are critical to improved economic and social outcomes, include

- a clear and coherent national economic policy, with policy stability as a prerequisite for reduced uncertainty and risk in the private sector;
- improved policy implementation in the interest of long-term national benefit, rather than short-term political imperative;
- stronger policy content in the budget (although budget processes and financial management are relatively sound, spending priorities are poorly chosen, capital spending is low, line control by the ministries is weak, and the allocation of resources, particularly to rural areas, is a matter of concern); and
- improved policy and regulatory settings and adequate investment in infrastructure.

The government’s medium-term strategy for development is outlined in the Priorities and Action Agenda (PAA). The priorities and approach set out in the PAA are consistent with those in the CRP and GFG; the agenda’s overall objective is to link policy and planning with the limited resources under the control of the government. The priorities and goals listed in the PAA are

- creation of an environment for economic growth and employment creation led by the private sector;
- macroeconomic stability and equitable growth;
- good governance and public sector reform, with the government and its agencies focusing on their core roles;
- primary sector development (natural resources and the environment);
- provision of better basic services, especially in rural areas;
- education and human resource development; and
- economic infrastructure and support services.

There is, therefore, general agreement about what is required to improve economic and social outcomes in Vanuatu among the government, donors,

27 AusAID and Government of Vanuatu. 2007. *Governance for Growth Program: Design Document*. Canberra.

and other stakeholders in economic development, particularly the private sector. The themes implicit in the programs outlined above are elaborated in this report, although there is a greater focus on particular aspects of development in the following chapters.

Furthermore, the government has stated that it intends to pursue reform, enhanced economic management, and policy stability and predictability. It has also signaled that it will address the impediments to development and recognition of necessary microeconomic reforms in areas such as infrastructure, SOEs, land, education, and the productive sectors. It will also emphasize distributing the benefits of development more widely across the nation. The government used the goals set forth in the PAA as a starting point in developing a 4-year strategy to address specific objectives, *Planning Long, Acting Short 2009–2012* (footnote 5). To succeed in all of the areas it has identified, the government will have to overcome the present policy inertia and substantially improve policy implementation.

THE ECONOMY

Introduction

After a decade of stagnation, Vanuatu grew at an average rate of 6.0% per year between 2003 and 2008, outperforming most other Pacific developing member countries, while maintaining a relatively low inflation rate and a steadily improving fiscal position. Growth has been led by particularly strong performance in tourism and property development. Tourism-related sectors account for nearly 67% of gross domestic product (GDP) and about 70% of the increase in economic growth in recent years. Per capita GDP adjusted for purchasing power parity is more than \$3,000 and is rising sharply, after having declined at an average annual rate of 1.1% during the 1990s. Growth remained strong in 2008 at about 6.6%, driven by strong investment (gross capital investment has averaged 20% of GDP), service sector activity, and aid inflows. Inflation accelerated to 5.8% in 2008 from 4.1% in 2007, driven by higher international food and fuel prices, appreciation of the Australian dollar, and rapid private sector credit growth, although in the second half of 2008 inflationary pressures started to ease with declines in global commodity prices. Despite a volatile international economic setting, macroeconomic stability has been maintained through prudent fiscal and monetary policies. Official reserves have grown to over 5 months of import cover, well above the target level of 4 months.

Despite its rapid growth in recent years, Vanuatu's economy remains small, with 2007 GDP of Vt51.9 billion (equivalent of \$490 million) and per capita GDP of about Vt226,000 (equivalent of \$2,385 as of May 2009). It is also an open economy, with few trade restrictions, significant foreign investment in recent years, substantial imports of a wide range of goods, and reliance on a limited range of exports. The economy has become increasingly bifurcated in the past 20 years as agriculture declined in importance and the significance of the services sector, which is found almost exclusively in urban areas (particularly the capital, Port Vila), grew continuously. The economy is now heavily service based, even though around 80% of the population lives in rural areas and most depend on agriculture for their livelihoods.

A review of economic data indicates that the economy has a narrow base; in the past 5 years, tourism and hospitality services, along with real estate, construction, and financial services, have been particularly important. Commercial agriculture has stagnated; exports of goods are limited and, in most cases, declining. By contrast, imports have grown in line with the recent construction boom, the greater use of private credit, and increasing transportation services. Bilateral development aid has become increasingly important and allows the government to run balanced budgets.

Tourism is a crucial economic driver of the Vanuatu economy; visitor expenditures account for approximately 20% of GDP and an estimated 4,700 jobs.²⁸ According to the World Tourism Organization, tourism also accounts for approximately 75% of foreign exchange in the country (footnote 4). Total visitor arrivals increased by more than 100% from 2002 to 2008, with cruise ship arrivals increasing by more than 110% during that period and continuing to increase in 2009. More than 75% of visitors to Vanuatu are holidaymakers, and survey work undertaken in 2007 indicated that tourists spent about Vt17.9 billion (equivalent of \$169 million) that year. Tourism and its importance to the economy are discussed further in the section on Tourism, where the trends in visitor numbers and earnings are outlined and a broader view of the sector is considered. The narrow base of the economy, coupled with its openness and the high level of imports, means that Vanuatu is vulnerable to changes in international demand, commodity price movements, and changes in taste in an area such as tourism. Structural adjustment remains limited, and government policy initiatives must be formulated in recognition of this fact.

Macroeconomic Targets

Macroeconomic stability and equitable growth are adopted as crucial strategic goals in the PAA. In its 2009 budget policy statement (BPS), the government's highest policy objective is "to maintain economic growth and the well-being of ni-Vanuatu in a way that is financially sustainable and does not jeopardize future economic growth." Under the Public Finance and Expenditure Management (PFEM) Act 1998, the government is required to pursue policies that ensure that borrowing is kept at manageable levels, maintain government assets in good condition, manage fiscal risks, and maintain stable and predictable tax rates. The long-term fiscal objectives, according to the 2009 BPS, are as follows:

- Maintain a positive recurrent budget balance (estimated at 0.9% of GDP for 2009).

28 TRIP Consultants. 2008. *MCA Vanuatu Tourism Survey: Baseline Study*. Brisbane. This study was undertaken for the Millennium Challenge Corporation to prepare baseline data for monitoring and evaluation. A follow-up survey is planned for 2010.

- Establish a broad revenue base with sufficient revenue to ensure a balanced budget (recurrent revenue is forecast at 19.9% of GDP in 2009).
- Ensure that recurrent expenditures support a balanced budget outcome (recurrent expenditures are forecast at 19.2% of GDP in 2009).
- Manage debt at prudent levels (total public debt is forecast to be 19.0% of GDP in 2009).
- Keep the average annual rate of economic growth above population growth (economic growth is forecast by the government at 3.8% in 2009).
- Keep inflation, as measured by the consumer price index (CPI), below 4.0% per annum (inflation is forecast at 3.0%–4.0% in 2009).

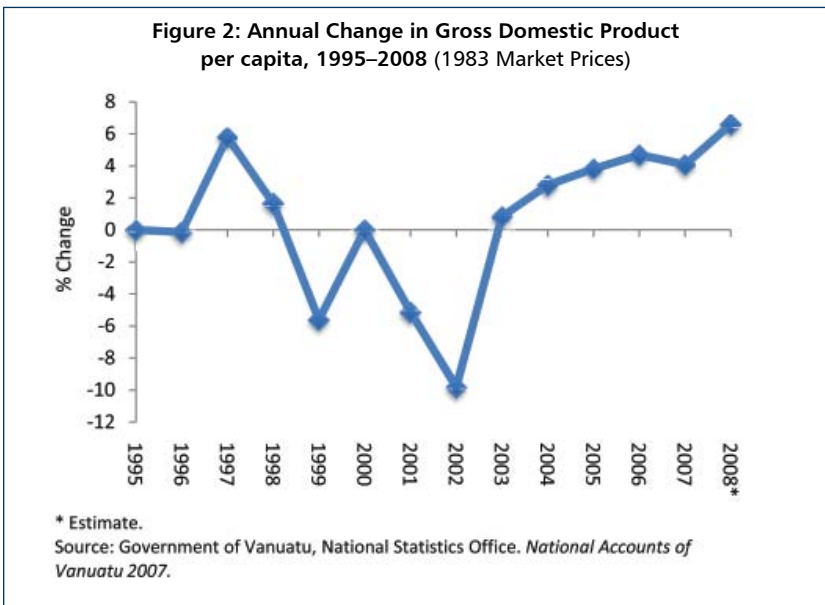
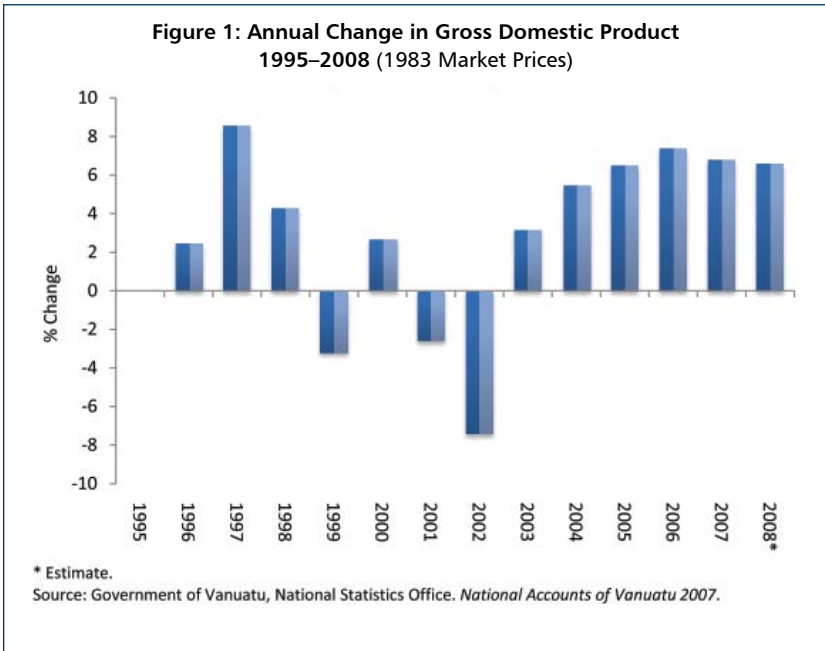
The government has achieved its macroeconomic targets in the recent past, although the fiscal position is sometimes affected by spending through supplementary budgets. This happened in 2007, although even then a surplus of 0.3% of GDP was realized. Prior to 2003, however, economic performance was volatile and typified by low or negative growth. Despite the recent solid performance, there are still challenges to maintaining favorable economic and social outcomes.

Economic Growth

From 1995 to 2002, economic growth was extremely volatile; the economy suffered a real economic contraction in this period (Figure 1). This volatility resulted from the narrow, agriculture-reliant base of the economy; international commodity prices; exchange rate movements; Vanuatu's vulnerability to natural events such as cyclones; and political instability. From 1995 to 2008, real growth ranged from a high of 8.6% in 1997 to a low of -7.2% in 2002 (Appendix Table A.2). Not surprisingly, GDP per capita tracked economic growth, with significant declines between 1997 and 2002 (Figure 2). The average rate of growth in real GDP per capita from 1997 to 2008 was 0.8%, supported by strong growth since 2005. As shown by its economic performance in recent years, Vanuatu can maintain an economic growth rate that is consistently at or above the rate of population growth. Greater political stability and improved economic management have been important factors in its robust economic performance.

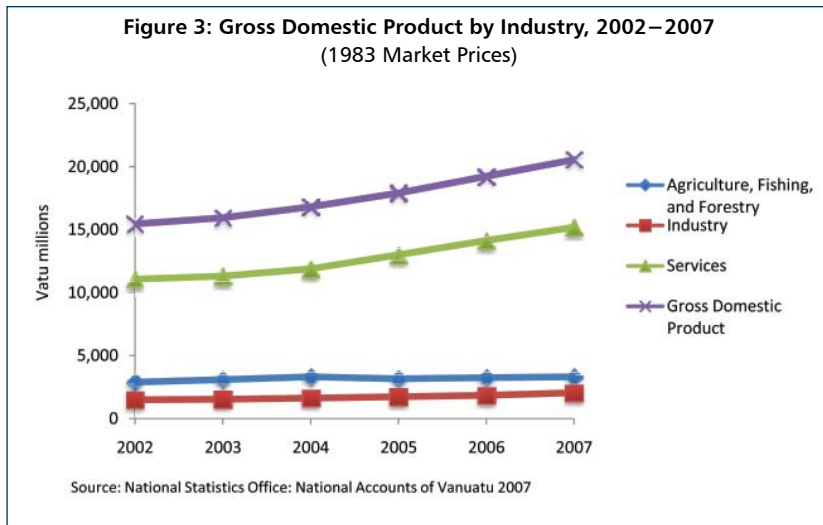
From 2003 to 2008, Vanuatu experienced very strong growth, which averaged 6.0% per annum. The Ministry of Finance and Economic Management (MFEM) estimated real growth of 6.6% in 2008 and forecasts growth of 3.8% in 2009. Sector contributions to economic growth in 2007 are shown in Appendix Table A.2 and summarized in Figure 3 and Table 3. Further improve-

ments to the enabling environment for private sector investment, coupled with political stability, will place the economy on a sustainable growth path over the medium to long term, a path that will support the nation's population.



Notwithstanding these positive outcomes since 2003, Vanuatu faces the policy challenge of achieving greater economic stability than in the past (through continued attention to reform, greater policy stability, and improved policy predictability) and ensuring that the benefits of growth and development are distributed throughout the nation.

While GDP is a useful measure of the market value of goods and services produced in the economy, it provides no information about the distribution of growth or its benefits. The current government has indicated that it will focus on decentralizing government services, relocating its human resources or using them more efficiently, but this does not guarantee an equitable distribution of development benefits. Improved infrastructure, better telecommunications since the introduction of competition in 2007, the open skies policy, and the current formulation of provincial tourism strategies are all initiatives that will, to some extent, promote economic stability and enhance the prospects for an improved distribution of the benefits of development.



The economy is dominated by the services sector, which has been the main driver of growth in recent years. The sector grew by a total of 37.3% during 2002–2007. The Reserve Bank of Vanuatu (RBV) noted that economic growth in 2007 was driven by services and the construction subsector.²⁹ In 2007, the services sector grew by 7.4% and contributed 73.9% of GDP (Appendix Table A.3). Investment in economic services and infrastructure for land development and tourism-related activities led the way for continued growth in services. The hotels and restaurants subsector grew by 13.4%, mainly as a result of a

29 Reserve Bank of Vanuatu. 2008. *Annual Report 2007*. Port Vila.

19.3% surge in visitor arrivals. Transport and communications expanded by 13.1%, largely due to expansion in postal and telecommunications services and land transportation services, particularly buses and taxis. Telecommunications expanded by 16.8% because the introduction of a second provider resulted in increased competition and further development of telecommunications infrastructure. Real estate activity grew by 7.7% in 2007, but may be more affected by the international financial downturn than other subsectors in the short to medium term. The increase of 5.4% in government services was associated with the salary increases received in 2007.

**Table 3: Sectoral Composition of Gross Domestic Product
(constant 1983 prices) (%)**

	2002	2003	2004	2005	2006	2007
Agriculture, Fishing, and Forestry	18.7	19.3	19.7	17.7	16.8	16.1
Custom/traditional agriculture ^a	11.0	11.0	10.6	10.2	9.8	9.4
Export agriculture ^b	6.6	7.4	8.2	6.1	6.1	5.8
Other commercial agriculture ^c	0.5	0.5	0.4	0.5	0.5	0.4
Forestry and logging	0.6	0.6	0.4	0.9	0.5	0.5
Industry	9.6	9.7	9.7	9.7	9.7	10.0
Manufacturing	3.7	3.7	3.7	3.7	3.5	3.4
Electricity and water	2.7	2.6	2.5	2.5	2.4	2.4
Construction	3.3	3.4	3.4	3.6	3.8	4.2
Services	71.6	71.0	70.7	72.6	73.5	73.9
Wholesale and retail trade	31.4	30.5	28.4	29.7	31.0	31.2
Hotels and restaurants	5.8	5.1	5.5	5.5	5.6	6.0
Transport and communication	9.4	9.5	10.4	11.1	11.2	11.9
Finance and insurance	7.5	7.9	8.0	9.0	8.9	8.5
Real estate and business services	6.5	7.1	7.9	8.1	8.4	8.5
Government services	13.8	13.8	13.2	12.6	11.8	11.7
Personal services	1.0	1.0	0.9	0.9	0.9	0.9
Domestic services	0.9	0.9	0.9	0.9	0.8	0.8
Less imputed bank service charge	(4.7)	(4.8)	(4.5)	(5.1)	(5.2)	(5.6)
Gross Domestic Product	100	100	100	100	100	100

() = negative number.

a Includes production of fruit, vegetables, kava and other food items, livestock, and poultry, as well as fishing and household forestry activities.

b Includes copra, kava, beef, cocoa, and coffee.

c Includes fishing, poultry, fruit, and vegetables.

Source: National Statistics Office. *National Accounts of Vanuatu 2007*.

Agriculture is the mainstay of livelihoods for the 80% of the population living in rural areas. The sector accounted for 16.1% of GDP in 2007, with traditional agriculture contributing 9.4%. However, commercial and export agriculture have shown significant volatility. The sector as a whole grew by only 14.3% from 2003 to 2007. Export agriculture declined by more than 20.0% in 2005, expanded by 6.4% in 2006, and made a minor gain of 2.4% in 2007.

With a growing population, the desire to distribute development benefits more widely, and the need to keep the export base as broad as practicable in a small economy, the government must formulate a national agriculture policy to support subsistence and commercial agriculture and to facilitate investment in the sector. However, it is critical for the government to focus on its core roles and not become involved in commercial activities. A robust agriculture sector will support growth and welfare, although it is unlikely to be the main driver of economic activity in the coming years.

Industrial production, including the national power and utilities monopolies, contributed 10.0% to GDP in 2007 and grew by a total of 38.1% from 2003 to 2007. The major source of growth in the sector has been construction, which grew by 18.3% in 2007. This subsector remained strong in 2008 and will be stronger still in 2009, but is then likely to fall away quickly as the projects currently in the pipeline are completed. The manufacturing subsector grew by 4.2% in 2007, largely as a result of increased demand for wood products for building construction and the reopening of the coconut oil factory in Santo—formerly operated by Coconut Oil Production (Vanuatu) Limited—by the local company CL Agencies. Most manufacturing occurs under sole proprietorship arrangements; the subsector is unlikely to see substantial growth in the medium term. The fish-processing plant opening in 2009 under Chinese ownership on Efate will contribute to manufacturing to some extent. Increased demand from the domestic, industrial, and commercial sectors resulted in growth of 6.6% in the electricity and water subsectors.

The economy is continuing to undergo structural adjustment; the agriculture sector is declining in relative importance and there is strong growth in the services sector, particularly in those subsectors related to tourism. Such a trend is typical of modernizing economies and indicates the success of economic reforms such as the open skies policy and the opening of the telecommunications sector to competition. These adjustments reduce the economy's reliance on a narrow resource base and its vulnerability to uncertain commodity export prices and weather-related shocks. More remains to be done, but with a reform-oriented government, change can be accelerated and the environment for development, particularly for private sector investment, can be significantly strengthened.

Exchange Rates, Trade, and the Balance of Payments

In a small, open economy such as that of Vanuatu, exchange rate policy can have an important influence on inflation, real wages, and the balance of payments; it has become increasingly important to the nation's economic prospects with the opening of the economy in recent years. Vanuatu pursues a managed exchange rate regime, under which the *vatu* is pegged to an undisclosed trans-

action-weighted basket of currencies of Vanuatu's major trading partners.³⁰ This approach is appropriate given the nation's small open economy, its narrow export base, its generally sound fiscal policies, and its limited institutional capacity to conduct monetary policy.

The exchange rates of the *vatu* with currencies of the three Vanuatu's most important trading partners are shown in Figure 4 and Appendix Table A.4. The US dollar exchange rate is significant in relation to merchandise exports, and the Australian and New Zealand dollars are important because of the services income, including tourism income, derived from these markets. Because imports from Australia, Fiji Islands, and New Zealand are important, the exchange rate with the currencies of these countries has a significant influence on the import bill. The exchange rate has been quite stable against the Australian dollar and the New Zealand dollar in recent years, while it has trended downward against the US dollar. In the first 2 months of 2009, considerable international financial market volatility resulted in a strengthening US dollar and weaker Australian and New Zealand dollars. By late March, the picture had started to change again as the US currency weakened in response to increased supply. Concomitantly, the Australian and New Zealand currencies began to strengthen.³¹ Given that most merchandise exports are denominated in US dollars, a stronger US dollar would be to Vanuatu's trading advantage. Conversely, stronger Australian and New Zealand currencies would be to the advantage of the tourism industry. The Japanese yen exchange rate has also been quite stable (Appendix Table A.4), although it appreciated in the first 2 months of 2009.

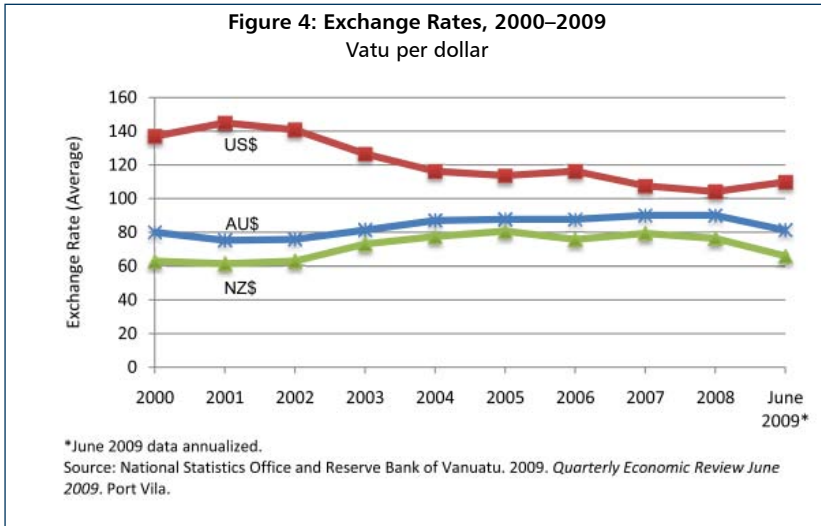
The managed exchange rate is an anchor on inflation; it influences competitiveness (the strength of Vanuatu's foreign reserves position) and, if structural problems are overcome, the prospects for tourism and other exports. While continued attention to the exchange rate is important to economic outcomes, improved export performance is more critical to overcoming trade deficits and achieving medium- to long-term social and economic gains. The heavy reliance on imports of goods for development also has a major impact on the trade deficit. But because the majority of these goods are financed by development aid, the effects may not be as severe as it would appear by simply looking at trade data. Nonetheless, a substantial weakening of the *vatu* would make imports more expensive and add to trade and current account deficits.

Vanuatu's current account and merchandise trade deficits both expanded significantly from 2003 to 2008, in line with substantially increased construction activity, expanded transportation services, increased private credit and consumption, and increased oil prices (Figure 5). The current account and trade deficits were reduced marginally in 2008 due to strong third quarter

30 The weighting is based on trade and tourism receipts.

31 These trends were occurring at a time when there were grave concerns in the United States about the global economic crisis, and this resulted in volatility in exchange rates.

export performance, particularly for copra (subsidized by the government), coconut oil, and cocoa. Pressure on commodity prices resulting from the global economic crisis suggests that the gains in merchandise exports made in 2008 may be short-lived.



Low total merchandise export earnings underlie the current account deficit, which averaged 6% between 2004 and 2008. But tourism earnings and official grants have continued to increase, offsetting the declining balance on traded goods. Private capital inflows and project-funded goods have also been significant. The combination of these factors has resulted in a positive net overall balance of payments since 2002. The short- to medium-term outlook is less encouraging: increasing imports and net income outflows are expected to more than offset increases in tourism earnings, and the current account deficit is likely to widen.

The balance of payments surpluses have supported healthy foreign exchange reserve balances (Table 4). The RBV's policy goal is a minimum of 4 months of reserves, a target it has exceeded consistently since 2003 as economic growth has accelerated and donor aid has grown (Table 5). The position at the end of 2008 was weaker than in the previous year because of a 42% increase in private sector imports, but still satisfactory at 5.8 months of import cover. Continued donor aid inflows, coupled with much lower growth in imports in 2009—estimated by the RBV at 4%—are expected to support a healthy foreign reserves position in the short to medium term.

Official development assistance to Vanuatu amounts to more than 5% of GDP. It has increased significantly in real terms since 2006 due to larger

contributions from Australia—Vanuatu’s biggest donor—and the implementation of the Millennium Challenge Account, funded by the United States, which resulted in the spike in 2008 (Figure 6).³² The European Union, France, Japan, New Zealand, and the People’s Republic of China are also important donors.

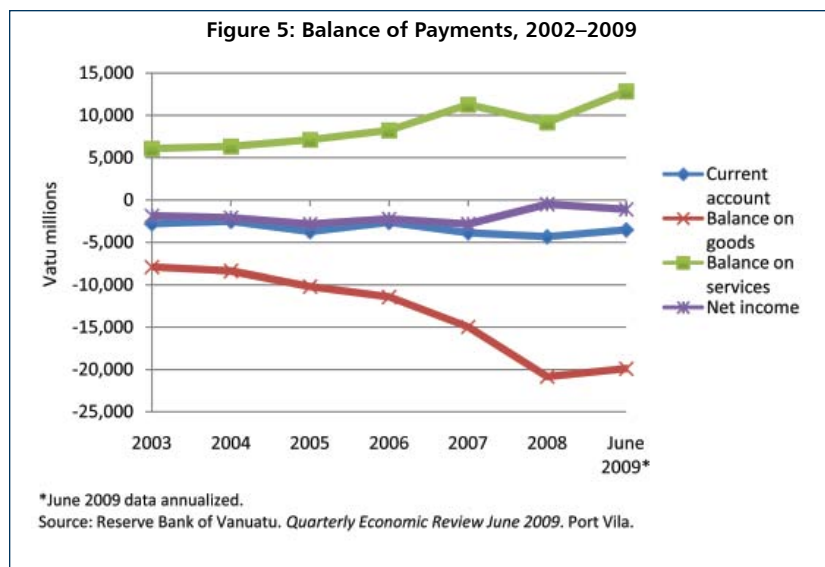


Table 4: Net Foreign Assets
(Vatu millions)

	2003	2004	2005	2006	2007	2008
Net foreign assets: monetary authorities	4,737.6	6,412.8	7,350.6	10,960.8	11,622.7	12,814.2
Net foreign assets: commercial banks	19,941.5	21,162.3	22,137.6	21,631.9	25,874.3	28,063.4
Total net foreign assets:	24,679.1	27,575.1	29,488.2	32,592.7	37,497.0	40,877.6

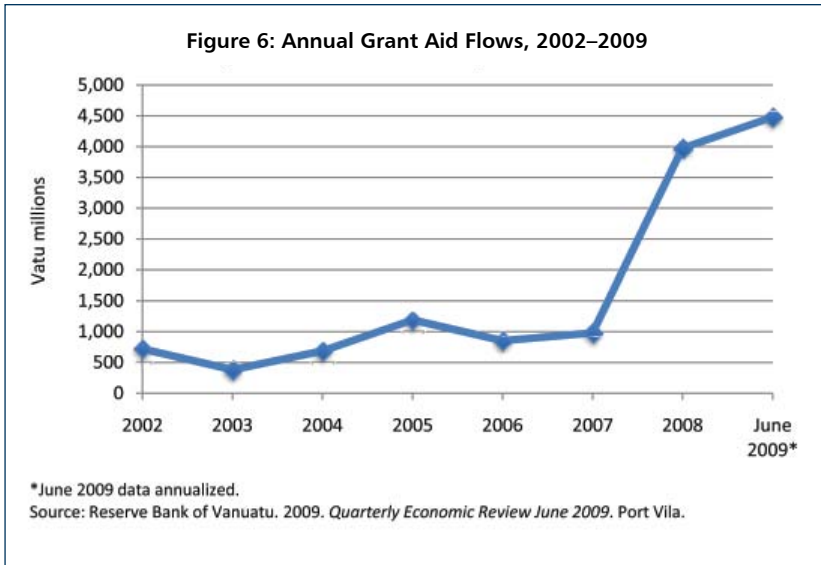
Source: Reserve Bank of Vanuatu.

Table 5: Import Cover
(months)

	2003	2004	2005	2006	2007	2008
Import cover	4.7	5.5	5.8	9.0	8.1	5.8

Source: Reserve Bank of Vanuatu.

³² The Millennium Challenge Account, totaling \$65 million, will pay for the upgrading of the Efate round-island road, along with improvements to a portion of the Santo East road.



The loss of United Nations (UN) least developed country (LDC) status (Box 1) would only have a minor effect on the economy, but could result in the loss of access to a range of dedicated funds and programs, such as external funding for representation at meetings and seminars run by UN agencies. Access concessions to European markets for commodities such as coconut oil would also cease. By contrast, the effect on bilateral aid and concessional loans from multilateral agencies would be minimal. As noted in Box 1, graduation from LDC status is unlikely in the foreseeable future. At meetings between senior government officials and the UN in early 2009, it was agreed that Vanuatu's LDC status would remain unchanged, but will be reviewed in 2012.

Box 1: Graduation from Least Developed Country Status

Least developed countries (LDCs) are countries that exhibit the lowest indicators of socioeconomic development according to the United Nations. A country is classified as an LDC if it meets the following three criteria:

- low income, based on a 3-year average gross national income per capita of less than \$750, which must exceed \$900 for the country to graduate from the LDC list;
- human resource weakness, based on indicators of nutrition, health, education, and adult literacy; and
- economic vulnerability, based on instability of agricultural production, instability of exports of goods and services, economic importance of nontraditional activities, merchandise export concentration, the handicap of economic smallness, and the percentage of the population displaced by natural disasters.

Box 1 (continued)

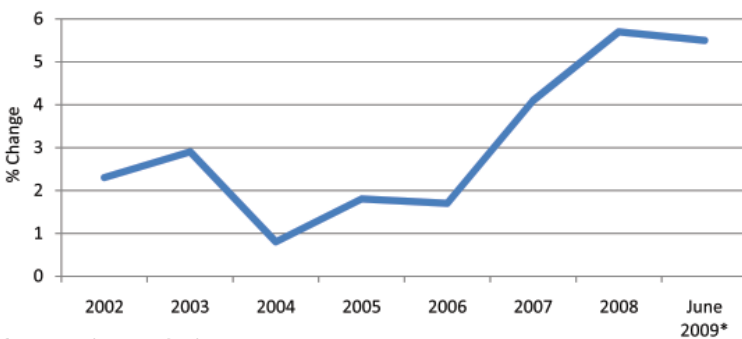
To graduate from LDC classification, a country must surpass the thresholds for two of these criteria in two consecutive triennial reviews by the United Nations Committee for Development Policy. On 29 January 2009, the classification applied to 49 countries, including the Pacific nations of Kiribati, Samoa, Solomon Islands, Timor-Leste, Tuvalu, and Vanuatu. Samoa has been listed for graduation since 2006, although a final decision was still pending as of February 2009. It is quite unlikely that Vanuatu will exceed the human resource and vulnerability thresholds in the medium term, so it will remain in the LDC category for some time. As noted, its position will be reviewed in 2012.

Source: United Nations.

Prices and the Monetary Sector

The RBV's objective for monetary stability is the maintenance of stable low inflation—less than 4.0% as measured by the consumer price index (CPI). It should be noted, however, that the basket of commodities measured by the CPI is based on import weights for urban residents and may not reflect consumer prices across the economy, given that 80% of the population lives in rural areas. The 4.0% figure was realized from 2003 to 2006, but exceeded in 2007 when inflation reached 4.1% (Figure 7). Inflationary pressures increased in 2008, mainly as a result of strong global price hikes for food and oil; inflation reached 5.8% by the end of the year. Significant increases in transportation and energy generation costs were passed on to consumers.

Figure 7: Consumer Price Index, 2002–2009



*June 2009 data annualized.

Source: Vanuatu National Statistics Office.

However, despite the decrease of world prices for food and fuel in 2009, annual inflation remained high in the first half of 2009. Annual inflation was 6.1% as of the March quarter of 2009, on a year on year basis. This is above the 5.8% increase in December quarter of 2008. Inflation for 2009 is projected to ease toward the 4.0%–4.5% range. In the medium term, inflation is likely to remain in the target range of 3.0%–4.0%. However, continued large aid inflows will maintain some inflationary pressure. Inflation can also be severely influenced by natural disasters; an example is the rise in food prices following two cyclones in 2001.

Wages and Employment

The minimum legal wage is currently set at Vt26,000 per month (equivalent of \$245), twice what is often reportedly paid in the informal sector. This suggests that the minimum wage is well above the equilibrium level, reducing employment. The large numbers of new job seekers each year will continue to exert downward pressure on wages. The larger businesses and the public sector will continue to abide by the minimum wage requirement, but will draw on the better qualified and skilled workers. As noted in the government's 2008 Diagnostic Trade Integration Study (DTIS), the only means of raising wages and employment simultaneously is by raising productivity through training and through the provision of adequate transportation infrastructure (footnote 13).

Public servants received a 25% salary increase in installments in 2006 and 2007. This increase comprised a catch up in pay rates, which had increasingly lagged behind private sector wages and salaries. However, wages and salaries now absorb more than 76% of the government's goods and services bill and account for more than 50% of recurrent expenditures, limiting the funding available for operational activities and public investment.³³ It should be noted that the Public Service Commission (PSC) makes decisions with limited consideration of their fiscal effects. Greater oversight and control of the PSC is desirable.

Amendments to the Employment Act were passed in late 2008, resulting in extremely generous provisions for those with formal employment. These amendments will substantially increase labor costs where formal employment is at a premium and the imperative is to create more jobs.³⁴ The ADB private sector assessment concluded that when the new provisions become law they will threaten the viability and existence of small businesses, result in increased unemployment, exclude women from the workforce, reduce the competitiveness of the economy, reduce economic growth, and lead to the substitution of capital equipment for labor where such substitution is possible (footnote 22). Because of these strong negative effects on Vanuatu's economy, the 2008 employment provisions should be repealed soon to reduce uncertainty in the business community.

33 These figures are based on data from the government budgets for 2004 through 2007 and preliminary data and projections for the budgets for 2008 through 2010.

34 Recent media reports suggest that the Government of Vanuatu endorsed, in September 2009, the Employment (Amendment) Act, which has slightly improved the situation.

Price Controls

The Price Control Act established a framework for price regulation, although it does not specify which goods may be controlled, leaving considerable discretion in the hands of the Price Control Bureau, which administers the act. A price advisory committee, which must be consulted if any proposed legislation is likely to affect or control prices, was also created under the act. But price controls have a poor track record internationally, including in Pacific island countries; they tend to distort the market and reduce the supply of goods desired by consumers. On the other hand, there is a strong argument to prohibit anticompetitive practices, such as monopolistic pricing and collusion, that occur due to market failure. Vanuatu should develop and implement an effective competition policy rather than relying on direct price controls.

Price Distortions

Union Electrique du Vanuatu Limited (UNELCO) Suez, which also operates the Port Vila water supply, provides reliable power with minimal system losses under concessions in Luganville, Malekula, Port Vila, and Tanna. Malekula and Tanna are operated under one concession and cross-subsidized by the Port Vila and Luganville concessions. Tariffs are comparable to Pacific economies of a similar size and are influenced by the fact that government does not subsidize energy costs.³⁵ However, Vanuatu has taken steps to improve regulation and expand access to electricity. The Utility Regulatory Authority Act 2007 enhances regulatory oversight of the power and water sectors. The Utility Regulatory Authority is based in the Ministry of Finance and Economic Management (MFEM) and is responsible for managing concession contracts. A national energy policy and a rural electrification master plan were also introduced in 2007.

Vanuatu's business environment and competitiveness is influenced by a range of other factors, such as the following:

- The port of Port Vila is highly inefficient. Stevedoring is provided under a 50-year monopoly arrangement. The cost of clearing a 20-foot container is \$1,000, the highest in the Pacific and five times the price in Port Moresby, Papua New Guinea (footnote 22). Port Vila also has the slowest turnaround time in the Pacific at 17 days.
- Telephone charges have been substantially reduced as a result of the introduction of competition, but internet charges remain high. Given the importance of the internet to trade and commerce and to rural development, it is important that these costs be reduced as well.³⁶
- The transaction costs of establishing new businesses and of operating extant businesses are extremely high. For example, while the system for

35 Tariffs are adjusted monthly and derived from a base rate tariff, which is indexed quarterly for changes in the costs of fuel, labor, and equipment.

36 It was announced in March 2009 that Digicel and two other providers had been given approval to commence internet services; this should lead to reduced prices.

foreign investment established by the Foreign Investment Act 1998 is transparent, it contains significant duplications that make it slow and unwieldy. Local businesses must also deal with a number of government agencies to start a business. ADB's private sector assessment observed that "the government appears to focus more on business regulation than business promotion. Foreign investors are often frustrated by the cost and time it takes to obtain government approvals to establish and run businesses." (footnote 22)

Economic development and growth, and therefore social advancement, are inhibited by these costs; it is important that the government continue and accelerate efforts to overcome them.

Private Sector Credit

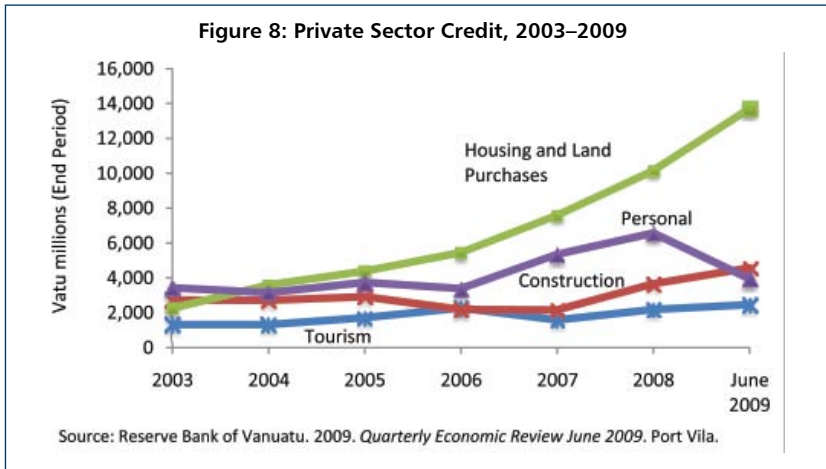
Private sector credit has expanded rapidly since 2006 (Figure 8 and Appendix Table A.5). Lending for the purchase of housing and land and for personal consumption has shown the most significant gains. At the end of 2008, private sector advances from the banks had increased by 38% over 2007, exceeding Vt31.7 billion, although the data are skewed by large one-off transactions such as the purchase of equipment by UNELCO in 2008. At the end of 2008, 31.3% of the value of outstanding loans was for housing and land, 19.5% for personal uses, 10.9% for construction, and 6.5% for tourism. Lending for agriculture and manufacturing has been relatively flat since 2003 (Appendix Table A.5).

The following major factors account for the significant growth in lending in 2008: (i) the opening of a fourth commercial bank in Vanuatu, leading banks to free up lending in an effort to maintain market share; (ii) the ongoing real estate boom; and (iii) the rapidly expanding demand for credit for consumption purposes.

This expansion in domestic credit resulted in a liquidity shortage in the second half of 2008. The Reserve Bank of Vanuatu (RBV) responded by reducing the statutory reserve deposit (SRD) level from 10% to 8%, which injected Vt600 million into the banking sector. However, demand for credit continued to exceed supply, and the SRD was further reduced to 5%. The total increase in liquidity as a result of these two adjustments was Vt1.2 billion, while the liquid assets ratio requirement, which had been reduced to 8% in November 2007, was reduced by the RBV to 7%.

The RBV's responses to the liquidity shortage were appropriate given the circumstances. It must maintain a close watch over the commercial banks, given the current global economic crisis, to ensure that their balance sheets remain robust. But given continued growth in the economy, it seems unlikely that the banking sector will confront further liquidity difficulties in the foreseeable future.

Official interest rates have been relatively stable (Figure 9). Some increases in the rates for fixed deposits and bank deposits occurred in the second through fourth quarters of 2008 as liquidity tightened. At the end of the year, the fixed deposit rate was 5.92% and the bank rate 2.69%. The weighted average rate for bank loans was 10.33%. Interest rate spreads are generally high in Vanuatu, perhaps reflecting the commercial banks' views on risk levels, but fell to 7.64% by the end of 2008 as a result of increased competition and reduced liquidity.



The Vanuatu National Provident Fund (VNPF) provides about 40% of the liquidity in the local financial market through placing deposits with the commercial banks. It chooses where to place deposits based on the highest interest rate bid and the length of time the bank will accept deposits at the agreed rate. Deposits were accepted for 1 year up to the second half of 2008, when the deposit period lengthened to 2 years. Rates on these deposits were capped at 8% by the RBV in March 2009. The significance of the VNPF in the market reduces the effectiveness of monetary policy.

The VNPF is also the main source of domestic savings. ADB noted that the rate of savings by those in the mainly rural informal sector is low; only 13% of the rural adult population has bank accounts.³⁷ ADB is funding technical assistance to make rural banking services more widely available and to increase the savings rate. Sufficient funds have generally been available for commercial lending with VNPF deposits and the reinvestment of surpluses by commercial businesses, particularly in the tourism sector. Nonetheless, the rate of capital formation is constrained by a low overall savings rate, while official transfers from donor partners to finance imports and other expenditures offset the outflows from the RBV to commercial banks.³⁸ Economic growth,

37 ADB. 2007. *Technical Assistance to Vanuatu for Expanding Access to Financial Services*. Manila.

38 Reserve Bank of Vanuatu. 2009. *Quarterly Economic Review, December 2008*. Port Vila.

therefore, relies predominantly on foreign direct investment (FDI) and aid inflows for developments such as those in tourism and fisheries.

While credit has been available for the commercial sector and larger businesses, rural enterprises and small businesses have found it difficult to obtain loans. The amounts at issue are small and impose high administrative costs, and potential borrowers are unable to offer security. These problems are being addressed through strategies such as the following:

- Smart banking initiatives based on the use of technology, such as mobile phones, are being developed by the National Bank of Vanuatu (NBV).
- The microfinance programs run by the NBV and the Vanuatu Women in Development Scheme enhance rural credit availability and credit for women, respectively.
- The Vanuatu Agriculture Development Bank (VADB) was established under the Vanuatu Agriculture Development Bank Act 2006 and became operational in 2008 to increase rural credit.
- The Personal Property Securities Act, passed in April 2009, and the recently launched personal property securities registry (which allows borrowers to pledge movable property as collateral, thereby reducing lending risks) will, when fully implemented, make credit available to a wider group of borrowers.

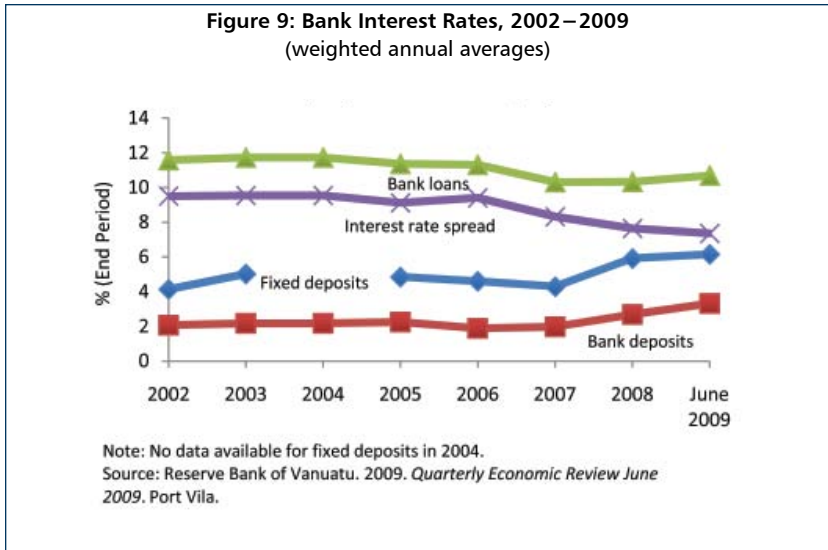
Notwithstanding these efforts, most of the population's access to credit remains severely limited; continued efforts will be required to enhance credit availability and use across the nation. Improving the oversight of commercial banks and supervision of the newly established VADB and the VNPF should also further enhance financial sector supervision.

The VADB was established under the Vanuatu Agricultural Development Bank Act 2006. The VADB received Vt200 million from the government and expects to receive a further Vt100 million per year over the next 3 years to bring it to its full capitalization of Vt500 million. It currently provides loans of up to Vt5 million, with a maximum term of 5 years and interest rates ranging from 14% to 21%. Since operations commenced, loans have averaged Vt11 million per month. A CEO has been appointed, and the bank's operational systems are under development.

Given the poor track record of development banks in the Pacific region, including in Vanuatu, there is concern about the long-term viability of the VADB. Most commentators, along with the International Monetary Fund (IMF), have recommended that the bank be placed under the jurisdiction of the RBV to ensure that it operates on commercial principles and remains free of political interference. This would also reduce the potential for "policy lending," where VADB is pressured to make loans based on government policy

initiatives, which will often not lead to genuinely commercial outcomes. In early 2009, the VADB was placed under the jurisdiction of the RBV.

The government has requested assistance from ADB to review banking legislation and the regulation of small-scale lenders such as the Vanuatu Women in Development Scheme (VANWODS) (footnote 37). Customer protection is an important focus of such assistance.



Debt and Liquidity

Debt Sustainability

Official outstanding government debt is estimated at Vt12.93 billion as of the end of 2008, equivalent to 22% of gross domestic product (GDP) (Table 6). It is forecast to decline to 16% of GDP by the end of 2011. This level of debt is manageable, particularly given that the external component is on concessional terms. Fiscal discipline and economic growth have enabled Vanuatu to achieve a sustainable fiscal position in relation to external debt. The RBV's goal is to keep total debt below 40% of GDP, although the government stated in the 2009 budget papers that it will consider all avenues of financing for capital investment projects that deliver economic rates of return well in excess of the cost of borrowing. The government will not use debt to finance recurrent budget activities and will continue to ensure that annual net debt service costs no more than 8% of domestic revenue. Domestic debt consists mostly of government bonds, which were held at the end of 2007 by the RBV (13.2%), commercial banks (16.2%), public corporations (70.4%), and others (0.2%) (Table 6).

Notwithstanding the official government position on incurring further debt, in its recent Article IV discussions, the IMF advised caution given the current global financial situation and other risks facing Vanuatu's economy. Although the government must carefully evaluate further borrowing to ensure that public debt remains manageable, it should not hesitate to do so as the global economy improves. Judicious use of concessional loan financing in important development areas that bring long-term benefits to the nation, such as infrastructure, would be appropriate.

Table 6: Government Debt, 2005–2011
(Vatu millions)

	2005	2006	2007	2008	2009	2010	2011
	Actual	Actual	Preliminary	Forecast	Projection	Projection	Projection
External Debt							
Bilateral							
Caisse française de développement	496.9	485.6	463.1	423.8	386.8	349.6	312.4
People's Republic of China	0.0	0.0	0.0	3,282.6	3,282.6	3,282.6	3,282.6
Total Bilateral Debt	496.9	485.6	463.1	3,706.4	3,669.4	3,632.2	3,595.0
Multilateral							
Asian Development Bank	5,516.7	5,237.9	5,024.5	4,902.2	4,765.2	4,614.6	4,456.4
European Investment Bank	552.7	540.2	500.9	440.5	384.5	327.8	269.9
International Development Association	1,442.3	1,406.3	1,333.0	1,294.8	1,235.8	1,177.2	1,116.9
Total Multilateral Debt	7,511.7	7,184.4	6,858.4	6,637.5	6,385.5	6,119.6	5,843.2
Total External Debt	8,008.6	7,670.0	7,321.5	10,343.9	10,054.9	9,751.8	9,438.2
Total Domestic Debt	3,328.0	3,103.0	2,983.0	2,583.0	2,533.0	2,533.0	2,533.0
Total Stock of Debt	11,336.6	10,773.0	10,304.5	12,926.9	12,587.9	12,284.8	11,971.2
(in % of GDP)	31%	27%	22%	22%	19%	18%	16%
Amortization							
Domestic	476.1	545.0	320.0	1,595.0	1,088.0	699.8	400.0
External	520.6	193.2	194.3	268.5	289.0	303.1	313.6
Total Amortized Payments	996.7	738.2	514.3	1,863.5	1,377.0	1,002.9	713.6

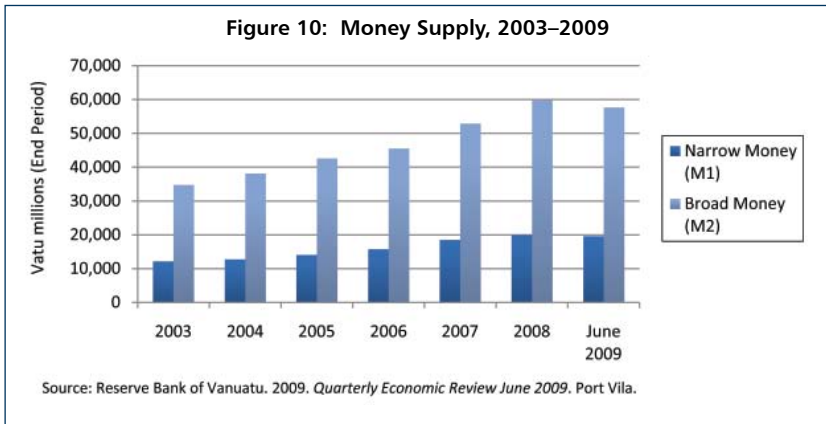
Source: 2009 Government budget papers.

Monetary Policy

The primary objectives of the RBV are to preserve monetary stability through price stability and to maintain adequate external reserves, with a minimum of 4 months of import cover (footnote 29). The policy instruments used to achieve these objectives include

- engaging in open market operations, the principal means of policy intervention, using RBV notes as the main instrument;
- setting and enforcing reserve requirements for financial institutions via the SRD (currently 5%) and liquid assets ratio (currently 8%);
- setting interest rates; and
- funding overnight bank shortfalls through repurchase and rediscount facilities.

Notably, broad money supply (M2) has continued to grow since 2003 (Figure 10). However, the money supply declined in the third quarter of 2008 because of reductions in net foreign assets held by the commercial banks and in net credit to the government. Following the decline in money supply, liquidity tightened, and the RBV suspended open market operations from September to November 2008. The RBV also tightened the monetary stance by increasing the rediscount rate—which is linked to private sector credit and money supply—by 0.25% to 6.25%, although this was subsequently returned to 6.00% in December 2008.



The RBV has shown that it can respond quickly to changing monetary conditions to maintain monetary stability. However, it has limited scope to use monetary policy to influence economic outcomes because of the small size and openness of the economy. As previously noted, the relatively large interest rate spread remains a concern, although the entry of a fourth commercial bank may have had some impact on reducing the rate. But the interest rate spread suggests that the level of risk is seen as high; it also indicates that the level of financial intermediation is shallow. The RBV has foreign exchange controls in place to protect foreign reserves, although it does not, at present, exercise them.

Deregulation of the financial sector has brought benefits such as increased flexibility in lending and greater availability of private credit. Potentially, it offers further benefits such as improved availability of some financial services (for example, domestic financial transfers). But while monetary policy is vital, the reality is that it is of limited effectiveness in Vanuatu, a small open economy with a managed exchange rate, a small financial sector where the VNPF has a significant impact on liquidity levels, a relatively large public sector, and a central bank of limited size. Consequently, the main economic focus should be fiscal policy.

Fiscal Aspects

Fiscal Management

The government has consistently achieved its goal of maintaining fiscal surpluses in recent years (Figure 11). The overall fiscal surplus increased to 2.2% of GDP in 2008, following a small surplus in 2007. Improved value-added tax (VAT) and trade taxes, reflecting an improvement in tax compliance, more than offset the additional (election-related) spending on goods and services. Development expenditures also picked up as the long-awaited donor financing from the Millennium Challenge Account (MCA) began to feed into capital projects. However, collection of VAT remains limited outside the main urban centers. Land and real estate taxes, which are the responsibility of provincial and municipal authorities, are not even collected in most instances.

Despite the improvements in fiscal management, areas of concern remain. The Department of Customs and Inland Revenue administers a duty exemptions system that allows the granting of full or partial exemptions on duty, excise tax, and VAT for a wide range of approved economic activities. The director of customs made the final decision on exemptions until 2007, when applicants gained the right to appeal to the minister of finance and economic management. This is likely to have increased inefficiencies in the system.

More than 70% of tax revenue comes from the VAT and import duties. But with the implementation of duty-free trading arrangements under the Melanesian Spearhead Group agreement and the increased likelihood of gaining access to the World Trade Organization (WTO), duty revenues are likely to decline. The government may need to implement new taxation arrangements to maintain its revenue streams.

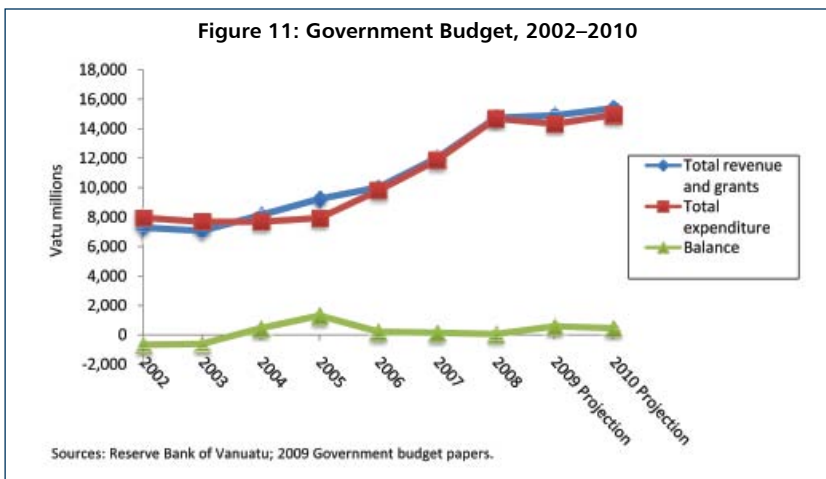
The issues of duty and tax exemptions, the narrow revenue base, compliance with tax requirements, and the future need for revisions to the tax system were addressed by the Pacific Financial Technical Assistance Centre (PFTAC) in 2007.³⁹ PFTAC made each of the recommendations presented above, as well as a specific recommendation for development of a proposal for revenue reform. These recommendations have not yet been adopted, but it is strongly urged that the government review the 2007 report and seek assistance from PFTAC to develop proposals to reform the tax system.

Actual government expenditures have been higher than in budgeted estimates in recent years, although the strong revenue performance has resulted in a sizable fiscal surplus. Furthermore, expenditures remain skewed toward nonproductive spending, with all revenue collections going toward meeting recurrent expenditures. The wage bill continued to constitute more than half of recurrent expenditures, and allocations for emergency spending were, in part,

39 Pacific Financial Technical Assistance Centre. 2007. *Developing New Sources of Revenue and a High-Level Implementation Plan*. Suva.

used to finance election-related spending.⁴⁰ The government should consider restructuring the expenditure system through streamlining the wage bill by eliminating vacant positions, avoiding ad hoc increases in wages, and repealing the recent amendments to employment policy and legislation.

Even with its responsible approach to the budget, Vanuatu faces certain risks in maintaining a sound fiscal position: the current global economic crisis, the inherent vulnerability of a small open economy, a return to high and increasing oil prices, the need to maintain service quality and delivery for a rapidly increasing population, susceptibility to natural disasters, and market isolation. Government revenues also rely on a narrow base, with VAT and import duties contributing more than 70% of tax receipts.



Political stability, relatively stable economic performance, and ongoing economic and institutional reforms are among the factors needed to support continued healthy fiscal outcomes. Consequently, it remains important for Vanuatu to continue to exercise fiscal restraint and to accelerate its reform programs, which have already produced sound outcomes such as the continued improvement in public financial management and the move to a medium-term budgeting framework.

Further discussion of budgeting processes and the legal and administrative framework under which they occur is provided in section on Budget Process.

Trade Balance

Merchandise exports are dominated by agriculture, which has made up more than 85% of domestic exports in recent years (Appendix Table A.6). Copra,

40 IMF 2009. *Vanuatu: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Alternate Executive Director for Vanuatu*. Washington, DC.

coconut oil, and kava⁴¹ are the chief products exported. Merchandise exports are minimal, volatile, undiversified, and relate closely to traditional activities in rural Vanuatu. The negative trade balance has continued to increase because of stagnating exports and increasing imports (Figure 12).

Two pieces of legislation administered by the Ministry of Trade, Industry, and Commerce are important to trade and have been used with increasing frequency to restrict trade flows, according to the Diagnostic Trade Integration Study (DTIS). The Vanuatu Commodities Marketing Board Act established the VCMB, originally to purchase copra at subsidized prices using European Stabex funds. ADB has noted that the VCMB is strongly criticized by stakeholders as being “inefficient and unaccountable” and that it has an adverse impact on the industries it regulates, and that there is said to be substantial political interference (footnote 22). In May 2009, the VCMB was reported to be the subject of an ombudsman’s inquiry, raising concerns about its lack of accountability as well.⁴² The reality is that the original rationale for the establishment of VCMB no longer exists; its marketing activities can now be undertaken by the private sector, and its quality control functions by the quarantine authorities. Consequently, it has been recommended that the VCMB be abolished (footnotes 13 and 22).

Second, the Import of Goods (Control) Act, under which the minister for trade has the authority to restrict imports in the interests of “protecting and stimulating local industry,” has been used to ban a variety of commodities. A ban on imported chickens in 2004 that resulted in a supply shortfall was replaced by a tariff;⁴³ another 2004 ban, on imported roofing iron, resulted in local users facing a doubling in prices; and a ban on imported Fijian breakfast crackers was imposed in 2005 to protect a small Santo-based factory. These bans are normally imposed on false assumptions about protecting inefficient local businesses and result in increased costs for consumers.

Trade Agreements

Vanuatu is a party to a number of multilateral and regional trade agreements. It completed negotiations to accede to the WTO in 2001 but chose not to do so at that time for “technical reasons.” Since then, its accession has remained in limbo, but there are indications that the government will pursue accession in the near future.

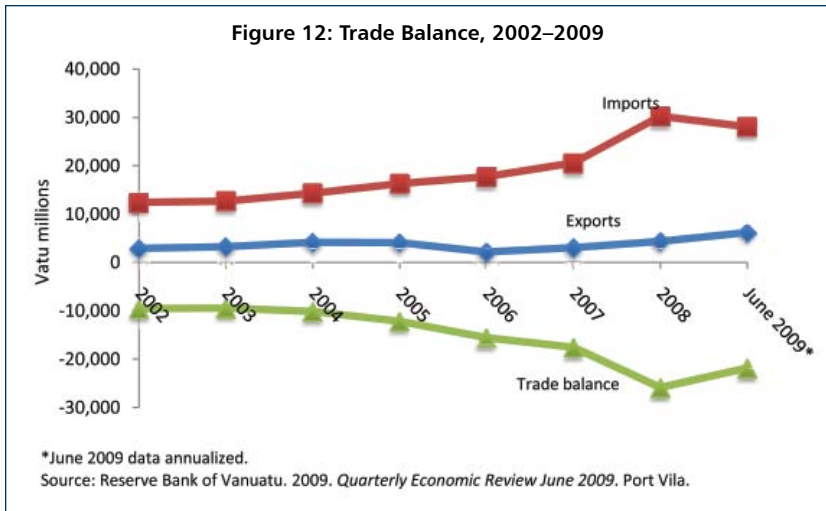
Vanuatu is also a signatory to the Pacific Island Countries Trade Agreement, under which tariffs on imports among member nations will reach zero in 2021. Most of the agreement’s provisions are also covered under the Melanesian Spearhead Group agreement, under which tariffs will reach zero in

41 Kava is a mildly narcotic beverage made from the aromatic roots of the kava shrub.

42 *Vanuatu Independent*. 16 May 2009.

43 The local industry had requested increased tariff protection, but the minister chose to ban imports instead. When the outcome of the ban was realized, it was removed.

2015. Vanuatu also has duty-free access to Australia and New Zealand under the South Pacific Regional Trade and Economic Cooperation Agreement.



Vanuatu could graduate from United Nations least developed country (LDC) status as growth continues and human development indicators improve; if it does, there would be some effect on preferential access to the European Union (EU) market, but it would be small because exports to Europe are presently limited to copra. Technical cooperation support under WTO arrangements would also be lost upon graduation, should Vanuatu decide to push for accession.

Trade agreements are important, but Vanuatu's most pressing need is to improve export performance significantly. There could be significant expansion of agricultural exports, which would improve the distribution of income and human development across the nation.

Outlook

Vanuatu experienced little, if any, adverse effects from the global financial crisis during the first half of 2009. The nation has little exposure to international financial markets, and the balance sheets of the local financial institutions appear to be sound. The rapid decline in international oil prices in the latter months of 2008 also helped minimize any potential adverse outcome from the international financial crisis.

ADB has forecasted Vanuatu's growth at 4.0% for 2009, reflecting strength in tourism and signs of improvement in domestic demand. Tourism in Vanuatu has continued its strong growth in the first half of 2009; substitution

from long-haul to short-haul tourism among regional visitors, mainly from Australia (which make up more than 40% of the total number of tourists), was of some importance here.

Construction activity also remained strong in the same period, primarily due to a pipeline of aid-funded projects, but also because of some private sector developments. The ongoing implementation of the Millennium Challenge Account projects on Efate and the recent commencement of the project in Santo have continued to provide a major boost to the construction sector. Conversely, the agriculture sector has been affected by falling commodity prices.

The pace of credit growth remains of concern, with credit increasing by over three times the forecasted nominal GDP growth rate. While bank liquidity came under pressure in 2008 (see section on Private Sector Credit), this resulted from domestic rather than international considerations. Credit to the private sector grew by 35.3% over the year to May 2009. This is, however, a slight easing from the 44.0% earlier in the year. This level of credit growth, which has been partly driven by new entrants to the banking sector, is unsustainable. It raises the prospect of an increase in nonperforming loans as the economy eases from the recent near-boom conditions.

Despite lower world prices for food and fuel, annual inflation remained high in the first half of 2009. The annual inflation rate was 6.1% in the March quarter of 2009, on a year on year basis. This is above the 5.8% increase in the December quarter of 2008. It is likely that inflationary pressures in the subsequent months are on the downside, with year-end inflation for 2009 projected to ease off toward the 4.0%–4.5% range.

Foreign reserves have continued to decline during 2009. Monthly import cover was equivalent to 5.0 months in June 2009, down from 5.8 months in December 2008. This remains somewhat above the RBV's minimum target level of 4 months. Fiscal surpluses and strong growth in nominal GDP have reduced the ratio of public debt to GDP to 18.4% in 2009. This strong recent fiscal performance gives the government room for a careful countercyclical fiscal response if the economy weakens.

Continuing Reforms

Vanuatu has achieved macroeconomic stability with strong growth since 2003. But its high rate of population growth and narrow economic base will make it difficult for the nation to continue that success in the medium to long term. Although its approach to economic and fiscal management is generally sound, some matters require attention, including the following.

Revenue, Taxation, and Exemptions

There is a pressing need to review the taxation system and to consider the potential role of other forms of taxation. The government might seek support from PFTAC for this purpose. There remains a need to improve tax compliance through institutional strengthening of the main collection agencies, and to address the issue of noncollection of revenues from rates and other real estate taxes.

The system of exemptions for import duties and taxation requires an immediate overhaul. The list of eligible items should be revised according to the principle that exemptions should be granted only where they provide a demonstrable benefit to the public that would otherwise not be obtained.

Government Expenditures

More than half of the recurrent budget is spent on the public sector wage bill, crowding out expenditures in areas that could help improve the productive capacity of the economy. Most development expenditures are currently financed by aid inflows. While aid inflows are projected to remain strong over the next few years, the government should increase development spending in priority areas through restructuring expenditures.

Wages and Employment

The legal minimum wage is well above the equilibrium level. In the long run, it will be important to move away from wage fixing. The recent amendments to the Employment Act will result in significant negative effects on business—particularly small business—and on employment, and must be repealed because they have the potential to do significant harm to the economy.

Trade

The use of controls on trade, such as those under the Import of Goods (Control) Act, should be removed, as should price controls under the Price Control Act. In the interests of efficiency, these should be replaced by a competition policy.

Credit

Credit to rural areas and small businesses remains very limited; the approaches the National Bank of Vanuatu (NBV) is developing with modern communications technology should be supported. Similarly, the Vanuatu Agriculture Development Bank (VADB) must operate on commercial principles, as its management has signaled it will ensure.

SOCIAL CHALLENGES

Demographic Profile

Vanuatu's population is currently estimated to be about 235,000 and is forecast to reach 270,000 by 2015.⁴⁴ While the country's population growth rate has fallen significantly in recent years, with a fertility rate of just under four children per woman, it remains one of the highest in the Pacific, at about 2.4% (footnote 44). According to some estimates, the population will double by 2030.⁴⁵ Like its Melanesian neighbors, Papua New Guinea and Solomon Islands, Vanuatu has a very young population; more than 50% of its residents are under age 20, and the median age is estimated at 19.4 with a dependency ratio of 80%. This clearly has serious implications for the growing demand for education, employment, and other basic services, and there is a strong argument for the government to develop and implement a population policy.

Currently, about 80% of the population lives in the rural areas and depends on subsistence agriculture. The proportion of the population living in urban centers, notably Port Vila and Luganville, has grown rapidly in recent years, mainly due to high in-migration from the islands, placing pressure on housing, infrastructure, and services. Current population growth suggests that the population of Port Vila alone could increase to approximately 60,000 by 2020, with many of them being young and unemployed (footnote 13).

Traditional Social Structure

Family Structure

Traditionally, the family has played a central role in social and economic life in Vanuatu; extended family networks and kinship groups form the basis of complex customary laws, beliefs, and practices (*kastom*) that lie at the core of political, social, economic, and spiritual life. Customary systems of kinship

44 United Nations Department of Economic and Social Affairs. 2008. *World Population Prospects: The 2006 Revision*. New York.

45 World Health Organization. 2008. *Country Health Information Profile: Vanuatu*. Suva.

determine people's rights and obligations, most notably to land and resources, while *kastom* governance and leadership, built around a custom-dominated system that is both inherited and earned, reinforce social, economic, and spiritual relationships, often through complex rituals and gift giving.

However, traditional family values and structures are breaking down in changing societies such as Vanuatu; the focus of social and economic life increasingly shifts from the kinship group or community to the individual, particularly in urban areas. This breakdown, together with changes in attitudes toward land and resources (for example, the treatment of land as a commodity), contribute to increasing social and political instability.

The Importance of Land

Land is traditionally the source of personal and clan identity, spirituality, *kastom*, power, and economic livelihood; without land, one lacks the very basis for survival. Land is commonly referred to as “the mother,” underscoring the importance of the relationship between people and the land associated with their kinship group or clan. The right to occupy an area of land is the closest traditional equivalent to the westernized concept of “ownership;” this right is determined by chiefs and held almost without exception by men. Even in parts of Vanuatu where inheritance is matrilineal, decision making about land, including the transfer of rights to land, is generally a male domain. Rights to use land (usufruct rights), or to use the natural resources on the land, are generally vested in both men and women; women traditionally have the main responsibility for tending home gardens.

Health

Overview

Health indicators have shown considerable improvement in recent years, due in large part to improved health services in both rural and urban areas, such as improved prenatal care; attendance at births by trained health workers; increased immunization coverage; better access to clean water and sanitation facilities; and greater emphasis on preventive programs aimed at raising awareness of health, hygiene, and disease prevention. Infant mortality rates are relatively low, at about 28 deaths per 1,000 live births. Life expectancy has also improved over the years from 1998 to 2008, from 66.5 to 70.0 years; women are expected to live an average of about 4 years longer than men (72.1 years for women, 68.3 for men).⁴⁶

Whereas in the past the leading causes of morbidity and mortality were largely preventable or treatable, diseases that were fatal because of physi-

46 United Nations Development Programme. 2008. *Human Development Report 2007/2008: Fighting Climate Change: Human Solidarity in a Divided World*. New York.

cal access to health services (such as acute respiratory infection, pneumonia, gastrointestinal diseases, skin infections, parasitic infestation, and complications associated with pregnancy and birth), recent years have seen an increase in lifestyle diseases associated with poor nutrition, increased consumption of alcohol, drug abuse, and unprotected sexual activity. Changes in diet and occupation, rural–urban migration, exposure to foreign influences, and other factors have contributed to an increasing incidence of diabetes and STIs, as well as social problems such as alcoholism, drug dependency, and teenage pregnancies. Psychosocial problems such as depression, anxiety, and suicide are also on the increase, possibly resulting from rural–urban migration and its associated dislocation, landlessness, unemployment, domestic violence, and family breakdown. As discussed below, younger people are the most vulnerable to these influences.

With about 50% of the population under age 20, an annual growth rate of about 2.4%, and increasing life expectancy, the population is expected to continue growing very rapidly. The implications for health care are serious. Demand for maternal and infant care, as well as treatment of childhood diseases, can be expected to grow significantly; at the same time, diseases of the elderly will continue to increase. Changes in lifestyle are reflected in an increase in noncommunicable diseases such as hypertension and its associated complications, heart disease, cancer, and diabetes. These trends are expected to accelerate as urban populations grow, and these diseases will place an increasingly heavy burden on health services.

Communicable and Noncommunicable Diseases

Communicable Diseases

Acute respiratory infections are a major health concern; 25,411 cases were reported in 2000 and 27,926 in 2007. It is estimated that about 50% of all hospital admissions are for children less than 2 years of age suffering from these infections.

Diarrheal diseases, particularly waterborne and water-related diseases and those related to poor hygiene, are commonly associated with poor housing and living conditions. Improved access to clean water and proper sanitation—particularly in rural areas and high-density districts such as informal settlements in peri-urban areas—together with effective public health awareness campaigns, including for food safety, will reduce the incidence of diarrhea.

Malaria is still a major public health problem; although reliable data are not available, the prevalence reported for 2006 was 111 per 100,000. The main strategy for combating malaria has been the introduction of long-lasting, insecticide-treated nets; 69.3% of households have at least one such net.⁴⁷

The Ministry of Health (MOH) has run control and awareness programs

47 World Health Organization. 2008. *Western Pacific Country Health Information Profiles*. Suva.

for the past 20 years in an effort to eradicate tuberculosis, dengue fever, dengue haemorrhagic fever, and filariasis. Other communicable diseases include viral hepatitis, typhoid, and measles. In 2007, 65% of infants under the age of one were reported to have been immunized against measles (footnote. 47).

Data from 2000 and 2001 indicate a high prevalence and incidence of sexually transmitted infections (STIs), although current data are unavailable. The first reported case of HIV occurred in 2002. There have been four additional confirmed cases of HIV infection since, with one AIDS-related death in 2006 and a second in 2007.

Noncommunicable Diseases

The incidence of diabetes and hypertension is reported to be increasing. Statistics for 2006 include 85 inpatient cases of diabetes mellitus and 8 deaths related to diabetes, while hypertension accounted for 62 inpatient cases and 8 deaths. In 2006, 89% of deaths were due to noncommunicable diseases, principally heart attacks, cancer, asthma, and stroke.

Maternal and Child Health

Antenatal clinics, child immunization, and contraception are provided under the Maternal and Child Health Program of the MOH. The program also offers support, information, and advice on parenting, child health and development, maternal health and well-being, child safety, immunization, breast-feeding, nutrition, and birth spacing. In 2006, 61% of reported births took place in health clinics and 29% in hospitals; 7% were attended by traditional birth attendants. Data from the Multiple Indicator Cluster Survey indicate that about 60% of mothers receive some form of antenatal care, although the level is lower in remote areas such as Torba. It was also found that only about 40% of children between 12 and 23 months were fully immunized. The Integrated Management of Childhood Illness Strategy⁴⁸ aims to address this problem.

Government Health Service Provision

Infrastructure

Vanuatu confronts the major challenge of providing health services to a widely scattered population with severely limited human and material resources. According to the MOH (Table 7), there are two tertiary hospitals in Vanuatu, providing 374 beds between them: the Northern District Hospital in Luganville, and the Central Vila Hospital in Port Vila. Provincial hospitals, adding another 443 beds, are located in Lenakel, Lolowai, and Norsup. A total of 89

⁴⁸ The Integrated Management of Childhood Illness (IMCI) Strategy, a joint initiative of the World Health Organization (WHO) and the United Nations Children's Fund (UNICEF), focuses on the well-being of the whole child. IMCI aims to reduce death, illness and disability, and to promote improved growth and development among children under 5 years of age. IMCI includes both preventive and curative elements that are implemented by families and communities as well as by health facilities.

primary health care centers, also known as dispensaries, provide outpatient and inpatient services (mostly deliveries), and health promotion and health preventive services such as immunization. Health centers are the referral centers for dispensaries; there are 32 of them, providing 376 beds, while 180 aid posts have been established in villages, funded by the community. The MOH provides basic medicine and training for their staff.

Table 7: Health Infrastructure, 2008

Public Health Facility	Number	Number of Beds
Tertiary hospitals	2	374
Provincial hospitals	3	443
Specialized hospitals	1	146
Health centers	32	376
Primary health care centers/dispensaries	89	0
Village-based aid posts	180	0

Source: Government of Vanuatu, Ministry of Health.

Human Resources

The shortage of trained health personnel, especially nurses, is a major problem, and recruitment of suitable staff is a huge challenge. Only about 700 of approximately 950 health positions are occupied. In 2007, a total of 96 nursing positions were unfilled. Of the 29 physicians and 51 paramedics working in the country in 2007, only 14 were ni-Vanuatu doctors; another 15 physician positions could not be filled. In Malampa Province, about 40% of health personnel positions remain unfilled; in Lolowai Hospital, 60% of staff positions are vacant. The Vanuatu Center for Nursing Education graduated 21 nurses in 2007 and 25 nurses will graduate in 2010. However, these graduates will hardly compensate for the loss of 40 to 50 nurses who are due to retire in the next few years.

Resource Issues in Health Service Delivery

The high unit cost of providing basic primary health care to a small population scattered throughout more than 80 islands is a key problem in service delivery. By international standards, Vanuatu devotes a high proportion of its recurrent budget to delivering health and education services, but despite this investment, the quality of services remains low, particularly in rural areas, because of a shortage of health professionals.

The cost of health services is also a major challenge for many people. Access to outpatient hospital services, for example, is a problem for those who cannot afford the Vt200 “contribution fee” charged at the two tertiary hos-

pitals. The cost of transport to the tertiary hospitals from outer islands is also prohibitive for most; the government should consider subsidizing the transfer of critically ill patients.

Some costs might be reduced through rationalization of services, but rural communities must have ready access to basic health services without long-distance travel. This means that the cost of delivery will necessarily remain high, and the number of qualified medical personnel per capita needs to remain relatively low. As noted above, however, many positions remain unfilled. There is a particularly urgent need to fill a significant number of vacant nursing positions. Until qualified ni-Vanuatu professionals are trained and able to fill these positions, the government should consider increasing the number of donor-funded foreign personnel employed on contract.

Health Policy, Planning, and Reform

The MOH is planning major institutional restructuring and reform. This reform is regarded as an important step in the achievement of the MOH's four broad policy objectives: improving the health status of the people, improving access to services, improving the quality of services delivered, and using resources more effectively.

These policy objectives are also highlighted in the government's Priorities and Action Agenda (PAA) 2006–2015,⁴⁹ the MOH Master Health Services Plan 2004–2009,⁵⁰ and its corporate strategic plan.⁵¹ The new program of reform focuses on rural health services provision, particularly on improving access to and quality of primary health care.

The planned reforms, as set out in the MOH Master Health Services Plan (footnote 50), include the revitalization and strengthening of areas including human resource development, planning, financial management, and health information management. The MOH has adopted the following five strategies to achieve the policy objectives:

- As a general approach, it will base health services delivery on a primary health care approach to ensure access to sustainable provincial services.
- It will seek to improve the health status of ni-Vanuatu by reducing illness and death in children under age five, promoting birth spacing, reducing teenage pregnancies, and reducing disability and death among productive adults.
- It will improve access to services by (i) distributing resources more

49 Government of Vanuatu, Ministry of Financial and Economic Management. 2006. *Priorities and Action Agenda, 2006–2015*. Port Vila.

50 Government of Vanuatu, Ministry of Health. 2009. *Master Health Services Plan 2004–2009*. Port Vila.

51 Government of Vanuatu, Ministry of Health. 2004. *Corporate Strategic Plan 2004–2006: Moving Health Forward in the Republic of Vanuatu*. Port Vila.

fairly based on community health needs; (ii) evaluating tertiary services and providing guidance for their access; (iii) developing an integrated primary health care strategy and public health care strategy; and (iv) improving transportation and communication to improve access for patients, reduce the isolation of health workers, and improve and strengthen the coordination of donors and NGOs.

- It will improve the quality of services delivered by (i) implementing a comprehensive hospital and health service quality and safety standards program, and (ii) empowering health professionals to provide leadership and to ensure workforce retention as well as continued development of skills by health-care workers.
- Finally, the MOH will make more effective use of resources by improving data collection to monitor health status and support health planning and management (adopting only those health initiatives that are cost effective and proven in the South Pacific), and continuing to roll out the planning process to include high-priority services and new programs.

Donor Assistance to the Health Sector

Donor assistance is the major funding source for health infrastructure and assets development throughout Vanuatu. In 2007, the MOH received donor assistance totaling Vt955.5 million, of which about 63% was directed to the six provinces rather than to urban centers.⁵²

AusAID supports the MOH's Master Services Plan 2004–2009. Australia provided support for hospital and village health services that focus on women and children, which helped the MOH reach 90% coverage for measles immunization in 2006 and increase the coverage of rural health care in two provinces under its Village Health Worker Program.

Japan International Cooperation Agency (JICA) has been supporting primary health care by dealing with infectious diseases such as acute respiratory infections, malaria, and diarrhea. JICA has started to support the government by placing volunteers through its regional programs such as Strengthening the Expanded Program on Immunization in the Pacific Region and the Pacific Program to Eliminate Lymphatic Filariasis. The main focus of these programs is on local staff training, improvement of inventory management, and logistics support. JICA has started to use its regional approach to explore options for tackling malaria, taking into consideration malaria-focused projects that have already been implemented in two other Melanesian countries, as well as programs under the Global Fund to Fight AIDS, Tuberculosis, and Malaria.

New Zealand Agency for International Development (NZAID) is helping to improve water service delivery and coordinating the heavily donor-dependent

52 The major contributors were AusAID, NZAID, UNICEF, and WHO. International NGOs also provided significant support.

water resources sector, as Vanuatu works toward the Millennium Development Goal (MDG) of halving the number of people without access to clean water by 2015. Civil society organizations also play a significant role in this sector.

The MOH also receives technical assistance support (including expatriate medical staff at the two tertiary hospitals), cash donations, and volunteer work.

Education

Overview

As with health services, the per capita cost of delivering education services is high in Vanuatu. Basic education is not compulsory and enrollments and attendance are among the lowest in the Pacific: only 74% of primary-school-age children are enrolled, only 63% reach grade 5,⁵³ and fewer than 3% of children who enroll in primary school manage to attend to year 13.⁵⁴

The literacy rate for the rural population is considered low, at about 69%. The overall rate is 74%, based on the findings of the 1999 census.⁵⁵ Given that the official definition of literacy is simply having completed 4 years of formal schooling, however, the actual rate of functional literacy is likely to be much lower. There is little prospect of Vanuatu achieving either the MDG or Education for All goals for improved literacy in the short- to medium-term.⁵⁶

School fees and associated costs undoubtedly have a negative effect on school enrollments and attendance. The requirement that parents make compulsory contributions to school fees is a major impediment to access. The government recently announced that it would abolish primary school fees, which should result in increased enrollment. While this is a laudable initiative, the reality is that lack of funding will limit the construction of needed school infrastructure, the hiring of qualified teachers, and the necessary significant improvement in the quality of education. These are critical policy issues that need to be addressed urgently.

The national curriculum is widely regarded as inappropriate for the needs of most ni-Vanuatu children. It has been criticized as too academic and biased toward urban life. It is reported that the current formal education system, particularly the national curriculum, is not training pupils to take their place in the public or productive sectors. Until very recently, little attention was paid to developing a more relevant curriculum that addresses the needs of the majority of students and provides them with the life, entrepreneurial, and livelihood skills they will need as they enter adulthood.

53 NZAID. 2007. *NZAID Making a Difference in Vanuatu*. Wellington.

54 NZAID. 2006. *Vanuatu Development Program Strategy 2006–2010*. Wellington.

55 National Statistics Office. 2000. *Main Report, 1999 Vanuatu National Population and Housing Census*. Port Vila.

56 Government of Vanuatu, Ministry of Education. 2008. *Vanuatu Education Support Action Plan 2008*. Port Vila. The Education for All literacy goal is to achieve a 50% improvement in levels of adult literacy by 2015, especially for women.

Educational Enrollment and Attainment

As noted above, only 74% of primary-school-age children are enrolled and only 91.2% of these continue to grade 5. Ministry of Education (MOE) analyses suggest the net enrollment rate (Box 2) may be as low as 63% of the total number of children in the grade 5 age group. Vanuatu also has the highest proportion of children in the Pacific who have never attended school (footnote 56).

Box 2: Gross versus Net Enrollment Rates

A distinction is made between gross and net enrollment rates. The gross enrollment rate refers to the total number of children enrolled in early childhood education, primary education, and secondary education, expressed as a percentage of the total number of children within the official age group for a particular level of education. Because many pupils repeat a year (sometimes several times), or are enrolled at either a younger or older age than the official age range for any specific level, gross enrollment can appear quite high.

The net enrollment rate refers to the enrollment of children within the official age group for a particular level of education, expressed as a percentage of the total number of children within the official age group for the corresponding level of education. This rate is generally considerably lower than the gross enrollment rate because it only includes those children who are within the official age range for their level.

Source: Government of Vanuatu, Ministry of Education.

There are differences in enrollment rates across the provinces and between urban and rural areas. Several areas, such as southwest Tanna, middle Santo, and urban informal settlements, have a nonattendance rate higher than 65%. The dropout, repeat, withdrawal, and absenteeism rates are also high (footnote 56). The reasons cited are costs (including fees, uniforms, and transport to and from school), long distance to the nearest school, poor teaching, irrelevant curriculum, and poor condition of school buildings and facilities. Other reasons not directly related to access or quality of education services include *kastom* or cultural prohibitions and practices, families giving higher priority to domestic tasks such as subsistence farming, and the low value placed on formal schooling by parents, particularly those who have received little or no education themselves.

Unifying Language

Vanuatu's language policies and languages of instruction are an integral part of the national and cultural identity, and are enshrined in the Constitution and the draft national language policy. The education system inherited at independence in 1980 was both Francophone and Anglophone; in 2008, there were 1,266 primary and 525 secondary Anglophone schools, compared with 563 and 211 Francophone primary and secondary schools. Many regard

bilingualism in English and French as a competitive advantage and a national asset. But maintaining two global languages of instruction increases costs, duplication, and inefficiencies.

A language policy has far-reaching consequences for resources, quality of education, availability of teachers, parents' choice of schooling, and student attainment. There is an urgent need to review the current bilingual system, particularly to analyze the costs and potential effects (including on the national curriculum) of the choice of language of instruction. The development of a comprehensive language education policy is a priority, and would constitute an important first step in the move from a dual system to a unified national system.

Curriculum

The school curriculum in Vanuatu needs a major overhaul. The need for revision has become more pressing with the recent announcement by the government that it intends to extend the period of universal basic education from 6 to 8 years, and to give schooling a strong community focus in the process.

Over the last few years, there have been repeated calls for “a long-term, 10-year commitment to reform that matches Vanuatu’s vision for the development of its youth, and harnesses national and donor resources in the interests of creating a progressive, coherent, and consistently high-quality curriculum.”⁵⁷ The Vanuatu Education Support Action Plan (VESAP) gives high priority to addressing the current shortcomings of the national curriculum.

Public Educational Services

The education system in Vanuatu currently consists of

- early childhood centers or preschools, covering years K1–K2 (ages 3–5);
- primary education, covering years 1–6 (ages 6–12);
- junior secondary education, covering years 7–10 (ages 13–16);
- senior secondary education, covering years 11–13/14 (ages 17–20);
- technical education, covering years 7–12 (ages 13–18); and
- tertiary education, e.g., Vanuatu Institute of Technology (ages 19 and up).

However, the MOE is in the process of extending primary schooling from year 6 to year 8, thus phasing out years 7 and 8 in junior secondary schools. Consequently, the future structure of the primary and junior secondary system will be

- primary education, covering years 1–8 (ages 6–14); and
- junior secondary education, covering years 9 and 10 (ages 15 and 16).

⁵⁷ T. Austin. 2003. *Report on Education in Vanuatu*. Quoted in Government of Vanuatu, Ministry of Education. 2008. *Vanuatu Education Support Action Plan*. Port Vila.

Early Childhood and Preschool Education

A total of 645 preschools (K1 and K2) were recorded in the *MOE Annual Report* for 2008, scattered across all the provinces. In 2008, total enrollment was 11,322 (5,872 boys and 5,450 girls). Most preschools are organized and run by individuals or community groups; as a result, activities, resources, and standards vary significantly from one location to another. They are not, however, recognized as part of the formal education system.

In 2007, net enrollments in preschool accounted for 29% of the total number of children within the corresponding age group. Gross enrollments were 54%. The government recognizes the need to improve the quality of preschool education with trained staff, adequate resources, and effective monitoring of standards. Parents' demand for such improvements is strong.

Primary Education

A total of 435 primary schools were listed for 2007 in the *MOE Annual Report* for 2008 (Table 8):

Table 8: Primary Schools by Province, 2007

Province	Primary Schools
Malampa	90
Penama	65
Sanma	94
Shefa	80
Tafea	83
Torba	23
Total Vanuatu	435

Source: Government of Vanuatu, Ministry of Education and Youth Development and Training. 2009. *Annual Report 2008*. Port Vila.

Primary school enrollments increased in absolute numbers, from 37,874 in 2007 to 40,820 in 2008, a 7% increase. However, from 2005 to 2008, gross and net enrollment rates declined steadily for both boys and girls, indicating that the percentage of children attending primary school has been declining (Table 9).

Table 9: Primary School Gross and Net Enrollment Rates, 2005–2007

Year	Gross Enrollment Rate			Net Enrollment Rate		
	Male	Female	Total	Male	Female	Total
2005	105	103.1	104.1	95.6	94.5	95.1
2006	100	98.4	99.3	89.9	89.3	89.6
2007	95	92.5	93.8	86.2	84.5	85.4

Source: Government of Vanuatu, Ministry of Education. 2008. *Digest of Education Statistics 2007*. Port Vila.

Secondary Education

At present, secondary schooling includes year 7 to year 13 in Anglophone schools, and year 7 to year 14 in Francophone schools. The official age for junior secondary school (year 7 to year 10) is 13 to 16 years, and for senior secondary school (years 11 to 13) 17 to 20 years. However, as noted, the government is in the process of extending primary schooling from year 6 to year 8, thus phasing out years 7 and 8 in junior secondary schools. There were 81 secondary schools in 2007, with 8,276 students enrolled in junior secondary and 3,428 in senior secondary. The gender split was relatively even.

In contrast to primary school, gross and net enrollments in secondary school have been increasing. Still, fewer than half (46.6%) of all children of junior secondary age were actually enrolled in junior secondary school in 2007, one of the lowest enrollment rates in the Pacific. From 2005 to 2007, an average of only 11.7% of youth of senior secondary school age (17 to 20 years) were enrolled in school.

Technical and Vocational Education and Training

Technical and vocational education and training (TVET) is delivered in a wide range of ways, formal and informal. The only publicly funded TVET is provided by the Vanuatu Institute of Technology (VIT), which delivers a range of courses for year 10 graduates to prepare them for jobs in modern industry. NGOs, including church-based organizations, and the private sector provide informal education and training. An extensive network of 36 rural training centers is run by church-based organizations and other NGOs with no government funding support.

Infrastructure

Most schools are disadvantaged by inadequate infrastructure and facilities: 58% of school buildings are reported to be in poor to very poor condition; 67% of schools lack adequate water supplies; and more than 80% lack adequate sanitation facilities. Almost 50% of all school buildings are constructed from temporary or semipermanent materials, a figure that rises to 64% in Torba, and almost 70% of staff housing is reported to be in fair to very poor condition. Many schools lack power, communications, or a library.

Personnel

The significant proportion of teachers who are unqualified and lack any form of teacher training is a major concern in the education system. A teacher who has completed senior secondary schooling to year 12 is considered “qualified,” even without any formal teacher training or qualification testing. A “certified” teacher is one who has undertaken formal teacher training for a minimum of

2 years. The minimum requirement for teaching at early childhood centers or primary level is the Pacific Senior Secondary Certificate.

The total number of primary school teachers is 1,829, of whom 59% are qualified and 41% are not (Table 10). Based on the number of primary school teachers and the total primary school enrollment, the student–teacher ratio is 1:21. There are 736 secondary school teachers, of whom 68% are qualified and 32% are not. The student–teacher ratio at secondary school level is 1:16. This means that 37% of all teachers in Vanuatu have not completed secondary schooling. The implications for the quality of teaching across all levels of education are of major significance. Improving teaching quality is a major objective of VESAP and an important goal of the Primary Education Improvement Project, funded by the Pacific Regional Initiative for the Delivery of Basic Education.

Table 10: Number of Qualified and Unqualified Teachers by Province, 2008

Province	Primary			Secondary		
	Qualified	Unqualified	Total	Qualified	Unqualified	Total
Malampa	215	143	358	76	42	118
Penama	163	128	291	73	54	127
Sanma	238	148	386	145	16	161
Shefa	223	185	408	159	92	251
Tafea	198	123	312	42	27	69
Torba	48	26	74	9	1	10
Total	1,085	744	1,829	504	232	736

Source: Government of Vanuatu, Ministry of Education and Youth Development and Training. 2009. *Annual Report 2008*. Port Vila.

Government Expenditures

In 2007, 26% of the national recurrent budget (Vt3,200 million) was directed to education. Approximately 85% was used to pay salaries. Just over 9% was spent on MOE operating expenses, and about 6% (Vt205.7 million) was provided as grants to government and nongovernment educational institutions.

Low institutional capacity at the provincial level, coupled with inadequate operational funding to provincial services, has resulted in schools not receiving the support or resources they need and to which they are entitled. Anecdotal accounts suggest that direct grants to schools in the provinces are being diverted, and parents have expressed serious concerns about the use of school fees. Without firm evidence, little more can be said, but it is clear that rural schools have suffered from a severe lack of resources, often lacking basic teaching materials, equipment, and facilities. The proposal to make primary schooling free in 2010 may add to cost pressures and may lead to even greater shortages of basic resources.

Education Policy, Planning, and Reform

The MOE finalized the Vanuatu Education Sector Strategy 2007–2016 (VESS) in December 2006. The VESS, which was endorsed by the Council of Ministers, identifies investments and policy reforms throughout the education system. It provides the foundation for education sector development for the next decade, and emphasizes the need for improvements in quality, efficiency, equity, and relevance to develop a system that meets national needs and that is financially sustainable in the long term. The goals of VESS 2007–2016 are reflected in Box 3.

Box 3: Goals of the Vanuatu Education Sector Strategy

- Achieve universal completion of primary education; strengthen literacy, languages, and numeracy; and develop a national preschool curriculum and preschool teacher training program.
- Continue to expand and improve affordable bilingual secondary, technical, and higher education which meet national and international standards.
- Provide more relevant and accessible curriculum, materials, and assessment systems.
- Provide qualified, productive, and well-supported teachers for every school, and strengthen the professional competence of teachers.
- Bring the education, management, and facilities of every school up to a sustainable minimum standard, able to provide a safe and caring learning environment and continuously improve its services.
- Strengthen the effectiveness, productivity, accountability, transparency, governance, and decentralization of the education system, and build capacities for results-based management at all levels.
- Strengthen partnerships at national, provincial, and local levels, and empower school communities.

Source: Government of Vanuatu, Ministry of Education.

In July 2007, the MOE prepared a draft medium-term expenditure framework for 2008–2010, which identified critical investments in four broad areas: improved access to basic education, improved quality, capacity building and policy development, and preparation of a national human resources plan.

A number of plans have been prepared for TVET since 2003. The TVET *Masterplan 2003–2010: Skills for a Self-Reliant, Productive and Proud Vanuatu* identifies seven goals: (i) strong policy coordination and support for TVET; (ii) expanded practical, high-quality, and relevant competency-based courses to meet the economy's development needs; (iii) expansion and strengthening of TVET in rural areas; (iv) a strong VIT as one sustainable multipurpose and multi-campus national institute; (v) strong, community-responsive informal TVET; (vi) an accessible and equitable TVET system; and (vii) sustainable funding for formal and informal TVET.⁵⁸

58 Government of Vanuatu, Ministry of Education. 2003. *TVET Masterplan 2003 to 2010: Skills for a Self-Reliant, Productive, and Proud Vanuatu*. Port Vila.

The VIT Strategic Plan 2004–2007 sets forth a strategy to upgrade VIT from a senior secondary-level institution (years 11–12) to a tertiary institution (years 13–14) and to diversify course offerings, among other things by including information communications and technology. In the long term, the aim is to create a polytechnic institution by combining other post-secondary institutions (agriculture, nursing, and teacher training) under one administration.

A study published by ADB in 2008 highlighted the important role of TVET in helping to address major skills shortages across the Pacific.⁵⁹ ADB recommended that investment in TVET should be based on evidence of success in achieving employment with minimum resource outlay. Specifically, enterprise-based training should be expanded through such means as apprenticeships, and institutional training should be closely linked with the labor market.

Donor Assistance in Education

In 2008, the MOE and its development partners (particularly AusAID and NZAID) prepared VESAP, which outlines a sector-wide approach for support to education, including resourcing, capacity building, teacher training, and refurbishment of schools. VESAP will facilitate a move from traditional project financing to on-budget support for education. External financing will be integrated with funds from the national budget appropriation and fully managed by the MOE. This will, however, require substantial strengthening of the MOE's administrative capacity.

AusAID recently supported the Vanuatu Secondary School Extension Project 2 (2002–2007), valued at A\$8 million. The project helped to meet increasing demand for secondary education by accommodating 350 additional places for secondary school students. AusAID has also been providing substantial support to TVET. The current TVET Strengthening Program (2005–2011) aims at strengthening delivery of formal and informal TVET and building the capacity of national TVET institutions. The program supports the development of a quality framework by the Vanuatu National Training Council and will help with training the TVET trainers. Australia has also been providing about A\$2 million per year to support scholarship and training programs in critical areas. These include scholarships for study in Australia, within the Pacific region, and in Vanuatu.

NZAID will continue to provide assistance in several important areas of education, including improving the quality of basic education through the Education Assistance Program. It is also working with the government to ensure the best use of its tertiary scholarships and training awards. NZAID is also involved in developing a long-term strategic partnership with the region's principal educational agencies, the University of the South Pacific and the South Pacific Board for Educational Assessment.

59 ADB. 2008. *Skilling the Pacific: Technical and Vocational Education and Training in the Pacific*. Manila.

Japan International Cooperation Agency (JICA) contributes through its volunteer program for mathematics education and through the Japanese Embassy's Grassroots Grants Scheme for the construction of classrooms.

Employment and Livelihoods

Current Patterns

Based on data from the 1999 national census, more than 78% of the population age 15–64 were economically active. More than 67% were engaged in subsistence farming; significantly more women than men were subsistence farmers (72.9% of women in contrast to 62.5% of men). A quarter of the workforce was working for pay, salary, or profit; of this group, about two-thirds were male and one-third, female.

The largest occupational grouping in 1999 was agriculture and fisheries workers, including subsistence farmers (71.8%). The second largest was technicians and associate professionals (5.4%), which includes teachers and nurses, followed by service workers and shop and market sales workers (5.2%). The second largest group of occupations for women after agriculture and fisheries, employing 6.1%, was low-skilled level occupations such as house girls (*hausgels*), cleaners, and food vendors.

The occupation profile of the economically active rural population is, as expected, quite different from that of those living in the urban centers (Table 11). Predictably, a larger percentage of people living in towns (6.2%) than of those living in rural areas (0.6%) is looking for work.

Almost a quarter of agriculture and fisheries workers have never been to school; more than a third have been to school but have no qualifications. In contrast, only 3.4% of those working in other occupations have never been to school and only 16.0% have been to school but have no qualifications. A much larger percentage of those working in other occupations (44.1%) have achieved a qualification higher than a primary school leaving certificate than those engaged in agricultural and fisheries occupations (6.7%).

Table 11: Main Occupations in Rural and Urban Areas

Occupational Group	Rural (%)	Urban (%)
Agricultural/fisheries workers	86.2	8.3
Service workers/shop and market sales workers	2.4	17.0
Craft and related workers	2.0	15.4
Technicians and associate professionals	3.6	13.0
Clerks	0.6	9.5
Looking for work/unemployed	0.6	6.2

Source: National Statistics Office. 2000. *Main Report, 1999 Vanuatu National Population and Housing Census*. Port Vila.

Key Issues

As in other parts of the Pacific, a burgeoning youth population and a lack of opportunities to earn a livelihood are major concerns in Vanuatu. The majority of school leavers complete only a few years of primary or junior secondary school; many lack basic functional literacy and numeracy skills. Most of these early school leavers have only two options: to remain in the village and seek a livelihood in subsistence or commercial agriculture, or to seek paid work in the informal sector in Port Vila or Luganville. However, work in the urban centers generally requires some vocational, technical, or business skills. Increasing numbers of youth, especially rural–urban migrants, have great difficulty finding jobs; a high percentage remain unemployed for long periods. Their choices are extremely limited, and many are forced to work in poor conditions or for less than the legal minimum wage. This situation is likely to contribute to growing social unrest, conflict, and crime. Moreover, it will affect these young people and their families directly (footnote 54).

Meanwhile, many positions in the public sector remain unfilled, and the private sector suffers from acute shortages of skilled personnel. Vocational education and professional training opportunities fall far short of meeting Vanuatu's needs in health, education, management, accounting, IT, agriculture, fisheries, forestry, and tourism. According to ADB, skills shortage is a major impediment to the development of the private sector in Vanuatu (footnote 59). Similarly, in a report on obstacles to effective governance, AusAID noted that skills shortages were severely hindering the public sector's ability to deliver basic services in areas such as health and education.⁶⁰

Skills development has become a priority. It is essential to both the formal and informal sectors of the economy. It is the key to enabling young people to capitalize on income-earning opportunities, providing them with choices of occupation, so that they can break out of cycles of poorly paid casual work, unemployment, and poverty.

The Informal Sector

The rural informal sector accounts for most of the current labor market in Vanuatu. It includes the production, processing, and marketing of agricultural produce and livestock; fishing and fish processing; carpentry and mechanical repairs; transportation, particularly sea transport in small craft such as motorized canoes; and small-scale marketing, handicrafts, and dressmaking. Rural women play an important role; among other things, they grow, process, and sell home produce, and make and sell clothing and handicrafts. ADB has highlighted Vanuatu's need for skills in processing and merchandising economically important products like cocoa and coffee (footnote 59). The predominance of self-employment means that entrepreneurial skills are also needed. The

60 AusAID. 2008. *The Unfinished State: Drivers of Change in Vanuatu*. Canberra.

development of these skills will support a transition of rural producers into the formal sector, along with productivity gains in rural enterprises.

In urban centers, informal labor provides a wide range of services such as cleaning, hotel and café work, retail, plumbing, electrical and mechanical repairs, and informal construction services. Informal employment includes many jobs in the hospitality and entertainment industry, such as those in cafés, bars, and kava bars.

The Formal Sector

There are skills shortages throughout the formal employment sector (i.e., public and private). Support for skills development is a priority, and TVET is crucial.

Rural versus Urban Employment: a Question of Priority

Many analyses of current skills shortages in the Pacific, particularly in Vanuatu, focus on the need for technical and vocational training in rural areas.⁶¹ These analyses recommend heavy investment in developing rural skills to boost productivity and address poverty. But some caveats might be in order. First, there is evidence that subsistence productivity is keeping pace with population growth. In other words, rural ni-Vanuatu are able to meet their immediate food needs and are generally also able to generate some cash for costs such as school fees and health care (although they would undoubtedly benefit from more opportunities to earn cash for these purposes).

Second, the trend toward urbanization and monetization of the economy will continue and most likely accelerate. Rural people's reliance on subsistence agriculture is likely to decrease over time as more people participate in the cash economy and large numbers, particularly of the young, move to the towns. Vanuatu's urban centers are growing faster than its rural areas as people move in search of cash employment and better access to services, material goods, and lifestyle choices.

Consequently, while it is undoubtedly important to improve the productive and business skills of those who remain in the rural areas, it is just as important to address skills shortages and increase employment opportunities in the urban centers.

Donor Programs

Australia, the European Commission, and New Zealand are providing assistance to develop employment and livelihoods, focusing on raising productivity, developing human capital, and creating employment and entrepreneurial

61 ADB. 2008. *Skilling the Pacific: Technical and Vocational Education and Training in the Pacific*. Manila; and ADB and Pacific Islands Forum Secretariat. 2007. *Technical-Vocational Skills Development in Vanuatu: Technical Assistance for Implementation of Pacific Education Strategy: Skills Development*. Suva.

skills and opportunities in rural areas. NZAID has funded a number of studies to help the government identify and analyze the impediments to economic growth, particularly in agriculture. These studies include an agricultural census in 2007 intended to provide planners with a more accurate picture of economic activity in the rural areas.

Australia is also planning to assist the government to improve rural productivity, income generation, and youth employment by creating an enabling environment for growth through legislative reform. For example, it would support legislation to remove obstacles to investment and trade, improve market access, and enhance business management and development of small- and medium-enterprise.

Gender Equity

Current Situation

Increasing awareness of social equity and discrimination issues is evident in public life in Vanuatu. The government is a signatory to the Convention for the Elimination of All Forms of Discrimination Against Women (CEDAW) and to conventions on disability and the rights of children, reflecting heightened recognition of the need to support the principles of equity and respect, to eliminate discriminatory policies and practices, and to protect all citizens, young and old.

The government plans to promote gender equity and to support the principles of CEDAW and the other conventions actively. The Department of Women's Affairs, for example, has recently sought donor funding to assess the extent to which its own programs and those of other departments have contributed to promoting gender equity and improving the status of women, and to prioritize initiatives on the basis of the findings.

However, ni-Vanuatu women continue to suffer the consequences of low social status and discrimination. In particular, many rural women have little or no education and very few opportunities to earn cash or improve their standards of living or that of their families. The pursuit of economic opportunities and employment has been perceived as the exclusive domain of men, leaving women to take care of the children, grow most of the food in *kastom gadens* (customary gardens), raise pigs and chickens, and gather fuel and water. Women play an active role in church-based groups, mothers' groups, and other community-based organizations, but rarely take part in public life in their villages (Box 4). Lack of access to the formal banking sector means that most rural women cannot develop small businesses or earn cash except by selling produce from their home gardens or handicrafts such as baskets. Vanuatu Women in Development Scheme (VANWODS) does provide microcredit to women in support of activities such as handicrafts.

Box 4: Rural Women in Public Life

At a meeting of members of the Women's Center in Santo, discussion turned to the role of rural women in public life. The women agreed that although they often feel they have something important to say about matters such as health services, education, water supply, power, transport, and land, they are in effect excluded from planning and decision making about these important community concerns. Membership of village committees dealing with these issues is generally regarded as a male prerogative; and although there may be no formal ruling to exclude women, strong social pressures effectively prevent women from nominating themselves or other women. "Men nominate other men," one woman said, "and if any one of us was brave enough to be nominated, her husband would probably punish her for doing so." While they do attend village meetings, the women agreed that only very rarely, if ever, would they be "brave enough" to speak up in public.

Source: Field notes from a meeting with members of the Vanuatu Women's Centre, Santo, on 19 February 2009.

Employment

Strong cultural influences restrain women from participating actively in many occupations that are not seen as suitable for them. There is still some stigma attached to the idea of women working for wages, although there are indications that this is changing. Particularly in urban areas, employers report preferring women in certain administrative roles because they are seen as more reliable than men.

There is evidence from studies of urban informal settlements that women from poor urban households are more likely to work in jobs that pay cash than their counterparts in rural areas.⁶² There are more opportunities for casual cash employment in an urban situation, and because men often experience difficulties finding work in the towns, women are encouraged or obliged to seek work, while men are often expected to take on more of the household tasks. These changing economic roles are challenging many families and may be a cause of conflict and domestic violence, which are often associated with alcohol consumption and drug abuse. Further research is needed to investigate these issues in more depth.

Lack of skills and education reduce women's options for paid work in towns, exposing them to exploitative employment practices. The amendments to the Employment Act passed in late 2008 could significantly improve conditions for women—for example, by increasing the period of paid maternity leave. However, there is a danger that these reforms might actually reinforce discriminatory practices by discouraging employers from recruiting women or inducing employers to dismiss them before they become eligible for benefits.

62 M. Chung and C. Hill. 2002. *Urban Informal Settlements in Vanuatu: Challenge for Equitable Development*. Suva: Pacific Islands Forum Secretariat and UNESCAP.

Violence against Women

Domestic violence continues to be widespread in Vanuatu, as it is throughout Melanesia. There is evidence that abuse of women is more common where their status is lower and there is less recognition of their potential or actual contribution to social, cultural, political, and economic life. Violence against women is often associated with alcohol or drug abuse, and the pressures and insecurities resulting from the transition from rural to urban life appear to increase its likelihood. Recent attempts to introduce a family protection act, which would provide greater protection for all family members against any form of violence or abuse, have been met with resistance from conservative groups, mainly on the grounds that the legislation would constitute a breach of families' privacy and interfere with the role of the chiefs as the main custodians of peace within communities and arbitrators in matters of family conflict. Although the act has been gazetted, the courts are not allowed to accept applications under the act until various support structures are in place. These include the appointment and training of various counselors or other persons who can stand in place of magistrates. None have yet been appointed, but this should not prevent magistrates from being able to hear an application. Under the new act, applications may be submitted to the courts by nonfamily members, including the police. This is one of a number of provisions that represent an improvement over existing civil procedure rules and will potentially benefit victims of domestic violence and their families. However, urgent action is needed to introduce the new provisions and make them operational.

Donor Activity

AusAID has been promoting gender equality and women's participation in public life. A 5-year program of support to the Vanuatu Women's Center, in partnership with the Fiji Women's Crisis Center, aims to reduce violence against women and children, and has placed the issue on the national agenda. In addition to providing counseling services, the center was the major advocate in lobbying Parliament to pass the Family Protection Bill. Other donor-underwritten activities include the Women in Decision-Making and Leadership initiative, supported by the United Nations Development Fund for Women.

Urbanization: Informal and Squatter Settlements

Rural–Urban Drift and Urbanization

Informal settlements in Port Vila have grown substantially in number and size since first developing in the 1960s. Approximately 30%–40% of Port Vila's population lives in temporary dwellings in informal squatter and peri-urban settlements. A study of urban migration and informal settlements conducted in 2000 noted that "the dramatic increase in urban growth has led to over-

crowding, poor housing conditions, high rents, poor sanitation, and rapid development of squatter and informal settlements,” and further observed that “the number and size of squatter or informal settlements has burgeoned in the last decade... [and that] the most notable feature of Port Vila is the speed at which informal settlements are growing.”⁶³

In small economies such as Vanuatu, high urban growth rates pose major challenges to infrastructure and services. The result, particularly in Port Vila, is overcrowding, unemployment, and deteriorating living conditions.

There is limited information on the composition of the migrant populations in Port Vila and Luganville, but research conducted elsewhere in the Pacific indicates that the majority of migrants to urban centers are people age 18–25. The reasons for in-migration reflect the usual aspirations of youth: education, training, employment, marriage, the attractions of the bright lights of the town, and escape from the strictures of rural village life.

One of the most obvious causes of rural–urban migration is the economic gap between rural and urban areas, exacerbated by what some analysts have called “urban-biased economic development.” This gap is particularly acute between Port Vila and the rest of the country, but is also evident in the secondary urban center, Luganville. There is a tendency to address rural–urban migration through greater investment in rural areas and improvements in rural living standards. This view is reflected in public criticism of the 2009 national budget, in which only 16% of government funds were directed at rural services and development. But evidence from developed and developing countries indicates that in-migration to the towns will continue at some level no matter what services and infrastructure are provided in rural areas. Consequently, Vanuatu must develop policies and strategies to deal with its growing urban populations.

Whatever the causes of rural–urban migration (better educational opportunities, greater likelihood of employment and entrepreneurship, better access to health and other social services), certain effects are apparent:

- There is increased pressure on infrastructure services, including water, sanitation, and roads, as urban areas, both formal and informal, become more crowded.
- Living conditions may deteriorate in many areas because heavily used infrastructure is not appropriately maintained, or because increased runoff reduces water quality.

Social and Health-Related Problems

Rapid urban growth is commonly associated with a range of social problems as jobs, housing, services, and amenities fall far short of demand.

There is strong evidence that young, recent migrants, many of whom

63 S. Mecartney. 2000. Blacksands Settlement: A Case for Urban Permanence in Vanuatu. Unpublished.

are poorly educated, are the group most vulnerable to depression and loss of self-esteem due to their loss of family support networks, unemployment, and poor living conditions. Whether or not they lead to depression, these factors undoubtedly contribute to rising crime rates, increasingly widespread alcohol and drug abuse, the high incidence of STIs, teenage pregnancy, and prostitution. Anecdotal evidence of very high rates of kava consumption is causing concern. Interviews with students and voluntary staff of youth drop-in centers indicate that marijuana use is widespread and growing, and that alcohol abuse is also prevalent.

Domestic violence is common throughout Melanesia, and is often associated with gender inequality. As yet, there is no research on its prevalence in urban centers in Vanuatu, but evidence elsewhere shows that domestic violence is often linked with poverty, unemployment, alcohol and drug abuse, social dislocation, instability, insecurity, and family breakdown. Anecdotal evidence from ni-Vanuatu informants indicates that domestic violence is extremely common in urban centers, where there are no chiefs or village elders to arbitrate in matters of family strife or to exercise their traditional authority in dealing with offenders.

Although there are no reliable data to support the perception that crime rates are rising in urban centers, there is substantial anecdotal evidence that property-related crime in and around Port Vila has increased significantly over the last decade. Violent crime, vandalism, and theft are thought to have increased in recent years.

Urban Poverty

Data from the most recent Household Income and Expenditure Survey (HIES) show that 27% of households and 33% of adults in Port Vila are living in poverty; their average expenditure is insufficient to meet their daily needs (footnote 15). In a center where the cost of living is higher than anywhere else in the country, these families spend about 40% less on their daily needs than the average. They face a daily struggle to balance income and spending, playing one basic requirement off another. The children of poor families are less likely to attend school. An additional 5.4% of the population in Port Vila, or 4.7% of households, cannot meet their basic daily food requirements.

The people of Luganville appear to be at less risk of poverty than those in Port Vila. Luganville seems to have more opportunities for income generation, cheaper food costs, and higher levels of home consumption.

Employment

Unemployment is a major factor contributing to urban poverty. Of all unemployed adults in Port Vila, 38% are living below the basic needs poverty line. In this group, 27% perform domestic duties, 41% are full-time students, and the

remaining 32% are reported to have “other” main daily activities, are retired, or are otherwise unable to work. One-third of adults who are working for wages or profit are poor, while another 10% are defined as “vulnerable.”

Housing

The poor are significantly more likely to live in low-quality housing constructed of temporary or traditional materials. In Port Vila, about 15% of all families live in makeshift or traditional style housing; of this number, 60% of households are poor. Only about 20% of poor families live in housing constructed of permanent materials, whereas that number doubled for nonpoor households and reached 40% (footnote 15).

About 40% of poor households in Port Vila rent their housing, compared with 26% of wealthier households. Just over one-third (34%) of poor households own their own home compared with about 63% of wealthier households (footnote 15).

Education

Only about 6% of adults in Port Vila have no schooling.⁶⁴ Among the poor, the percentage is much higher; 29% of heads of poor households are reported to have never attended school.⁶⁵ The numbers for primary schooling are comparable: 42% of all urban residents, only 10% of the poor. The link between poverty and low educational attainment has been well documented, and the data on poverty in Port Vila confirm that those with the least education are overrepresented among the poor.

Conclusions and Recommendations

Health

The low quality of health services in rural areas is attributable largely to extremely weak institutional capacity at the provincial, district, and area levels. It is recommended that the Ministry of Health (MOH) expand the outsourcing of primary health care services to NGOs significantly, and that selected organizations be supported by capacity building.

The MOH must make more efficient use of limited resources. It should also make efforts to use more aid-funded foreign medical and nursing staff as local capacity continues to be developed.

The MOH must also pay greater attention to the health needs of the burgeoning urban population, particularly those of people living in overcrowded, unsanitary conditions in informal and squatter settlements. More information

64 1999 National Census. Quoted in M. Chung and D. Hill. 2002. *Urban Informal Settlements in Vanuatu: Challenge for Equitable Development*. Suva: Pacific Islands Forum Secretariat and UNESCAP.

65 National Statistics Office. 2008. *The Vanuatu Poverty Record Card 2006: Summary of Key Results from the HIES 2008*. Port Vila.

is needed on the health profile of these groups.

Health messages related to STIs, drug and alcohol abuse, and unplanned pregnancy should be aimed at youth, especially in urban areas. These messages could be delivered through community education programs and radio announcements.

Education

The major medium- to long-term education challenge is to ensure that teachers at all levels are better trained and equipped to teach (a key objective of the Vanuatu Education Sector Strategy [VESS]). It is recommended that there be greater investment in regular and appropriate in-service training for teachers in the short term.

The Ministry of Health (MOE) should consider the introduction of compulsory primary education (now extended up to year 8, age 14). Coupled with the forthcoming abolition of primary school fees, this will have a direct positive effect on the number of years of formal education for school-age children.

A national education language policy developed in consultation with key stakeholders in the public and private sectors is strongly recommended. The comparative costs and benefits of an integrated system will need to be carefully assessed. The MOE should consider a national adult literacy campaign. Technical and vocational education and training (TVET) courses must be better tailored to the demands of public administration and the productive sector.

It is therefore recommended that a national human resources development strategy be prepared and that education policies and programs be realigned to support the strategy.

Employment

The government must give youth employment the highest priority, and youth training programs must match job opportunities. It must also give high priority to targeted training in sectors suffering from acute shortages of skilled or semiskilled workers in the urban centers.

Donors should expand their support for vocational placements—such as those already provided by New Zealand in a range of industries—to respond to demand from potential students and employers.

Gender

As a signatory to major international agreements on equality, the government should take positive steps to introduce new provisions under the Family Protection Act, giving greater legal protection to women.

The recently introduced amendments to the Employment Act should

be reviewed urgently, with specific attention to the likelihood that women will be discriminated against in employment and the workplace as a result of the changes in employment conditions.

Urbanization

A number of social problems are associated with rural–urban migration, including health problems associated with poor housing, overcrowding, and poor sanitation.

It is recommended that the government give much higher priority to urbanization and urban planning and management. Infrastructure provision will be a particularly important consideration.

THE PRIVATE SECTOR AND PRODUCTIVE SECTOR

The Private Sector

Vanuatu is establishing a foundation for sustained economic growth.⁶⁶ The government has signaled its intention to make Vanuatu a more business-friendly environment for private sector development, with sound macroeconomic management and improved policies affecting the private sector. Key improvements include the following:

- **Competition in the airline industry.** Vanuatu recently opened its air transport market to international airlines, creating competition that has resulted in significantly lower airfares and higher tourism arrivals. Recent figures illustrate the extent of this increase: international tourist arrivals were nearly 30% higher in January 2009 than in January 2008. These results reinforce the wisdom of opening the country to additional foreign airlines, and demonstrate the benefits of greater competition. In another positive step, the government is also considering options for restructuring Air Vanuatu.
- **Competition in the telecommunications sector.** The government issued a license to a foreign mobile telecommunications operator to provide services in competition with Telecom Vanuatu, the state-owned telecommunications company. This has led to a significant increase in coverage and a decrease in prices.
- **Strengthened regulation of existing monopolies.** A utilities regulatory authority act was passed in 2007, which established a new regulatory authority to monitor the power and water concessions.

⁶⁶ The following analysis and conclusions on the private sector are based on ADB. 2009. *Sustaining Growth: A Private Sector Assessment for Vanuatu*. Manila.

- **Some divestiture.** The government has reduced the state's holdings in the abattoirs.
- **An extensive commercial legal reform program.** The government has passed a new personal property securities law and has put a supporting electronic registry in place. It is engaged in extensive reform of the laws governing business, including the Companies Act, the Trustee Act, and the bankruptcy framework. Once completed, these initiatives will result in Vanuatu having a modern commercial legal framework that is tailored to the structure of business transactions and the needs of the country.

Vanuatu's small but robust private sector could expand significantly and make a substantially greater contribution to employment and overall economic development if the environment for private sector investment were further strengthened. The following are the principal constraints on private sector development:

- Infrastructure services are low in quality, high in cost, or both.
- Weak governance and intrusive interventions by the state, including through the operation of SOEs, reduce productivity.
- Inefficient and expensive monopolies continue to operate under state ownership.
- The commercial legal framework is complex, costly to access, and outdated in many areas.
- Access to financing is limited, particularly for small and rural businesses, although some progress is being made through microfinance initiatives and implementation of the Personal Property Securities Act.
- Land access and tenure issues have pervaded development efforts and continue to present difficulties for investors.
- The government has a propensity to regulate rather than facilitate business investment.

As discussed in the section on Private Sector Credit, private sector credit expanded rapidly from the beginning of 2006. While credit has been available for the commercial sector and larger businesses, rural enterprises and small businesses have found it difficult to obtain loans. The amounts at issue are small and impose high administrative costs, and potential borrowers are unable to offer security. These problems are being addressed through strategies such as the following:

- Smart banking initiatives based on the use of technology, such as mobile phones, are being developed by the National Bank of Vanuatu (NBV).
- The microfinance programs run by the NBV and the Vanuatu Women in Development Scheme enhance rural credit availability and credit for women.

- The Vanuatu Agriculture Development Bank (VADB) was established under the Vanuatu Agriculture Development Bank Act 2006 and became operational in 2008 to increase rural credit.
- The Personal Property Securities Act, passed in April 2009, and the recently launched personal property securities registry that reduces lending risks by allowing borrowers to pledge movable property as collateral. When fully implemented, this will make credit available to a wider group of borrowers.

Notwithstanding these efforts, most of the population's access to credit remains severely limited; continued efforts will be required to enhance credit availability and use across the nation. Improving the oversight of commercial banks and supervision of the newly established VADB and the Vanuatu National Provident Fund (VNPF) should also further enhance financial sector supervision.

Tourism

Introduction

Vanuatu is an island paradise. Its beaches, forests, coastline, climate, and coral reefs make it a potentially attractive tourist destination. To date, this potential is unrealized, even though tourism is already a major part of the economy. Vanuatu's physical beauty is extraordinary. What isolation and dispersion take from the economy is compensated by its "tropical paradise." It has a higher ratio of beaches to internal land than most countries, and the internal land comprises scenic and spectacular volcanic mountains, differentiating it from the atoll countries such as Kiribati and the Marshall Islands.⁶⁷

In 2006, Vanuatu was identified as the "happiest country in the world."⁶⁸ It is easily reached, particularly from Australia, New Caledonia, and New Zealand. Airfares have declined significantly since 2003, cruise ship visits are increasing, and it is seen as a safe destination with a relaxed lifestyle. These and other factors have contributed to Vanuatu's increasing popularity as a tourist destination in recent years.

Tourism has several benefits if it is well managed: it makes a positive contribution to the balance of payments, it is relatively labor intensive and creates substantial employment, it provides incentives to retain cultural traditions and activities, and it uses the nation's scarce resources in a mostly low-impact manner.

67 World Bank. 1998. *Enhancing the Role of Government in the Pacific Island Economies*. Washington, DC.

68 In 2006, the Happy Planet Index ranked Vanuatu as the happiest country on earth. Vanuatu was followed by 10 Latin American and Caribbean countries, which are ranked according to ecological footprint, life satisfaction, and life expectancy.

However, international experience shows that social problems, including increases in prostitution, drug use, and crime, often accompany the development of tourism. Poorly designed and managed developments can also have a substantial adverse effect on the environment. Tourism development should take account of social and environmental factors, not just physical and market development plans.

Sector Performance

Tourism is Vanuatu's leading export industry, growing continually since 2004. Travel receipts cover most of the gap arising from trade in goods and have been the largest source of foreign exchange revenue. Tourism-related sectors (wholesale and retail trade, hotels and restaurants, and transport and communication) play an increasingly important role in the domestic economy. These three sectors account for more than 66% of gross domestic product (GDP), and about 70% of the increase in real GDP from 2006 to 2008.

The following are some results from the survey work on tourism undertaken in 2007:

- Total direct tourist spending in 2007 was estimated at Vt14.7 billion.
- Spending by travel agents on behalf of visitors was Vt3.2 billion.
- Local incomes, direct and indirect (value added), derived from tourism totaled Vt10.2 billion.
- Approximately 3,300 full-time and 1,400 part-time jobs resulted from tourism spending—about half in the hotel and accommodations sector.
- About 60% of air visitors, 63% of yacht visitors, and 40% of cruise ship arrivals visit sites and attractions outside Port Vila. Approximately Vt3.3 billion, or 22.6% of all tourist spending, is on local transport.
- Tourism's contribution to GDP is about 20%.
- Approximately 14% of tourist nights are spent on islands other than Efate, accounting for total expenditures of about Vt1.5 billion (footnote 28).

Figure 13 shows the numbers of nonresident visitors arriving by air and by cruise ship. From 2002 to 2008, the numbers increased by 104%, from 99,488 to 202,943. The number of tourists who stayed for more than a day increased by 96%, from 49,461 in 2002 to 96,805 in 2008. The average stay also increased from 8.2 days to 10.0 days during the same period. Nearly all of the tourists who stay for more than a day arrive by air; the rest come by yacht. Since 2002, 77%–78% of visitors arriving by air came for a holiday (Table 12). Most tourists come to Vanuatu from Australia (55% of air arrivals in 2008), New Caledonia (10%), and New Zealand (14%).

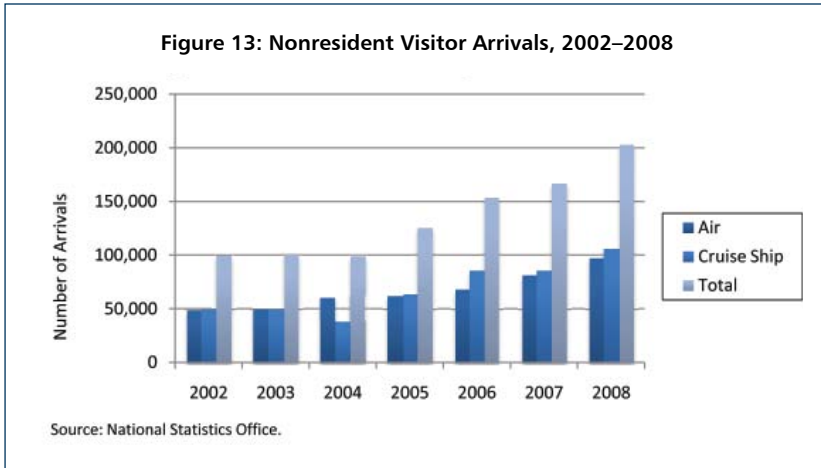


Table 12: Air Arrivals by Purpose of Visit, 2002–2008

Year	Stopover	Holiday	% of Total	Visiting			Total
				Friends or Relatives	Business	Other	
2002	611	38,740	78	3,563	6,544	4	49,462
2003	835	38,924	77	3,887	6,746	8	50,400
2004	1,521	46,805	77	4,593	7,685	6	60,610
2005	1,326	47,865	77	4,451	8,411	29	62,082
2006	775	53,030	78	5,061	9,312	1	68,179
2007	1,020	63,323	78	6,161	10,837	0	81,341
2008	1,235	72,278	78	9,783	9,965	0	93,261

Source: National Statistics Office. 2008. Port Vila.

Cruise ship arrivals have increased by 112%, from 50,027 in 2002 to 106,138 in 2008. Cruise ship passengers are day visitors calling in to Port Vila. They also make occasional day trips to Champagne Bay in Santo, to Malekula, and to Pentecost.

The tourism industry also remained strong in the first half of 2009 and is expected to remain strong amid signs that the Australian economy has not been affected significantly by global economic crisis. The key to Vanuatu's economic growth is the continued resilience of Vanuatu's main trading partners. Vanuatu's proximity to its main tourist market has helped inbound travel to remain strong, boosted by Vanuatu's open sky policy, increased promotion internationally, and discounting of airline fares, coupled with regular cruise ship calls to Vanuatu. The recent appreciation of the Australian dollar and New Zealand dollar against the vatu is also expected to increase spending by tourists on domestic goods and services and augment foreign exchange flows into the country.⁶⁹

69 Reserve Bank of Vanuatu. 2009. *Half-Yearly Monetary Policy Statement, September 2009*. Port Vila.

Over time, Vanuatu should seek to diversify its market, perhaps with some focus on the People's Republic of China and other emerging Asian markets. However, as discussed in the 2009 Vanuatu Tourism Action Plan (VTAP), such an initiative requires a strategy to bring the greatest benefit to Vanuatu (footnote 4).

Growing Tourism

Tourism relies on political and social stability to ensure continued market growth. Further economic reform and greater public investment in physical and social infrastructure are required to make the country an easier place in which to do business and to visit. Careful attention to environmental management is also needed to preserve natural assets (footnote 19). The government must set the policy context and operating environment for developing tourism, but the private sector must drive investment and employment.

The deregulation of the airline industry in 2003 led to a significant reduction in airfares to Vanuatu from Australia and New Zealand, resulting in a spike in visitor numbers. This coincided with the commencement of services from Australia by Pacific Blue, which now provides flights from Brisbane, Melbourne, and Sydney. Air Vanuatu has code sharing arrangements with Air New Zealand and Qantas, and added a Melbourne route to its schedule in 2008. It also provides international services to Pekoa Airport in Santo. Air Pacific and Solomon Airlines fly into Bauerfield Airport in Port Vila.

The most frequently visited islands other than Efate are Santo, mainly because of the attraction of scuba diving on the sunken vessel, the SS President Coolidge; and Tanna, because of the attraction of the Yasur volcano. While efforts have been made—with funding from the Government of France—to bring the airports on Santo and Tanna up to international standards, and to develop the airports at Ambae and Pentecost, the limited accommodations and the high cost and irregularity of domestic flights hamstringing tourism development in these locations. Similarly, cruise ship visits to islands other than Efate are hindered by a lack of infrastructure. These issues are well recognized, however, and in March 2009, a strategic plan for tourism in Sanma Province was completed. A strategy for tourism development in Tafea Province is planned to be released in 2009/2010.

About 500 rooms were added to Vanuatu's stock of hotel accommodations in 2007, and international flights increased in 2008, both supporting tourism growth. However, further growth might be limited by accommodation shortages on Efate in the short- to medium-term. An analysis by Boudart and Gavotto in 2008 indicated that there could be a hotel room shortage by 2010, although a representative of the Vanuatu Hotel and Resorts Association suggested that such a shortage is already being felt in 2009.⁷⁰

70 A. Boudart and P. Gavotto. 2008. *Research on the Development of Tourism in Vanuatu: Analysis and General Recommendations*. Port Vila: Vanuatu Tourism Office.

The Boudart and Gavotto study was derived from 2008 occupancy rates of establishments with more than 50 rooms. With the present global financial crisis, significant tourism investment is less likely in the short term, although the Vanuatu Investment Promotion Agency reports that construction of a high-end resort has commenced on an island near Santo, and approval has been granted for the construction of a five-star resort at Malapoa Point, Port Vila.⁷¹ Nevertheless, these developments will be a minor addition to a particular segment of the market. Even if Vanuatu avoids the worst effects of the global financial crisis, the number of tourists arriving by air may plateau in 2010 because of limited accommodation.

Other tourism issues that must be addressed include the following:

- It is difficult to obtain land with well-defined property rights, including certainty of tenure; the establishment of specific tourism zones on some islands might be a partial answer, particularly in provincial locations outside Efate. The Land Sector Framework (LSF) might also be helpful.
- There are no five-star resorts or hotels, so the higher end of the market is not catered to at present.
- Many other infrastructure deficiencies hobble tourism, such as limited availability of electricity, water, and sanitation outside the main centers, and the high cost of electricity.
- The Vanuatu Tourism Office and the National Tourism Development Office, the main government institutions responsible for tourism, are under resourced, resulting in a lack of cohesion and insufficient focus on important policy development initiatives.
- Appropriately skilled staff are in short supply, although the Vanuatu Institute of Technology (VIT) now offers a Certificate of Hospitality through its dedicated Tourism and Hospitality Training Center. Short-course training modules are being developed for the outer islands.
- Reserving business activities such as operating buses, taxis, and small-scale accommodation facilities for ni-Vanuatu may restrict investment by international and joint-venture activities.

Two other matters are also important. First, the environment for the foreign investment necessary for tourism development is complex, bureaucratic, often unpredictable, and subject to political interference. To facilitate investment in tourism facilities, it is critical to improve the enabling environment for business activity.

Second, the government has no clear policy for tourism development in Vanuatu. The government might consider the establishment of tourism zones, resulting in clusters of resorts, and the role of eco-resort developments.

71 Land negotiations have taken place, a lease has been signed and an upfront payment has been made to landowners, but this development remains held up by a dispute between groups of landowners.

It could widen the definition of tourism to include international retirement complexes, for example.

The VTAP contains a number of appropriate strategies:

- Improve policy coordination and increase capacity for sustainable planning and marketing of tourism. Because tourism is Vanuatu's leading industry, it must be strengthened as an institution and receive greater funding support from the government and donors.
- Increase awareness in identified primary target markets of Vanuatu's unique selling points as a tourist destination. This course of action answers the regular criticism that there is no clear view of how to market tourism or what kind of tourism Vanuatu wishes to develop. The VTAP includes a range of specific actions to address these and related issues.
- Support greater local and international participation by improving Vanuatu's business-enabling environment, investment attractiveness, and variety of offerings. This strategy relates to all investment activity and emphasizes the importance of the government focusing on its core roles, thereby facilitating investment in the economy.
- Increase destination accessibility, infrastructure use, and viability through strategic investment, maintenance, and market development. This strategy addresses infrastructure limitations and the desire to spread tourism across the whole country.
- Develop a coordinated approach to human resource development, planning, and training for the tourism sector that meets industry, government, and community needs. Institutional and skills deficiencies are also covered under this strategy.

The VTAP provides a blueprint for the further development of tourism in a manner that best meets the needs of Vanuatu and that is appropriate to its economic, social, and geographic setting. It should, therefore, be given high priority by the government, the business sector, and donors to ensure further development of the country's most critical sector in terms of economic growth and employment.

The National Tourism Development Office has begun to prepare a cruise ship strategy with funding support from the European Union (EU), based partly on a predicted significant increase in the number of cruise ships visiting Vanuatu over the next 4 years. The International Finance Corporation has recently also started to undertake a tourism sector evaluation for Vanuatu. Its tourism sector diagnostic tool uses the following three interdependent drivers to assess whether a country is enabling or impeding sustainable development of the tourism sector: (i) the destination (its tourism-related characteristics and support for tourism), (ii) the market (market perceptions and activity affecting demand), and (iii) investors (investor requirements and perceptions of the investment climate).

Agriculture

Introduction

Agriculture remains fundamental to the traditional and cash economies and involves all but a small percentage of the population. It is the second-largest contributor to GDP and provides virtually all of the goods exported from Vanuatu (Appendix Table A.7); it also provides subsistence for most of the population.

Despite its importance, however, the sector, particularly its commercial component, is underperforming. Earnings from the principal commodities, excluding copra, have remained virtually stable since 1990 (Figure 14). Following a period of high prices supported by the Vanuatu Commodities Marketing Board (VCMB) in the mid to late 1990s, export earnings from copra fell away sharply. As the nation tries to broaden its economic base and adjust to meet the needs of a rapidly growing population, it will be even more critical for Vanuatu to develop its agriculture sector, make structural adjustments, and reap productivity gains. There is a pressing need to develop real vision, institutional structures, and service delivery that will support more productive and dynamic agricultural enterprises.

However, recommendations for a national agriculture policy must be critically qualified. First, the government must focus on its core roles, including regulation, quarantine, research, and information provision through extension services. Government involvement in the sector should cease altogether. Policies such as the VCMB's price support for copra are inefficient, inequitable, and counterproductive. They limit structural adjustment, and should be terminated. If the government wants to increase rural incomes, this should be treated as a part of welfare policy, not disguised as agriculture policy.

Institutional Setting

The Ministry of Agriculture, Quarantine, Forestry and Fisheries (MAQFF) is responsible for policy making, implementation of policy and legislation, and the delivery of a range of assistance programs and services. It is also responsible for a number of SOEs. The MAQFF consists of four departments: (i) agriculture and rural development, (ii) fisheries, (iii) forestry, and (iv) livestock and quarantine. It has four major medium-term programs to address increased resource production, market access and trade facilitation, biosecurity, and agro-processing and adding value.

The other significant agriculture institutions are the Vanuatu Agricultural Research and Training Center (VARTC), the Agricultural College, and VCMB. VARTC undertakes applied research (an important core role for a government agency), but it has little ability to influence agricultural development because it is under resourced. The Agricultural College, based in Santo, was funded by the People's Republic of China and commenced limited operations in 2007.

It runs short courses for farmers delivered by MAQFF extension officers. It is also developing curricula for horticulture, forestry, and livestock management courses, each of which must eventually be accredited by the Vanuatu National Training Council. Like the VARTC, the college is under resourced; it requires adequate funding, staffing, and operational budgets to be effective. MAQFF management should consider coordinating the activities of VARTC and the Agricultural College to make both institutions more relevant.

The VCMB was originally established to support quality improvement and price stabilization for copra using EU Stabex funds.⁷² It has been the subject of a number of recent reviews, including ADB's 2002 agriculture policy review,⁷³ an EU-funded report by Gay in 2005,⁷⁴ the Diagnostic Trade Integration Study (DTIS) in 2008 (footnote 13), and ADB's 2009 private sector assessment (footnote 22). According to that assessment:

Overwhelmingly, stakeholders indicated that the VCMB is inefficient and unaccountable, that it imposes a substantial burden on the industries it regulates (particularly on small-scale farmers), and that it does not assist in the industries' development. There is also said to be substantial political interference in the VCMB (footnote 22).

The 2005 EU report concluded:

The VCMB has become outdated following the end of Stabex and its role as a vehicle for delivering price support to farmers.... The VCMB currently performs only a marginally useful role, one that could be better achieved by existing government departments. The levy on exports is effectively a tax that disincentivizes a sector the government should be doing everything in its power to promote.

There has clearly been a loss of confidence in the VCMB, which independent analysts no longer see as relevant. Little of its original rationale remains, if any. Exporters can and do take more responsibility for quality control, and the Quarantine Inspection Service provides the final assurance for export documentation. There is no sound reason for allowing VCMB to continue to operate, and in the interest of developing an efficient and productive agriculture sector, it should promptly be abolished.

AusAID has recently started providing the government with assistance for formulating strategic policy options for the development of Vanuatu's coconut-based industries, funding an audit and review of VCMB, and providing advice on the most appropriate future role for the VCMB.

72 Stabex funds are the European Commission's compensatory finance scheme to stabilize export earnings of the African, Caribbean, and Pacific group of countries. It was first introduced in the 1975 Lomé Convention with the purpose of remedying the harmful effects of the instability of export revenue from agricultural products. Stabex, along with Sysmin, a similar mechanism for mineral products, was abolished by the Cotonou Agreement in 2000. The agreement has been linked closely to that of the International Monetary Fund (IMF) compensatory package. However, the debate rages that such schemes are not as effective as free trade due to the long-term instability of the products.

73 ADB. 2002. *Policy Issues in the Agriculture, Fisheries and Forestry Sectors*. Manila.

74 D. Gay. 2005. *Baseline Study of the Trade Situation and Business Environment in Vanuatu*. Port Vila: Government of Vanuatu, Department of Trade, Industry and Investment and Transport.

Policy Setting and Service Delivery

The second national priority listed in the government's Priorities and Action Agenda 2006–2015 is “improving the lives of the people in rural areas by improving service delivery, ensuring market access to rural produce, lowering costs of credit and transportation, and ensuring sustainable use of natural resources (footnote 9).” Productive use of credit by farmers and the benefits of better market access and transportation systems to them require research and extension services that lead to increased productivity, better use and management of scarce agricultural resources, and accessible market information.

The Department of Agriculture and Rural Development undertakes programs relevant to each of the needs noted above. Programs for improved production, processing, marketing, farming systems, horticulture, and provision of information are all in place. Similarly, the Department of Livestock and Quarantine delivers livestock production services in addition to animal health and quarantine programs.

However, the outcomes of all these programs have been very limited over a long period, for two principal reasons. First, a lack of suitable extension materials, funding, staffing, and transportation access hinders staff. Future programs will need to take account of funding and other limitations, and seek alternative means to deliver information and other support to farmers, such as using modern telecommunications systems.

Second, and more important, is the lack of a national agriculture policy to underpin a strategic development program, resulting in piecemeal, disconnected projects funded by a range of donor agencies, which may be useful, but tend to be one-off and unsustainable. The management of MAQFF and various donors agree that the development and implementation of a national agriculture policy should be given the highest priority. This has been the subject of a series of joint donor inputs involving the government, AusAID, the European Commission, and New Zealand Agency for International Development (NZAID), with principal conclusions as follows:

- There is no comprehensive government-wide policy for productive agriculture development. Such a policy would require adjustments across multiple institutions, such as those responsible for land, transport, taxation, labor, and energy.
- When such a policy is developed, along with its associated strategies, longer-term support for agriculture will become available from donors.
- However, certain subsectoral initiatives can be supported immediately. Possible measures include strengthening of (i) agricultural food export inspection, standards, certification, and quarantine service capacity; (ii) extension services in agriculture, fisheries, and livestock; (iii) crop and livestock enterprise value chains; (iv) market and other information; (v) rural financial services; and (vi) domestic shipping.

Immediate support for diverse initiatives creates a risk of perpetuating piecemeal development without a policy framework. Policy development requires attention to issues such as the level of focus on commercial versus subsistence activities; agreement on the fundamental roles of government, the private sector, domestic and foreign development; and the potential role of farmers' cooperatives, such as those developed in the fisheries sector.

NZAID released a review of agricultural extension services in June 2008.⁷⁵ The review makes a number of recommendations concerning capacity building, and promotes the development of a new extension system, not merely a revised extension service.

Though there is clear agreement on the need for a government-wide policy for the productive sectors, government officials say that the donor group dealing with this issue has moved very slowly. However, the government must provide the leadership required and decide, in consultation with its development partners, how best to take policy development forward expeditiously. This is the highest priority for agriculture and agricultural development.

The recommendations for capacity building of extension services are strongly supported, and support for a capacity-building program should be sought as soon as practicable. The NZAID-funded review of extension services provides a sound framework on which to base such a program. The framework includes suggestions that the MAQFF should

- have the ability to provide public services on a sustainable basis, with donor support. In addition, it should rationalize its staff and restructure through voluntary redundancy.
- support nongovernment and private sector providers through collaborative and integrated programs. In particular, it should offer specialist technical support for specific products (such as coffee and vanilla) and for national action plan objectives for agriculture and women.
- allow private sector providers to compete for agricultural extension public funds and donor funds.
- use participatory approaches to determine producer needs and priorities.
- be revitalized through (i) training for extension workers, including on issues of gender awareness; (ii) provision of adequate logistical and administrative support to provincial offices; (iii) rationalization of provincial offices, housing, and equipment; and (iv) development of efficient and low-cost media for disseminating information through radio, DVD, and mobile phone technology.

75 NZAID. 2008. *Review of Vanuatu's Agriculture Extension Services*. Wellington.

Fisheries

Introduction

The core functions of the Department of Fisheries are development of rural fisheries for income and subsistence, sustainable management of fisheries resources (including management plans for the main fisheries), and licensing and surveillance of commercial fisheries and the sport-fishing charter boat industry.

Domestic Fisheries

Fisheries development officers support the local fishing industry by providing equipment such as ice-making machines and fish-aggregating devices, technical advice, information, training, and improvements to marketing networks. They are also helping to develop alternative fisheries. Most fisheries are in the coastal and nearshore zones, although some deepwater and pelagic fisheries supply urban markets. According to the 2007 Agriculture Census, 75% of rural households are involved in fishing, so it is not surprising that coastal fishing for local markets and home consumption also occurs (footnote 14).

Trochus, green snail, and sea cucumber are harvested, although concerns about overexploitation resulted in a 15-year moratorium on green snail harvesting that began in 2006, and a 5-year moratorium on sea cucumber that began in 2008.⁷⁶ An aquarium products industry has developed recently (Table 13); of 358 export permits issued for fisheries in 2007, 96% were for marine aquarium products.⁷⁷ The National Aquarium Trade Management Plan⁷⁸ was launched in 2008, under which limits have been placed on the number of traders and allowable activities.

An aquaculture management plan was also launched in 2008. Aquaculture began in Vanuatu only in 2005, when the first local prawn farm was established. The farm produces about 30 metric tons each year, all of which is sold locally, mainly to restaurants and resorts. Small community trials of freshwater tilapia production are also underway, while a local company produces about two metric tons of tilapia each month, which is sold locally.⁷⁹

76 Small quantities of sea cucumber may still be caught for medicinal uses.

77 MAQFF. 2008. *Annual Report 2007*. Port Vila.

78 Government of Vanuatu, Ministry of Agriculture, Quarantine, Forestry and Fisheries. 2008. *Vanuatu National Marine Aquarium Trade Management Plan 2008*. Port Vila.

79 Government of Vanuatu, Ministry of Agriculture, Quarantine, Forestry and Fisheries. 2008. *Aquaculture Management Plan*. Port Vila.

Table 13: Exports of Aquarium Products by Quantity and Value, 2007–2008

Product	2007		2008	
	Quantity	Value (\$)	Quantity	Value (\$)
Live Fish	175,283	99,103	148,194	450,000
Live Rock	17,464	24,240	–	11,187
Live Clam	11,883	33,768	13,002	84,125
Coral	6,543	35,893	279	2,085
Invertebrates	5,273	4,400	19,740	4,142
Total	–	200,404	–	551,539

– = not available.

Sources: Government of Vanuatu, Ministry of Agriculture, Quarantine, Forestry and Fisheries. 2008. *Annual Report 2007*. Port Vila; and Government of Vanuatu, Department of Fisheries. 2009. *Annual Report 2008*. Port Vila.

Domestic fishing is an important source of income and nutrition. As the population grows, the pressure to fish in nearshore areas is likely to increase. Previously, the EU-funded Village Fisheries Development Project, which ran from 1982 to 1987, and the follow-up Vanuatu Fisheries Training Center and Extension Services, which ran over two phases from 1987 to 1996, provided support to rural fishers. Since then, fishers have had little or no direct support other than assistance from the Department of Fisheries on establishing cooperative associations for fisherfolk, which resulted in 71 fish markets by the end of 2008. The department is developing a coastal fisheries policy and plans to provide more support to rural fishers.

The Department of Fisheries has achieved success in areas such as the preparation of management plans, but has only limited resources to help develop local fisheries. Since 2000, the department has installed only seven ice-making machines in the six provinces. It has continued to support the maintenance and operation of these machines, and has also been involved in enterprises such as the Malampa butchery and fish market, which it supported in 2008. This enterprise is funded by the Japan International Cooperation Agency (JICA).

Commercial Offshore Fishing

Tuna, mainly albacore, but also yellowfin and bigeye, is the basis of offshore fishing. Foreign-flag vessels fish under license; vessels registered on the Vanuatu Shipping Registry operate as Vanuatu-flagged vessels. There were 30 such ships licensed to fish in Vanuatu waters in 2008. In 2008, a total of 142 fishing licenses were issued to foreign vessels, and 11 to local vessels, resulting in Vt144.9 million from licensing and registration fees—more than three times the budget allocated to the Department of Fisheries for the year.

All the tuna caught in local waters is delivered to American Samoa, Fiji Islands, or Papua New Guinea. Vanuatu is now seeking to increase the license fees it can command (thereby generating more revenue) by processing tuna domestically. It is developing two shore-based processing facilities: a tuna longlining base at Blacksands in Mele Bay, quite close to Port Vila, and a second in Port Vila Bay between the Department of Fisheries and the main wharf. The longlining plant is to be managed by the China National Fisheries Corporation (CNFC), and to commence operations in late 2009 to early 2010. The plant will be jointly owned by CNFC (the majority shareholder) and the Government of Vanuatu (managed by Vanuatu Livestock Development); it will process and pack the tuna catch of 40 Chinese longline vessels for export. The vessels will unload an estimated 300 metric tons per month at the main wharf in Port Vila Bay; the catch will then be transported to the processing plant by road. Thirty Vanuatu-flagged longline vessels are meant to deliver directly to the second proposed plant in Port Vila Bay, although estimates of the total amounts are not available.

The CNFC development at Blacksands has been quite controversial in the local community, resulting in the establishment of a community group known as Residents Against Processing Tuna. The main concern is the potential impact on tourism—the nation's largest industry—of the weekly unloading of fish from a number of vessels each week at an already overcrowded wharf, and the potential for pollution from fish effluent and fuel spills from vessels. The development was also not subjected to an environmental impact assessment (EIA), which causes concern. The situation as at the end of the third quarter of 2009 was as follows:

- Under the Environmental Management and Conservation Act 2002, the preparation of an EIA is a two-step process. First, a preliminary environmental assessment (PEA) is undertaken by the Environment Unit or another approved government agency; if it is found that an EIA is needed, a full assessment is then undertaken. An independent consultant found that a full EIA was not required for the CNFC development. However, the use of an independent consultant contravenes the act.
- The PEA was the subject of a legal challenge. The court ruled that it and the associated environmental management and monitoring program should be independently reviewed. This review was undertaken in early 2009, but the findings are yet to be released.

By contrast, the development in Port Vila Bay is the subject of a full EIA, although here, too, the PEA found that an EIA was not required. However, the Environment Unit ruled that an EIA should be undertaken, perhaps because of the community response to the CNFC development.

Regardless of the outcome of the processing plants, marine and terrestrial pollution must be avoided. The inner harbor already suffers from high organic loading and the presence of coliform bacteria, partly as a result of limited tidal flushing (footnote 13). The presence of bilge water, biological waste, and fuel oil spills from fishing vessels all indicate the importance of robust environmental management and the need for monitoring.⁸⁰ The fish-processing plant proposals are also ideal candidates for performance bonds to ensure that resources are available to address any adverse effects.

Vanuatu will benefit from onshore processing, despite the concern over the locations chosen. The Department of Fisheries will be able to better monitor catches and more readily implement its observer program. A 4% levy on all fish exported by the processing plants is expected to return about Vt1.4 billion in revenue each year.⁸¹ The landowners of the CNFC site will also realize substantial returns. They have already received Vt28 million in lease payment, and will receive Vt2 million each year in rent as well as 5% of the gross value of the fish processed.⁸² They also have first preference for employment in the plant.

In summary, onshore processing should ensure that Vanuatu receives a greater share of the profit from tuna fishing. But crowding in the harbor and at the main wharf, and adverse environmental effects (particularly on the important tourism industry), remain concerns. Final approval for operation of the processing plants should be contingent upon well-funded environmental management and monitoring programs. The potential to require performance bonds should also be investigated, and such bonds should be required if found appropriate at this late stage of the process.

Conclusions

Private Sector

Over the past 5–6 years, Vanuatu has been one of the most rapidly growing economies in the Pacific region. The government has expressed a strong commitment to pursuing continued reform to promote private sector development in the country, which augurs well for the future. In the medium term, putting high priority on implementing the following reforms will raise the sustainable growth rate:

- Upgrading infrastructure is necessary to ensure sustained long-term growth, as it has experienced underinvestment for a prolonged period

80 Biological waste refers to the heads, tails, blood, frames, and skins of processed tuna. Three local companies have approached the Department of Fisheries with proposals to take the waste and process it into fish meal and related products. Such downstream processing is important and should be supported, provided that the locations chosen are appropriate.

81 This estimate is based on a yield of 35% and free on board price of \$10 per kilogram.

82 It is reported, however, that disputes over ownership of the land are possible because of internal disagreement regarding who had the right to sign a lease.

and urgently requires additional resources. To the greatest extent possible, this should be done using private sector solutions, such as public–private partnerships.

- Introducing competition policy to regulate power and port charges to reduce monopoly profits in these areas, especially since Vanuatu has the highest electricity and port charges in the region. In the longer term, these monopolies should be addressed by bringing in additional power providers (including for alternative energy) and constructing another harbor near Port Vila.
- Rationalizing the state-owned enterprise (SOE) portfolio, including divestiture, public–private partnerships, and upgraded governance, will raise productivity and enhance the long-term sustainable growth rate of the economy.
- Reviewing the land leasing system to ensure the sustainability of current and future leases, particularly as significant tensions are developing in this area.
- Proceeding with commercial legal reform by bringing legislative drafts to Parliament and passing them into law as soon as feasible. This will help Vanuatu become a better place in which to do business.

While the global economic crisis brings short-term uncertainty, these measures should increase Vanuatu's ability to weather the storm and add to the future prosperity of the country. Significant progress has been made over the past few years in implementing measures that enhance growth prospects. The government's commitment to reform continues, and if existing measures and future plans are implemented, Vanuatu will continue to be one of the fastest growing economies in the region.

Tourism

Tourism is the nation's leading industry, but it has further potential to expand. The Vanuatu Tourism Action Plan (VTAP) provides a blueprint for the development of tourism. Critical issues include environmental protection and management, formulation of a clear government tourism policy, and spreading tourism activity to the provinces. Land, infrastructure, and rural credit need to be addressed, as well as an accommodation shortage that may occur in the short to medium term. However, the most important requirement for further development is a robust enabling environment for private sector investment.

Agriculture

The most urgent task is the preparation of a national agriculture policy and a strategy for development of the sector. At the same time, the MAQFF organizational structure should be reviewed with a view to combining the various extension services. The government should also urgently try to obtain

donor funding for the development and implementation of a new extension system.

Fisheries

It is critical to ensure that the authorities can enforce the full implementation of the various fishery management plans. Cooperative associations for fisherfolk should also continue to be supported. The two onshore tuna processing facilities will bring economic benefits despite the controversy surrounding their location. If they are approved, environmental management and monitoring will be crucial, and the capacity to undertake monitoring and to enforce compliance must be in place. The government, through the Environment Unit, could also consider requiring performance bonds for each facility.

INFRASTRUCTURE DEVELOPMENT

Introduction

Situation Assessment

Vanuatu relies critically on infrastructure services, particularly communications and transport, for the achievement of its development goals for its geographically dispersed population. Income-generating opportunities are scarce in rural areas, where most of the population lives; the rural economy is based on agriculture and fishing and, increasingly in some areas, tourism. Access on and between islands is essential for rural development and poverty reduction, but transportation infrastructure and services are inadequate.

The main form of travel in the country is by sea, using small craft in coastal areas and combined passenger and freight vessels for interisland journeys. Outside of Port Vila and Luganville, shipping services call at about 36 small jetties or wharves and many more informal anchorages or beach landing sites. Vanuatu relies on international shipping for the movement of goods, and the cruise ship tourism industry has become an important economic subsector.

The land transportation network consists of about 1,800 kilometers of roads, of which less than 100 kilometers are paved and less than 400 kilometers have gravel surfaces. Most of the network is on the two main islands around Port Vila and Luganville. Many islands have no roads at all.

Vanuatu depends on international air services for international trade and tourism, and on high-quality domestic services for internal tourism and service delivery. Recent liberalization of international access has led to a dramatic increase in services. There are 3 international airports and 26 domestic airfields, not all of which have scheduled services.

Urban planning and development has received relatively little attention until very recently. Yet the rapid growth of urban areas, particularly those of Port Vila and Luganville, puts pressure on the urban infrastructure, making its development critical.

There has been little new capital investment in recent years. The Ministry of Infrastructure and Public Utilities (MIPU) and the Public Works Department (PWD), one of its main departments, are responsible for providing and maintaining transportation infrastructure. Although the MIPU has allocated about 12% of the total 2008 government budget, it has made little progress in improving the country's poor physical infrastructure because it is inefficient in converting plans to actual operations and rarely seeks external funding. As a result, deferred maintenance has led to widespread deterioration. Most capital investment for infrastructure has been provided by development partners.

Roads are inadequately maintained and typically need rehabilitation as well as ongoing maintenance, but the budget has never been sufficient. Until 2007, funding for road maintenance was less than \$2 million per year. Under a compact with the Millennium Challenge Corporation (MCC), that figure has now increased to \$5 million per year, but this is still only about 25% of what is required for routine maintenance, let alone rehabilitation. Road conditions are deteriorating every year—reducing service, increasing costs, and creating a growing backlog of maintenance and repairs that will cost increasingly more as time passes.

Among the priorities for infrastructure are

- lowering the cost of transportation and utilities;
- expanding access to markets for products from rural areas, and supporting development of the important tourism sector;
- improving roads, jetties, and other transportation infrastructure in the rural areas and outer islands to enhance interisland transport;
- strengthening local contracting services for infrastructure maintenance; and
- paying greater attention to urban planning and development and the provision of infrastructure services such as roads, water supplies, and sanitation facilities.

Development Partner Activities

A number of donor-sponsored interventions in infrastructure have focused on public sector reforms through capacity building, including institutional strengthening and improved governance. The Governance for Growth (GFG) is a particularly useful program that has provided specific assistance in electricity, telecommunications, and air transportation, geared toward improving competitiveness through private sector participation and increasing the government's capacity as a regulator (footnote 27).

Several development partners are providing assistance, primarily for land transportation, to improve sector performance and reform planning and budgeting frameworks, strengthen asset management, provide opportunities for private sector participation, and develop capacity in the MIPU and the PWD.

The United States' MCC has provided approximately \$65 million in grants to develop rural infrastructure under the Vanuatu Transport Infrastructure Program. This program was originally intended to include roads, wharves, and an airstrip, as well as institutional support and capacity building, but the project has been scaled back to land transport due to delays and rising costs. Australia and New Zealand are providing financing to complete several of the important roads originally identified for MCC funding.

AusAID has given approximately \$11.5 million for civil works, maintenance, and capacity development under the Vanuatu Transport Sector Support Program (VTSSP). The VTSSP will focus on strengthening and using the private sector to undertake works, using small- and medium-scale contracting, labor-based appropriate technology methods, and government processes, as much as is practicable. The VTSSP is intended as the first phase of a long-term partnership (10–15 years) between the governments of Vanuatu and Australia in the transportation sector.

The VTSSP will be delivered in three phases.⁸³ Phase 1 will run for 2 years and will complete road rehabilitation subprojects on the islands of Ambae, Malakula, and Tanna. Projects on these islands were selected from the list of dropped MCC projects following consultation with the government on priorities. The suitability of the roads for the mechanisms (labor-based appropriate technology) to be used through Phase 1 was also given consideration. Phase 1 will also begin the process of building capacity within MIPU and PWD, including the design of Phase 2 and a long-term program of support. Phase 2 will be a longer (5 years) program to strengthen budget processes and management of maintenance and rehabilitation. Phase 2 will provide sector-based support focused on improving the general performance of the transport sector. The government has expressed a desire for donors to work together in developing a sector-based approach. Phase 3 will build on the objectives and outcomes of Phase 2. The key directions of Phase 3 will be decided following a review of the implementation of phases 1 and 2.

ADB and New Zealand Agency for International Development (NZAID) have been active in the maritime subsector; beginning with an interisland shipping study conducted in 2008.⁸⁴ The study recommended institutional reforms, a shipping support scheme, and targeted infrastructure investments in Port Vila and rural areas. ADB is preparing a project for possible implementation in 2010 to address these areas.

Agence Française de Développement is the only agency that is active in the aviation subsector. It is supporting an outer islands project to upgrade two provincial airfields. The government has recently passed legislation to facilitate public–private partnerships for international aviation, but there are

83 AusAID. *Vanuatu Transport Sector Support Program (VTSSP) Concept Document*. Canberra.

84 McGregor and Company. 2008. *Vanuatu Interisland Shipping Study*. Auckland.

no short-term proposals for such partnerships, nor is there any indication that significant work is required to support domestic aviation.

Japan International Cooperation Agency (JICA) is funding an upgrade of the main international wharf, which will provide additional cargo handling capacity for international shipping. JICA has also assisted the government in the past to improve rural electrification through small-scale solar power projects. This approach will be adapted to (i) support more systematic maintenance of the key infrastructure that is fundamental for rural development, and (ii) improve the maintenance and management capacity of PWD through the dispatch of experts and training courses. JICA will also look into the possibility of fundamental improvement of PWD through technical cooperation projects, field support by volunteers, and response to social service needs in rural areas, such as water supply. As for infrastructure for information communications and technology, it is necessary to find technology that is both technically feasible and economically appropriate for people living in rural areas. JICA will attempt to study ways of assisting the provincial governments and civil societies with such technology in order to mitigate the digital divide.

ADB has funded a number of infrastructure projects over the last 15 years, including support for urban infrastructure in Port Vila and Luganville, outer-island wharves, and rural roads.⁸⁵ The mixed success of these projects offers a number of lessons:

- Subproject designers must ensure beneficiary buy-in by consulting with local communities about proper site selection, demand for the services to be provided, and use of technology and design appropriate for local conditions.
- Project design must account for the limitations of national agencies.
- Project plans must take into account delays and unexpected cost increases.
- Civil works must be integrated with the government's priorities and plans for governance and institutional reforms, and there must be improved co-ordination across sectors and agencies in planning infrastructure projects.

Economic Infrastructure

The geographic dispersal of the islands that constitute Vanuatu makes infrastructure development and service provision difficult and expensive. Land ten-

85 These include: Loan 766–VAN (SF) Multiproject for \$3 million, approved on 5 December 1985; Loans 843/1080–VAN (SF) Santo Port Project for \$9.15 million, approved on 29 September 1987 and 19 March 1991; and Loan 1448–VAN (SF): Urban Infrastructure for \$10 million, approved on 27 June 1996. ADB has also provided technical assistance such as TA 901–VAN Institutional Strengthening of Public Works Department, for \$412,000, approved on 29 September 1987; TA 2596–VAN Urban Growth Management Strategy for Port Vila, for \$600,000, approved on 27 June 1996; TA 2597–VAN Sanitation Master Plan for Port Vila, for \$360,000; both approved on 27 June 1996.

ure also creates uncertainty and often impedes land acquisition for rights-of-way or the leasing of easements that are required for infrastructure projects.

The rural economy makes different infrastructure demands than urban areas do because of lower rural population densities and the lack of economies of scale. The rural context presents different service provision challenges and opportunities, has different potential funding mechanisms, and often requires different technology and scale. Another distinction cutting across the rural–urban divide is that between infrastructure that should be provided by the private sector, and infrastructure that has “public good” characteristics and should therefore be provided by government.

Vanuatu’s infrastructure deficiencies make doing business there expensive, as numerous reports attest. For instance, its shipping services are the most expensive in the Pacific (footnote 22). Unfortunately, neither state nor private provision of infrastructure in Vanuatu has often given value for money. Government provision has often suffered from the common public sector issues of weak incentives for efficiency, political accommodations made at the expense of customer service, and institutional overstaffing. Private provision has often suffered from the inexperience of government in negotiating competitive concession agreements coupled with ineffective or nonexistent regulation. Examples from the maritime and electricity subsectors are discussed in Box 5. However, positive changes are resulting from the introduction of competition from the private sector (for example, in areas such as telecommunications) and better regulation (such as by the Utilities Regulatory Authority [URA]).

Box 5: Monopoly Agreements

The Port Vila international wharf is the most expensive and most inefficient in the Pacific, and is a significant fetter on trade and economic development. While it is acknowledged that there are difficult political issues to deal with, the reality is that market failure occurs as a result of the 50-year monopoly agreement for the wharf’s management and operation. In line with other moves by the government to introduce competition and improve the environment for private sector operations, the potential for introducing competition for wharf management and operation is worth examining. Similarly, Union Électrique du Vanuatu Limited (UNELCO) holds long-term electricity supply contracts. Such contracts can be appropriate to induce investment, but they should then come under regulation, as the Utilities Regulatory Authority (URA) is now demonstrating. Allowing increased competition in electricity supply and generation is important and will lead to cheaper and more widespread provision of electricity.

Source: Research findings.

Transport

The establishment and maintenance of transportation infrastructure is vital to economic growth, however challenging it may be in island nations. The three main types of transportation infrastructure required to support growth are wharves (to anchor interisland shipping services and link rural areas to the two major urban centers), interisland and international air transport, and rural roads.

The MIPU is responsible—through the Civil Aviation Authority, the Department of Ports and Harbors (DPH), and the PWD—for safety and regulation of civil aviation; administration and management of the two main ports and harbors at Port Vila and Luganville; construction and maintenance of the national road network; and overall infrastructure.

Maritime Subsector

The cost of moving goods through Vanuatu's international ports is the highest in the Pacific. There are 22 ports and wharves, although both international and interisland shipping is centered on the facilities at Port Vila and Santo. Approximately 70% of all imports and 30% of all exports are handled at Port Vila wharf, which was recently overhauled through the ADB-funded Urban Infrastructure Project. Port Vila's inadequate container-handling facilities make it the worst-performing port in the Pacific, since more than 80% of the cargo entering the port is containerized. Despite the recent overhaul, there is an urgent need to increase wharf capacity; in the longer term, a dedicated container port is needed.

The main Port Vila international wharf, which is owned by the Port Authority, has been slated for further rehabilitation under a JICA grant of \$17 million.⁸⁶ Port Vila's privately operated domestic wharves are also in very poor condition and are unsafe for cargo or passenger operations.⁸⁷ Port Vila's international and interisland port facilities alike require a specific master plan for infrastructure and cargo- and passenger-handling systems. Stakeholders have expressed growing dissatisfaction with the queuing procedures for the main wharf. Cruise ships are given berthing preference over cargo vessels, halting container movements and warehousing operations in the international terminal area due to space limitations.

Santo Port, which is owned by the Port Authority but privately operated, handles the remainder of the overseas traffic and serves as an international collection point for the northern islands. An ADB-funded rehabilitation project for the port in the late 1990s enhanced its performance significantly, reducing average ship turnaround time by 50% and ship waiting time to almost zero.⁸⁸ While expansion of the international facilities at Santo Port is not required, the domestic wharves are in a state of disrepair and require considerable upgrading.

86 JICA also provides capacity-building assistance in the ports sector.

87 NZAID. 2008. *Final Report: Vanuatu Inter-island Shipping Study Phase I*. Wellington.

88 World Bank. 2006. *Pacific Infrastructure Review*. Washington, DC.

Landing craft and lightering operations are used in the outer islands because few jetties or wharves are still operational. Inadequate initial site planning, poor design and construction, a lack of ownership and maintenance, and damage from storms and wave action have all contributed to the deteriorating state of the country's rural wharves. Consequently, domestic interisland shipping services reach fewer destinations and are more infrequent in many of those they do. Any redevelopment of the nation's network of rural wharves should be carefully examined in the context of complementary infrastructure such as the rural road network.

The DPH is responsible for the management and operation of the Port Vila and Santo ports, providing pilotage services, administering the government-owned wharves, and maintaining navigation aids and maps. It is also responsible for national shipping and ports administration, legislation, control of shipping, and maritime safety. Maritime safety had previously been the responsibility of the Vanuatu Maritime Authority, which was established in 1999 and abolished in 2007 following allegations of corruption, and whose functions were taken over by the DPH. In 2002, it was noted that the DPH was understaffed.⁸⁹ However, aside from some professional appointments, no significant organizational capacity-building efforts have been undertaken. Staff numbers remain near 2002 levels. The provincial governments are responsible for the operation and management of ports in their areas of authority.

Given the limitations of the DPH and the lack of an effective regulator, owner-operators of the nation's wharves are not meeting their maintenance and repair obligations. Ship operators typically arrange their own stevedoring services, usually employing the ship's crew (footnote 87).

For most communities, shipping is relatively frequent and reliable, but more remote locations—where populations are small, economic activity is low, and the cost is high—do not receive regular, reliable, and safe services. At many locations, vessels cannot berth and passengers and cargo must be carried ashore in motorized canoes. This adds expense and detracts from the security of passengers and cargo.

Because accessibility problems and poor transportation are binding limitations on the country's development, and because a number of development partners are heavily engaged in land transport, ADB will focus on domestic maritime transport. In 2010, it will prepare an interisland shipping support project. The goal will be to improve the efficiency and effectiveness of maritime services with an integrated package of assistance comprising infrastructure investments in rural wharves, a shipping support scheme for uneconomic routes using an output-based aid approach, and reforms to sector governance and regulation. The components will complement each other so that shipping to remote communities will increase to self-sustaining levels. ADB is working closely with NZAID on this initiative.

89 ADB. 2002. *Vanuatu Infrastructure Master Plan*. Manila.

ADB's interisland shipping project will include the provision of regular shipping services to islands and locations that are not commercially viable. The mechanism will need to be agreed upon. One suitable approach would be for shipping to those locations to be subsidized, but for the subsidies to be tendered to the lowest bidder, resulting in the best use of scarce resources. Apart from price, service quality—including reliability and safety—would be an important criterion.

Air Subsector

Vanuatu's air transportation infrastructure is a critical asset, supporting international tourism and internal movement, including medical evacuations and the delivery of urgently needed supplies. There are 29 airports, four of which have paved runways.⁹⁰ Of the four facilities with a paved runway, Bauerfield on Efate is the primary international gateway, while White Grass on Tanna and Pekoa on Santo are also international airports.

Options for expansion of the air transportation infrastructure, particularly at Bauerfield, are being assessed. The topography and maximum runway length limit potential future expansion at Bauerfield to Boeing 767-class flights.⁹¹ The current state of the terminal and other airside facilities further restrict it to Boeing 737-class operations.⁹² Given existing conditions and the importance of tourism, the Civil Aviation Authority should continue its investigations into physical expansion and upgrading of options at Bauerfield. It is recommended that a master plan concentrating on terminal and apron expansion be prepared.

The cost of individually ensuring air sector safety and security compliance with International Civil Aviation Organization standards would be prohibitive to small Pacific island countries. In response, ADB supported the establishment of a Pacific Aviation Safety Office in 2007. Based in Port Vila, this office provides considerable technical safety and security support to government regulators and airport operators in its 11 Pacific island member countries.

Maintenance work on international and domestic airstrips is routinely reported to be inadequate, and the remoteness of many of the domestic airstrips substantially increases maintenance costs. These issues will be amplified if more remote airports are upgraded. Given the safety issues related to operations and maintenance, the three rural airports require immediate work or they will have to be closed.

Airport management was corporatized on 1 January 2000, with the establishment of Airports Vanuatu Limited, a government-owned corporation

90 The number of airports varies from 29 to 31, depending how one classifies two remote airstrips.

91 The topography may hinder satisfaction of International Civil Aviation Organization Code 4 precision instrument runway requirements; this issue should be investigated in future study.

92 ADB. 2002. *Development Framework: Vanuatu Master Plan*. Manila; and ADB. 2003. *Vanuatu: A Private Sector Assessment—Issues, Challenges, and Policy Options*. Manila.

responsible for providing all aviation services at the nation's three international airports. The remaining facilities are operated by the Civil Aviation Authority, which regulates all airports (including the international ones), issues aircraft operating certificates to airlines wishing to operate in Vanuatu, and regulates those airlines. The MIPU has overall institutional responsibility for policy development in the sector.

The government also retains a commercial interest in air services through the national carrier, Air Vanuatu, which is 100% government owned. Historically, the airline did not operate profitably, which limited service provision and tourism. To overcome this limitation, the government implemented an open skies policy in 2005. Since then, a number of other international carriers have offered services to Vanuatu, some under code sharing arrangements (Table 14).

Table 14: International Carriers Serving Vanuatu

Airline	Routes
Air Vanuatu	Australia, Fiji Islands, New Caledonia, New Zealand, and Solomon Islands–Vanuatu
Qantas	Australia–Vanuatu
Solomon Airlines	Solomon Islands–Vanuatu
Air Calin	New Caledonia–Vanuatu
Air New Zealand	New Zealand–Vanuatu
Virgin Blue	Australia–Vanuatu
Air Pacific	Fiji Islands–Vanuatu

Source: Research findings.

The government merged Air Vanuatu with Vanair, its domestic service provider, in 2004. Since then, Air Vanuatu's operations have reportedly been more successful. Even so, in 2007, the government enlisted the assistance of the International Finance Corporation, with the support of AusAID's Governance for Growth (GFG) program, to privatize Air Vanuatu through a public offering. The offering process resulted in only one bid, which the government considered inadequate. The process to privatize Air Vanuatu is ongoing, however, with the government considering interest from other parties.

Road Subsector

According to its national road inventory, the PWD was responsible for 1,766 km of roads in 2006, while the six provincial governments were responsible for another 225 km.⁹³ It is generally agreed that the national road network is in poor condition overall because of inadequate government funding and the limited availability of maintenance equipment. It is not known how much of the road network is operational in 2009, however, given that the road inventory has not been updated recently. The PWD has limited staffing, budget,

⁹³ Of this total, only an estimated 256 km (13%) is paved.

and equipment in the provinces for proper road asset management, planning, and maintenance.

In 2006, Vanuatu became the only Pacific island country to receive funding from the MCC. The MCC agreed to provide nearly \$66 million for infrastructure civil works, primarily transportation, over the 5-year period 2006–2011. Twelve subprojects were considered for funding, including the upgrading of pavement and drainage works for rural and urban roads, construction of causeways leading to wharves, strengthening of existing wharves, construction of bridges and creek crossings, construction of new runway pavement for rural airfields, construction of warehouses near wharves, and procurement and supply of road-building equipment. This list of activities reflects what were seen as the most important needs for transportation infrastructure improvement, with particular emphasis on the estimated economic benefits of complementary investments in rural roads linked to outer island wharves.

Because of delays, international currency movements, and cost escalation, only two subprojects are currently being implemented: the Efate Ring Road, totaling 92 km, and the Santo East Coast Road from Luganville to Port Olry, a distance of 70 km.

AusAID has developed a design for the Vanuatu Transport Sector Support Program (VTSSP), which will be managed through the GFG program. The VTSSP will include physical works and institutional development for the MIPU and the PWD. It will also implement three of the subprojects identified but not funded by the MCC: (i) construction of the Whitesands rural road on Tanna, totaling approximately 15 km; (ii) upgrading of the Norsup–Lits Lits Road on Malekula over 12 km of rural and urban roads; and (iii) construction of river crossings on Ambae.

These roadworks are mostly rural, but the urban roads in and around Port Vila also need maintenance and are becoming increasingly congested as Port Vila's population increases. In addition, inadequate drainage reduces road life and increases the need for maintenance.

According to the PWD, road maintenance expenditures have historically been less than 10% of what is needed. At present, in dollar terms, about 60% of road maintenance is undertaken by private firms under contract; the remainder is carried out by the PWD. Most of the private sector participation occurs in Santo, Efate, and Malekula. JICA has provided considerable assistance in the form of road maintenance equipment, yet equipment and staff are still insufficient.⁹⁴ Future road maintenance should make greater use of local contracting rather than rationalizing further equipment purchases or increased staff numbers for the PWD. The PWD also lacks an efficient asset management tool for synthesizing survey data on road conditions and traffic volumes, and for setting maintenance priorities.

⁹⁴ PWD staff estimates vary, but a figure of 72 current staff members was recently given.

The Public Roads Act, under which roads will be categorized as national, provincial, or municipal based on traffic volume and other criteria, is a recent development. It is envisaged that the PWD will only be responsible for the maintenance of roads designated as national, while the remainder will be either municipal or become the responsibility of the provincial governments. In preparation for the transfer to provincial governments, the PWD is reportedly gravelling as many roads as possible to ensure they are handed over in reasonable condition. Given provincial governments' limited ability to maintain infrastructure, some are concerned that the transfer of roads may result in deterioration of the national road network.

Electricity

Electricity is important for economic and social development. Education, health, tourism and hospitality, manufacturing, telecommunications, retail businesses, and other sectors rely on an affordable and reliable supply of electricity. However, only about 27% of the population has reliable electricity, and only Port Vila, Luganville, Malekula, and Tanna are supported by municipal electricity networks.⁹⁵ Given budgetary limits and the geographic nature of the country, it is not surprising that electricity provision is at low levels. Moreover, even those with high per capita incomes continue to have relatively little access to electricity compared with their counterparts in similar nations in the region.

Electricity is expensive because of the small size of the systems, reliance on imported fuel for diesel generators, and the provider's financial self-sufficiency and lack of subsidies. Those areas serviced by electricity on a grid do, however, enjoy relatively high-quality service with infrequent service cuts.

The electricity generation and transmission infrastructure is owned and operated by Union Electrique Du Vanuatu Limited (UNELCO) under a concession contract with the government. The Port Vila and Luganville networks are operated by UNELCO under concession contracts until 2031 and 2010, respectively.⁹⁶ UNELCO is also providing power to Malekula and Tanna under a concession that runs to 2022. UNELCO scores well on quality of service indicators, labor productivity, and levels of system loss compared with other Pacific-based utilities. However, its tariffs are relatively high; it completely recovers its costs, including depreciation. The 2007 Utility Regulatory Authority Act strengthened regulatory oversight of the power sector and made the URA responsible for managing concession contracts.⁹⁷

95 According to a recent survey, only 47% of rural respondents have access to electricity, compared with 85% in urban areas. Clearly, overall access to electricity relates to the urban-rural divide; these statistics emphasize the need for further rural electrification.

96 Electricity is now also provided to some of the unplanned peri-urban settlements near Port Vila.

97 Prior to the recent legislation, questions arose regarding the process for tariff setting and adjustment. Electricity tariffs are now set on a uniform basis for the three concessions operated by UNELCO. The tariffs charged are derived from a base rate tariff, which is indexed quarterly for changes in the costs of fuel, labor, and equipment.

UNELCO recently established a 2.5-megawatt wind farm on Devil's Point outside Port Vila. The first 11 windmills are operational and working well according to UNELCO, providing extra system capacity. A second wind farm is under consideration for Efate, although the proposed ownership arrangements and feasibility study have not yet been released. Alternative energy generation systems also underpin the provision of electricity to rural village communities in various parts of the country. The Energy Unit of the Ministry of Land and Natural Resources, which is responsible for rural electrification, establishes solar or mini-hydropower projects in rural locations. Vanuatu's national energy policy guides the Rural Electrification Master Plan, under which more than 3,000 sites with 1,700 possible generating facilities have been identified.⁹⁸ A pilot subproject at Port Olry on Santo was launched in October 2007 to generate electricity for about 260 households using coconut oil as the sole fuel. However, the projected end user cost is more than Vt100 per kilowatt-hour, whereas base service for households on the existing urban networks only costs approximately Vt40 per kilowatt-hour. Nonetheless, Port Olry is an excellent pilot project, and the European Union (EU) is funding two similar projects in Vanuatu.

AusAID, International Finance Corporation, and the World Bank recently initiated a regional program, which includes Vanuatu, for renewable energy projects under their Global Environmental Facility (GEF). JICA has also been funding the improvement of the Sarakata River hydroelectric plant as a means to reduce the need for diesel-fueled power generation for the network around Luganville.

ADB has two regional technical assistance projects that involve the power sector in Vanuatu. The projects seek to advance energy efficiency and renewable energy, and in so doing reduce dependency on imported diesel fuel for power generation. Promoting Energy Efficiency in the Pacific⁹⁹ began implementation in April 2009 and has allocated a total of \$1.2 million to energy efficiency initiatives across five Pacific island countries (Cook Islands, PNG, Samoa, Tonga, and Vanuatu). In Vanuatu, technical assistance consultants have carried out an assessment and identified policy and regulatory recommendations for encouraging wider deployment of energy efficiency practices. Subprojects have been identified, and the tourism/hotel sector has been selected to implement these initiatives during the course of the technical assistance. Subject to a successful application to the GEF for \$6 million in funding, a follow-on project will commence in 2010 to scale up the energy efficiency initiatives across the same five countries. It is envisaged that GEF funds will be supplemented by \$1 million in ADB capacity development technical assistance and \$6 million in cofinancing.

98 The Rural Electrification Master Plan, prepared by UNELCO for the government, was financed by the Sarakata Fund from revenue generated through the hydropower facility of the same name. However, it is only in draft form and has not been officially endorsed by the government.

99 ADB. 2008. *Technical Assistance for Promoting Energy Efficiency in the Pacific*. Manila.

Promoting Access to Renewable Energy in the Pacific¹⁰⁰ was approved in August 2009. This is also a regional initiative and involves a budget of \$3 million for allocation across PNG, Solomon Islands, and Vanuatu. The Vanuatu government has requested that its share of the funding be used to support the development and demonstration of grid-connected solar photovoltaic technology. Consultant selection for this project will take place in early 2010.

Telecommunications

A recent study for the Department for International Development of the United Kingdom linked rural populations' access to telecommunications with their ability to develop sustainable livelihood strategies and implement effective poverty reduction measures.¹⁰¹ Other studies suggest that there is a strong correlation between teledensity, defined as lines per 100 persons, and the level of development. The nature of this relationship may be changing with the rapid proliferation of increasingly cheaper mobile technology, but relative teledensity is still a benchmark for the level of development.

Vanuatu's overall teledensity is not only low compared with neighboring Pacific island countries; it is low relative to its reported income levels.¹⁰² By 2007, there were only 23,300 mobile phone subscribers and 7,300 fixed-line subscribers, representing penetration of 3% and 11% respectively.¹⁰³ This situation has started to change rapidly as a result of the introduction of competition for mobile telecommunications, supported by policy reforms that prescribe minimum service levels.

Until recently, Telecom Vanuatu Limited (TVL), owned equally by the government of Vanuatu, Cable and Wireless, and France Cable and Radio, was the sole provider of public telecommunications services. Service provision and usage data supported accusations that TVL provided poor service, had high calling costs, limited mobile network coverage, and relatively low teledensity levels. In 2007, the government amended the Telecommunications Act and made the following legislative changes:

- The government gave up its one-third share of TVL, making it fully privately owned.
- An independent telecommunications regulator was established to ensure compliance with licensing conditions.
- A universal access fund, financed by donors and licensing fees, was established and administered by the regulator to subsidize telephone and internet operations in loss-making rural areas.

100 ADB. 2009. *Technical Assistance for Promoting Access to Renewable Energy in the Pacific*. Manila.

101 D. Souter et al. 2005. *The Economic Impact of Telecommunications on Rural Livelihoods and Poverty Reduction: A Study of Rural Communities in India (Gujarat), Mozambique and Tanzania*. London: Department for International Development.

102 World Bank and Public-Private Infrastructure Advisory Facility. 2004. *Infrastructure Regulatory Review for the Government of Vanuatu*. Washington, DC.

103 World Bank. 2008. *Telecommunications in the Pacific*. Background Paper for the Pacific Economic Survey. Jakarta.

- A requirement for interconnectivity between the networks of service providers was introduced.¹⁰⁴

The GFG assisted in the design and creation of the independent regulator and provided advice during the offering process. It is supporting efforts to assess the socioeconomic impact of increased service coverage following deregulation.

In the first quarter of 2008, a new telecommunications provider, Digicel, was granted a license to provide mobile telecommunications, thereby breaking the TVL monopoly. A performance-based contract was established under AusAID's GFG initiative to give Digicel a significant financial incentive to achieve service area coverage of more than 85% of the country by the end of 2009.

A 2008 study of the liberalization of telecommunications in Vanuatu concluded that lower-cost telecommunications services needed to be supported by complementary infrastructure if they are to promote economic development.¹⁰⁵ The findings included the following:

- There is significantly increased access to and use of mobile telecommunications throughout Vanuatu, particularly in rural areas.
- There is a preference for mobile in both rural and urban areas.
- Increased telecommunications access can significantly assist in the promotion of small- and medium-sized enterprises.

Improved telecommunications cannot improve the production and actual movement of goods from rural areas to markets without the infrastructure for market access, including a reliable electricity supply, rural roads, and consistent and competitively priced interisland shipping facilities and services (footnote 19).

Water Supply, Sanitation, and Solid Waste

Water Supply

All water supply infrastructure assets in Vanuatu are owned by the state.¹⁰⁶ Accurate data on the percentage of the population with regular access to safe drinking water are not available; estimates vary from 65% to 88%.¹⁰⁷

Until the mid-1990s, all urban water services in Vanuatu were provided by the PWD. At that time, service quality and tariff collections were low, and the PWD was unable to cover its operating costs or undertake new investment. In 1994, the government entered into a contract with UNELCO to supply water to Port Vila for 40 years. Under this contract, all management, operating, and

¹⁰⁴ Some of these changes are yet to be completed.

¹⁰⁵ Pacific Institute for Public Policy. 2008. *Social and Economic Impact of Introducing Telecommunications throughout Vanuatu: Research Findings Report*. Suva.

¹⁰⁶ ADB. 2003. *Vanuatu: A Private Sector Assessment—Issues, Challenges, and Policy Options*. Manila.

¹⁰⁷ The low estimate was provided by the Department of Geology, Mines, and Water Resources, while the high estimate was cited in the Millennium Development Goals report. United Nations. 2006. *The Republic of Vanuatu: The Millennium Development Goals Report 2006*. New York.

investment functions are delegated to UNELCO. The government continues to own the assets and monitors contract performance on the basis of periodic technical and financial reports. UNELCO is required to guarantee quality, quantity, and continuity of service, and incurs penalties for noncompliance.¹⁰⁸ The URA regulates UNELCO and its service delivery.

The PWD still provides water supply infrastructure and services in Luganville, Isangel, and Lakatoro. Prices are lower, but the service in these locations is reportedly not up to the standard in Port Vila. Systems managed by the PWD generally operate at a loss, failing to recover operating and maintenance costs. Given current population growth rates, the demand for water will soon exceed the capacity of the current infrastructure, along with the financial, technical, and human resources capabilities of the PWD.¹⁰⁹

In rural areas, water supply is the responsibility of the Department of Geology, Mines and Water Resources (DGMWR). The current National Rural Water Supply Program is intended to provide potable water to the entire rural population, based on community access to water rather than individual household connections. Despite government commitment to this program, many rural communities still lack an adequate water supply. The DGMWR provides supply systems to communities on an ad hoc basis, usually as funding is made available after communities request new systems or repair or rehabilitation of existing systems.

There are approximately 1,100 small water supply systems scattered across Vanuatu. Based on the rural water supply database, 663 of these systems are functioning well, 269 are in need of repair, and 189 are not operating at all. When a water supply system is established, it is the local community's responsibility to set an appropriate tariff, collect user fees, and implement maintenance works as required.¹¹⁰ However, local communities are hindered by a shortage of spare parts and materials, as well as a lack of skilled technicians. The rural water supply systems are designed to have a 15-year lifespan, but due to lack of proper maintenance most have a lifetime of only 5–10 years.

The DGMWR is also responsible for water resources legislation, management, and quality monitoring. Waterborne illnesses are common, particularly among children. The Port Vila and Luganville water supplies are treated, but there are no quality guidelines for drinking water. Furthermore, there is no regular monitoring of provincial water systems or of the private water suppliers around Port Vila.¹¹¹

108 J. Chaniel. 2002. *A Case Study of the Privatisation of Port Vila*. Port Vila; and UNELCO Vanuatu. World Bank and Public–Private Infrastructure Advisory Facility. 2004. *Infrastructure Regulatory Review for the Government of Vanuatu*. Washington, DC.

109 Government of Vanuatu, Department of Geology, Mines and Water Resources. 2008. *Vanuatu National Water Strategy 2008–2018*. Port Vila.

110 In Shefa province, it was reported that the tariff was typically Vt100 per month per household.

111 Interestingly, UNELCO has been contracted for quality monitoring of PWD's Luganville system, while the DGMWR is monitoring UNELCO's operations of the Port Vila system.

Sanitation: Sewage and Wastewater

Sanitation management is a substantial and growing environmental and public health issue. There is no comprehensive sanitation infrastructure in the urban areas of Port Vila or Luganville. Both municipalities lack sewage and wastewater treatment systems; waste is generally disposed of by illegal storm water connections, direct discharge into waterways, or poorly designed and maintained septic systems that leach contaminants into groundwater.

Septic tank systems predominate in the formal residential areas of Port Vila. However, generally only toilet wastes are discharged to septic tanks; gray water is discharged either to the septic soakway or over the garden. Typical households have little understanding of septic tank maintenance requirements. Few residents use the expensive public and private service providers that maintain and empty septic tanks, depositing the sludge at the local Bouffa landfill. Sewerage services outside Port Vila are limited or nonexistent; informal settlements commonly use pit latrines, communal toilets, or bush latrines.

Port Vila has a number of private sewage treatment plants, including those at Port Vila Central Hospital, Iririki Island Resort, Le Meridien Resort, Le Lagon Resort, and the University of the South Pacific complex.

Sanitation was previously managed by the Ministry of Health (MOH); trained sanitation officers worked at the provincial level to ensure the proper construction of pit latrines. This system is no longer operational; consequently, nobody is clearly responsible for providing appropriate sanitation. Furthermore, there are no regulations for wastewater management or for the monitoring of receiving environments. The 1998 ADB-funded sanitation master plan for Port Vila included a sewage collection system, primary and secondary treatment, and final disposal of effluent to land, but no action was taken.¹¹²

Water contamination because of improper sewage disposal is likely to occur more frequently as the population grows and urbanization increases. Potable water, fishing resources, Port Vila Bay and nearby waterways such as Erakor Lagoon, and popular tourist areas are all under threat. This will have an adverse effect on health indicators, such as infant mortality and overall morbidity, and result in economic losses. Sanitation is, therefore, an urgent issue that must be addressed.

Solid Waste

Solid waste disposal services, like water supply services, vary depending on location. Service levels, frequency, methods, and costs are different in the municipal areas than in local communities under provincial authority. But in either case, there is no legislation for waste management and the quantity of waste being generated is unknown.

112 ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance to the Republic of Vanuatu for the Urban Infrastructure Project*. Manila.

Port Vila municipality operates a landfill at Bouffa for disposal of residential, commercial, and industrial waste, and provides curbside refuse collection services. The landfill, which opened in 1995, has a capacity of 525,000 cubic meters and was originally designed to last 15 to 20 years, suggesting that it will soon reach full capacity. Approximately 10 tons of waste are currently collected and disposed of each day.

The municipality operates waste collection services for its residents and for some in the informal settlements outside the Port Vila municipal boundaries in Shefa Province. The costs of waste collection and the landfill are funded by property taxes and waste collection and tipping fees. The system is meant to be self-funding, based on the user-pays principle. Rates vary depending on user characteristics and estimates of the type of waste and quantity collected. A typical household rate is Vt6,000 per year.

While the solid waste collection system in Port Vila is functioning reasonably well, there is uncertainty regarding whether it can sustain operations in the long run, particularly as waste levels and demand for services increase. This is despite the 2005–2006 JICA technical assistance and grant funding to upgrade the Bouffa landfill, strengthen the municipality's solid waste management operational capacity, draft a solid waste management plan, and provide additional equipment for landfill operations.

Few solid waste removal services are provided in provincial locations. Rather, local communities or villages are responsible for their own solid waste collection and disposal.¹¹³ In some cases, waste disposal services are provided by locally contracted private sector operators who negotiate rates and frequency of collection services with community residents.

Water Supply and Sanitation Developments

The Vanuatu National Water Strategy 2008–2018 (footnote 109), prepared under New Zealand Agency for International Development (NZAID) funding, was recently released and endorsed by the government, but is now waiting for additional funding. Key actions to be undertaken in the strategy include the following:

- adoption of integrated water resources management principles, including project facilitation and regulation under a sector-wide approach;
- major change in the role of the DGMWR from that of service provider to main proponent and facilitator of the sector-wide approach;
- establishment of a Department of Water to regulate the water sector, and strengthening of the National Water Resources Advisory Committee to provide representative and expert input and advocacy across the sector;

¹¹³ In the case of Shefa, solid waste is supposed to be delivered to the Bouffa landfill. However, due to tariffs charged at entry to the site, many provincial residents reportedly prefer to dispose of waste through a combination of composting, burying, and burning.

- transfer of urban water scheme management from the PWD to the Department of Water, ultimately promoting private sector participation; and
- assignment of sanitation issues to the Department of Water, concentrating on more appropriate sanitation solutions for Port Vila and reinstatement of the provincial sanitation officers.

Urbanization

Urban centers are a relatively new phenomenon in Vanuatu, and in the Pacific in general. Introduced under colonial rule, they are still small by international standards. Nonetheless, over the past 50 years they have become hubs for finance and commerce, manufacturing and processing, and transportation and marketing. They are also the home of government and the public service. Consequently, the majority of formal jobs—in both the private and public sectors—are found in the urban centers. Port Vila, and to a lesser extent Luganville, are now the main centers of economic growth and development in Vanuatu, while a third municipal area—Lenakel on the island of Tanna—was established in July 2008. The quality of urban development directly affects the prospects for national and provincial development, yet there has been a policy vacuum in relation to urban development and rural–urban migration.

Urban growth from rural in-migration is generally high in Pacific island countries, in most cases higher than overall national population growth. Vanuatu, along with Kiribati and Solomon Islands, has one of the highest rates of urban population growth in the Pacific, estimated by the 1999 census at about 4% annually. The estimated populations at the beginning of 2009 were 42,000 in Port Vila and 15,000 in Luganville.¹¹⁴ Vanuatu's urban population is approximately 24% of the national population. By 2020, it is projected to be approximately 27% of the national population (or 89,000).

Some analysts have suggested that the importance of the urban economy to national development and the problems resulting from rapid, uncontrolled urban growth have not been adequately recognized.¹¹⁵ As urban centers grow in importance, it is crucial that they develop so as to function effectively. If they fail to do so, both urban and rural populations will suffer. However, urban development is low on the political agenda because policy makers have failed to understand the critical role of urban centers in development. There is evidence that this state of affairs is changing: last year, the country's first urban zoning and development planning exercise was conducted for Luganville, and

114 These are based on 1999 census data and an annual urban population growth rate of 4%. Government of Vanuatu, National Statistics Office. 2000. *1999 National Population and Census Main Report*. Port Vila. The next census is scheduled for 16 November 2009.

115 See, for example, D. Storey. 2006. *Urbanisation in the Pacific*. Research paper produced for the State, Society and Governance in Melanesia Project. Massey University. Auckland.

was due to be tabled in Parliament in April 2009. The resulting development control plan will provide a model for Port Vila. While only in its infancy, this zoning and planning process is a significant step toward more proactive urban planning, and ultimately more orderly development of urban areas.

Informal and Squatter Settlements

Squatter and informal settlements became established in and around Port Vila in the early 1960s, when the lack of available land within the official municipal boundary forced increasing numbers of migrants from other islands to move into the town's peri-urban areas. Since then, these settlements have grown significantly, in both number and size. These are areas of unplanned, high-density, low-quality housing, characterized by a lack of basic services (e.g., water, sanitation, electricity, and waste collection) and insecurity of tenure.¹¹⁶ Squatters are illegal residents and usually pay no rent. In informal settlements, by contrast, there has usually been some kind of agreement with the landowner, and some rent is paid.

A study of urban migration and informal settlements conducted in 2000 noted, "The dramatic increase in urban growth has led to overcrowding, poor housing conditions, high rents, poor sanitation, and rapid development of squatter and informal settlements," and further observed that "the number and size of squatter or informal settlements has burgeoned in the last decade....[T]he most notable feature of Port Vila is the speed at which informal settlements are growing (footnote 63)." There is evidence that this trend is continuing. Based on current growth rates, the population of informal settlements in the peri-urban areas of Port Vila and Luganville could reach 19,000 by 2010, constituting approximately 25% of the population of these centers. This is clearly a sizable proportion and one that demands the urgent attention of national, provincial, and municipal authorities.

In addition to the rural–urban migration, the informal settlements have grown in size and number within the urban areas themselves. One of the more obvious reasons for this internal movement is a household's loss of economic status: unemployment or underemployment of the main income earner causes families to seek cheaper housing. This was a factor in the rapid growth of some informal settlements in the late 1990s, when the real per capita income of many households in Port Vila fell as a consequence of the public service "rightsizing" exercise conducted under the (comprehensive reform program) CRP; an estimated 15% of public servants were fired and were obliged to move to cheaper housing.

¹¹⁶ Land tenure is the relationship, whether legally or customarily defined, among people, as individuals or groups, with respect to land. (For convenience, "land" is used here to include other natural resources such as water and trees.) Land tenure is an institution, i.e., rules invented by societies to regulate behavior. Rules of tenure define how property rights to land are to be allocated within societies. They define how access is granted to rights to use, control, and transfer land, as well as associated responsibilities and restraints. In simple terms, land tenure systems determine who can use what resources for how long, and under what conditions.

The growth of informal settlements in peri-urban areas, on customary land, is largely attributable to the increasing pressure on a limited amount of available land and an acute shortage of affordable housing within the municipal boundaries of Port Vila and Luganville. Landowners, concerned about allowing settlers to stake a permanent claim to the land, often impose conditions such as permitting only temporary dwellings and limiting services and amenities. Given the rights of landowners to use, manage, and dispose of their customary land as they choose—rights that are enshrined in the Constitution and deeply cherished and defended by customary landowners—the settlers have little choice but to accept whatever conditions are imposed upon them.

Government bodies such as provincial and municipal councils are hard-pressed to know how to deal with the squatters and informal settlements at the periphery of urban centers. For example, while the Port Vila municipal council normally provides its residents with services such as garbage collection, such services are unavailable to most settlements because they are outside the municipal boundary.

Legislation already in place includes specified standards for urban development, including housing and associated services. However, because the peri-urban settlements lie outside the jurisdiction of the municipal councils, there is no legal requirement to provide them with water, sewerage, drainage, and electricity before leases can be issued, unlike housing plots on government-owned land—that is, land within the municipal boundaries.

Urban Development Projects

In the early 1990s, the World Bank funded an affordable housing project with the aim of establishing low-cost housing at Freswota, the site of a formal subdivision managed by the National Housing Corporation in Port Vila. Due to the high cost of house plots, however, the area was increasingly settled by middle class, higher-income residents.

The \$10 million ADB-funded Urban Infrastructure Project, implemented in the 1990s, was one of the largest donor-funded programs of assistance to the urban sector. The 5-year program consisted of road and bridge rehabilitation, port rehabilitation, water supply, drainage, and sanitation in Port Vila and Luganville; it achieved some significant improvements in these areas. An internal evaluation reported that although the scope of the project had to be reduced and physical implementation took several years to commence, most of the works were completed by the end of the loan period in December 2001. The project also brought about some important changes in environmental and water resource regulation and building codes. However, two major components—the sanitation component and the Port Vila traffic intersection improvements—were put on hold because of inadequate funding and severe institutional limitations.

Institutional Arrangements and Capacity

The Physical Planning Act 1986 resulted in the establishment of the Physical Planning Unit within the Department of Local Authorities, itself located in the Ministry of Internal Affairs. The Physical Planning Unit provides development planning guidance and advice to province-based planning officers and the municipal councils, and is responsible for creating physical planning areas (PPAs) for each province and city to delineate planning control boundaries. However, it has no power to implement plans or enforce design standards. Furthermore, while the act provides for the formulation of planning policies, none have been prepared.

The Shefa Planning Office is responsible for planning within the province. It works under the guidance of a physical planning committee that consists of Shefa councilors. While the Physical Planning Act provides for the declaration of PPAs, and a new PPA is planned, none has been formally approved for Shefa.

Municipal planning within the Port Vila PPA is carried out by the Port Vila Municipal Council. Its Physical Planning Office assesses development applications, drawing advice from a range of relevant government departments. The development applications are then passed for final assessment to the Town Planning Committee, which is made up of councilors and can seek technical input when necessary.

A strategic planning framework was proposed in the 1992 draft physical plan and the 1997 ADB-funded Port Vila Urban Growth Management Strategy (UGMS). The UGMS was an integrated growth management strategy for Port Vila that coordinated the physical planning process and established an institutional and legislative framework to better manage infrastructure development. The UGMS included a sanitation master plan to address the critical issue of pollution of the Port Vila harbor and lagoon. While the government supported the proposal at the time, there has been no significant action to implement the UGMS, including the sanitation plan. Although the Physical Planning Unit can devise plans and advise other stakeholders, ultimate responsibility resides with politicians in the municipal and provincial government councils. As a result, planning is limited and often reflects political imperatives.

The quality and reliability of urban utilities in Vanuatu vary widely; so do the delivery mechanisms. Water and electricity are provided to Port Vila and its peri-urban areas under long-term concession agreements between the government and UNELCO Suez Limited. UNELCO also supplies electricity to residents of Luganville. Water supplies in Luganville and Lenakel are provided by the PWD (within the Ministry of Infrastructure [MIPU]).

The provincial and municipal governments are responsible for providing sanitation services. However, in practice, the absence of sewerage systems and supporting sanitation policies means that treatment and disposal of wastewater

is left to individual households and businesses. Septic tanks are the most common form of on-site wastewater treatment facilities in the formal areas of Port Vila and Luganville; pit toilets are the most common sanitation facilities in the informal settlement areas. In general, sanitation facilities are poorly designed and maintained. High levels of fecal contamination of groundwater, urban streams, and the foreshore, as indicated by water-quality monitoring, can be attributed to poor sanitation practices.

The PWD is responsible for the development and maintenance of road and drainage systems throughout Vanuatu. Road maintenance expenditures have historically been less than 10% of the total amount required. There is almost no spending on the development and maintenance of drainage systems. The limited drainage infrastructure not only creates a flooding hazard, particularly to the residents of low-lying areas (including several densely populated informal settlements), but is also a major cause of road pavement failures.

In general, the national, provincial, and municipal planning agencies have only limited ability to prepare and implement spatial plans, and their coordination with key stakeholders is poor. The result has been ad hoc urban development, a reactive approach to urban infrastructure, and insufficient staff and funds to enforce compliance with regulations. In some cases, political interests, inertia, and corruption can also undermine regulatory controls. In addition, the minister of lands has discretionary power to grant planning approvals in cases of dispute (for example, over land ownership), which could effectively circumvent legal requirements such as environmental impact assessments for proposed development sites.

There are no formally trained urban planners in government at any level. This is a critical issue. The training of town planners will take some time, and in the interim support from donors for the appointment of foreign planners should be considered.

ADB has indicated that it will support urban planning and development. Specific assistance may include preparing an integrated spatial (physical) and services master plan for Port Vila; refining draft legislation for urban planning for approval by Parliament; updating the building code for approval by the government; preparing the national sanitation policy; preparing a prioritized and costed integrated storm water drainage and sanitation master plan, including identification of a suitable institutional framework and mechanisms for sustainable operations and maintenance of Port Vila's drainage and sanitation systems; and institutional strengthening and capacity development for sustainable drainage and sanitation planning and management, along with provision of the high-priority drainage and sanitation infrastructure identified in the integrated master plan.

Each of these initiatives, in coordination with activities such as the AusAID-supported land program, JICA support for landfill rehabilitation at Bouffa,

and New Zealand Agency for International Development (NZAID) support for water and health programs, would add substantially to the institutional capability of Vanuatu to plan and implement urban infrastructure projects while supporting crucial programs such as those for sanitation and drainage.

Urban Infrastructure Planning with a Focus on Port Vila

Port Vila has clearly outgrown its original urban boundaries and is unable to accommodate its expanding population, cater to additional commercial development, or provide needed urban infrastructure services. The municipality has a PPA but no urban growth strategy, and carries out planning on an ad hoc basis. Poor planning in the Port Vila area has resulted in a badly designed sanitation and drainage system, increasing degradation of the environment, a lack of plans for solid waste collection and disposal, and failure to maintain the roads, particularly those to the informal settlements.

All levels of government should make planning for increased urban infrastructure for water, sanitation, solid waste services, drainage, and road maintenance in Port Vila a high priority. Among other things, this will require a focused effort on improving national, provincial, and municipal government coordination.

The CRP recommended the development of a national urbanization policy and planning guidelines. Similarly, a 2002 study on urban informal settlements commissioned by the Pacific Islands Forum Secretariat and the United Nations Economic and Social Commission for Asia and the Pacific advised the government to appoint a national task force to oversee the development of a national urban growth and housing strategy that would address the lack of affordable, adequately serviced housing (footnote 62). The last 7 years have seen little follow-up on these recommendations. In the meantime, the shortage of low-cost housing has continued to worsen, directly contributing to deterioration of the already severely overcrowded, inadequate, and unsanitary conditions prevalent in many informal settlements around Port Vila. This report, therefore, makes the following recommendations:

- A comprehensive study of Vanuatu's urban centers should be undertaken. The study should focus on the causes and consequences of rural–urban migration, the growth of informal and squatter settlements, and the incidence of poverty. It should use empirical research and secondary data to assess the current and future ability of the urban infrastructure to provide basic social services. It should also include recommendations for specific improvements in the most critical areas, which would then be subject to stakeholder consultation and endorsement.
- A multistakeholder urban task force, led by the Ministry of Internal Affairs and appointed by the government, should prepare a national urban strategy, with extensive public consultation. The strategy should

be supported by up-to-date research findings from the urban study outlined above.

- The urban task force should be responsible for coordinating and overseeing all donor activities, policies, and laws in the urban development sector and for providing strategic advice and direction to the government, donors, and the private sector.

Development Policies and Strategies

Based on its *Planning Long, Acting Short 2009–2012* planning matrix, the government has developed the following six key strategies for increasing the reliability, accessibility, and overall quality of infrastructure services (footnote 5):

- Strengthen the institutional resources of the MIPU through a capacity-building program.
- Rehabilitate and better maintain the national road network (the government has committed to providing more resources for road maintenance).
- Continue to improve communications access and lower costs through private sector competition.
- Ensure that power is increasingly available, at affordable prices, through exploration and expansion of renewable energy sources.
- Improve shipping, wharf, and storage facilities and their maintenance.
- Undertake a feasibility study on civil works improvements to facilities such as parking aprons and the upgrading and expansion of the Bauerfield terminal, possibly resulting in construction of a new international airport.

The government's strategies are generally consistent with Vanuatu's infrastructure needs and demands. Based on the government's priorities, donor interest, and ongoing development activities, ADB will contribute to the above activities by helping the government reform the maritime subsector (particularly interisland shipping); possibly provide additional rural wharves; and address the urgent need for urban planning, management, and development of Port Vila and its surrounding areas.

Conclusions and Recommendations

The state of infrastructure and associated services provision in Vanuatu is mixed. In some sectors, infrastructure is adequately planned and implemented to meet growing demand. In other sectors, infrastructure is poor and in some cases deteriorating, impeding economic growth and the delivery of social services.

Policy reform and private sector participation in infrastructure services have reduced the capital investment required from public funds while lowering

costs and increasing efficiency through competition. It is important that the government has increasingly concentrated on its core roles—regulation and promotion of private sector provision of services—with significant positive outcomes in sectors such as air services and telecommunications.

Maritime Subsector

The shipping sector needs considerable support, including major rehabilitation of the infrastructure at the domestic wharves of the nation's two principal ports. Port Vila needs a new master plan for port and harbor development, and the institutional arrangements for sector management must be reviewed and reformed. Private sector operators provide interisland shipping, but many areas are underserved. The government must formulate a strategy for improved shipping transportation. It should analyze the possibility of subsidizing uneconomic routes subject to a transparent, competitive bidding process. The rural wharf network should also be assessed and priorities established for a rehabilitation program.

Urban Development

Urban development policy and planning, including service provision to informal and peri-urban settlements, has received little attention. There is an urgent need for urban planning in Port Vila, but it is first necessary to address the institutional relationships between national, provincial, and municipal agencies that preclude effective planning and management in Port Vila for water, sanitation, solid waste treatment and disposal, building standards, drainage, and road maintenance. A national task force with representatives from each level of government, the private sector, and other stakeholders should be established as a first step toward improved urban planning and management. Findings from the previous ADB-funded sanitation master plan should be reviewed in connection with any proposed new urban master plan. Water quality standards and waste disposal regulations are needed. Implementation of the Vanuatu National Water Strategy 2008–2018 should be given high priority as well.

Electricity

The electricity sector is functioning well in the urban and peri-urban areas, but coverage in rural areas is poor. The performance of UNELCO should be monitored by the Utilities Regulatory Authority (URA) and any cost savings passed on to consumers. Implementation of the rural electrification plan is a priority.

Air Transport

Significant positive reforms in air services have been realized through the open skies policy and reform of the institutional arrangements for management of the sector. Continued planning for rural airport maintenance is required, while the preparation of a master plan for upgrading Bauerfield Airport should be given high priority in overall infrastructure development. The highest priority



in the sector is, however, a solution to the long-term viability of Air Vanuatu, most likely through privatization.

Institutional Strengthening and the Road Subsector

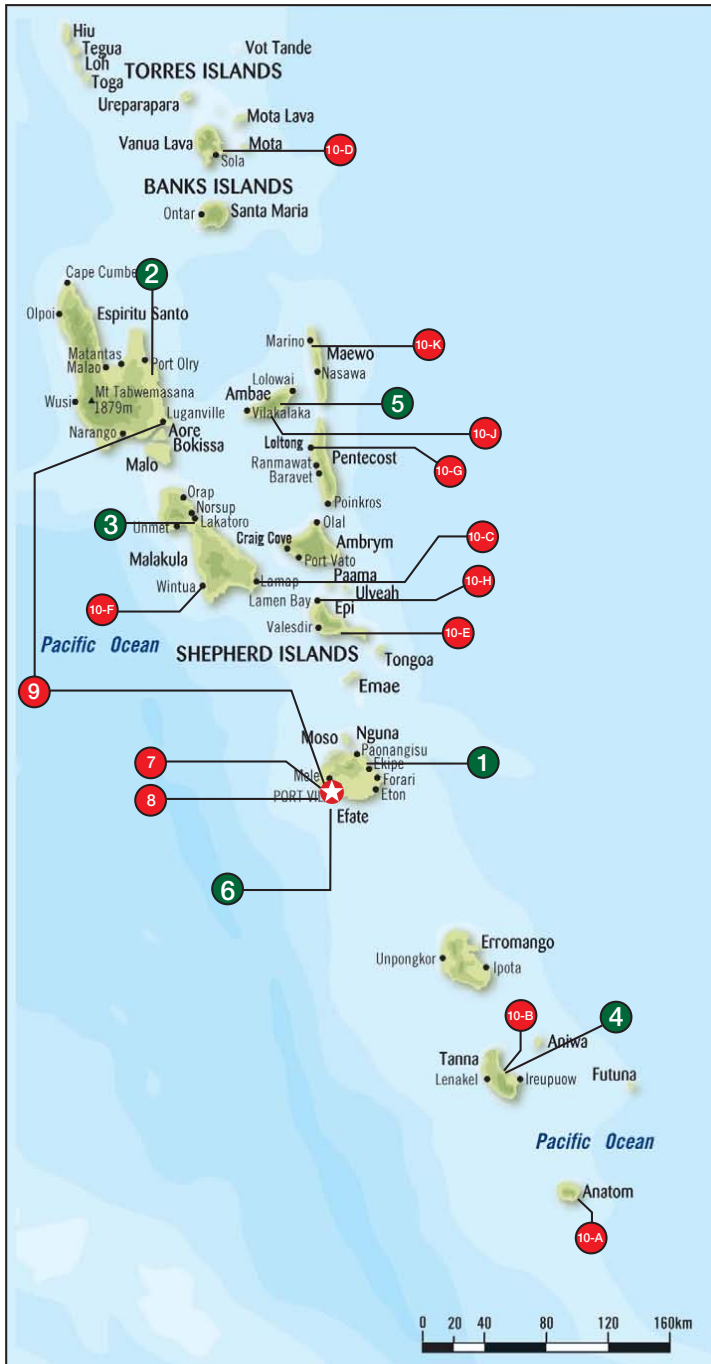
The PWD requires strengthening to better serve the road sector in planning improvements and maintenance, supporting civil works implementation, and managing the procurement of private sector contractors. The Vanuatu Transport Sector Support Program (VTSSP) will contribute significantly in these and other areas. The implementation of a nationwide road asset management system should be closely coordinated with the reforms being pursued under VTSSP. The ability of provincial governments to maintain roads should also be reviewed if the proposed public road act is introduced.

Finally, ongoing infrastructure interventions are shown in Map 2, particularly rural–urban transportation links: those sites where further study is warranted into the possible establishment of networked rural roads, wharves, and ancillary infrastructure such as warehouses.¹¹⁷

Map 2: Ongoing and Required Infrastructure Projects

	<p>ONGOING OR PROGRAMMED IDA DONOR FUNDED PROJECTS</p> <ol style="list-style-type: none"> 1. MCC Efate Ring Road 2. MCC NZAID Santo East Coast Road 3. AusAid VTSSP Malekula Norsup Lits Lits Road (2009-11) 4. AusAid VTSSP Tanna-Whitesands Road (2009-11) 5. AusAid VTSSP Ambae Road River Crossings (2009-11) 6. JICA Improvement of Port Vila Main Wharf (2009-11)
	<p>NEEDED INFRASTRUCTURE INTERVENTIONS</p> <ol style="list-style-type: none"> 7. Port Vila Urban Development 8. Civil Aviation Master Plan and Upgrade of Bauerfield International Airport. 9. Interisland Shipping Service Reform and Rehabilitation of Domestic Wharves at Port Vila and Santo Port 10. Rural - Urban Transport Links (Roads and Wharves) <ol style="list-style-type: none"> a. Anelghowhat (Anatom Island) b. Waisisi (Tanna Island) c. Dillons Bay - Port Sandwich (Malakula Island) d. Sola Landing (Vanua Lava Island) e. Votlo-Port Quimie (Epi Island) f. Southwest Bay (Malekula Island) g. Bwatnapni - Loltony (Pentecost Island) h. Lamén Bay (Epi Island) i. Noluindi - Lolowai (Ambae Island) j. Maewo - Narovorovo (Penama Island)

¹¹⁷ More specifically, these are rural sites where transportation infrastructure was either built some time ago but is in need of major rehabilitation, or sites that have been identified for new development by the ADB Outer Island Infrastructure Development (TA 3224–VAN), the Millennium Challenge Corporation (MCC) Compact original design, or both, but which have not been implemented.



Source: Asian Development Bank project preparatory technical assistance findings.

GOVERNANCE AND PUBLIC SECTOR MANAGEMENT

Introduction

Transparent and effective governance is a fundamental requirement for successful economic and social development. The previous Comprehensive Reform Program (CRP) and the current Governance for Growth (GFG) program were each implemented on this principle, which is also critical for ensuring that development provides benefits throughout the nation and to the entire population.

Vanuatu performs better than the Pacific islands average on all six standard governance indicators (Tables 15 and 16). Positive trends are discernible for 1996–2008, particularly for political stability, rule of law, and control of corruption.¹¹⁸ Vanuatu joined the ADB/Organisation for Economic Co-operation and Development (OECD) Anti-Corruption Initiative for Asia-Pacific on 30 November 2001. In 2004, an in-depth study of national integrity systems concluded inter alia that “since the commencement of the CRP in 1997, Vanuatu has made significant steps in developing a strong legal framework designed to foster accountability, transparency, and responsibility, especially in the public sector.”¹¹⁹

118 D. Kaufmann et al. 2008. *Governance Matters VII: Governance Indicators for 1996–2007*. Washington, DC: World Bank.

119 Transparency International. 2004. *National Integrity Systems: Country Report Vanuatu 2004*. Canberra.

Table 15. Governance Indicators, 2007

	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Vanuatu	0.46	1.36	-0.34	-0.48	0.63	-0.21
Pacific Average ^a	0.43	0.58	-0.56	-0.71	0.18	-0.29

Note: The indicators are measured in the range of -2.5 to +2.5, with higher scores indicating better governance.

a The Pacific average has been calculated for countries for which data are available for the particular year, from the group comprising the Cook Islands, Fiji Islands, Kiribati, Palau, Papua New Guinea, the Marshall Islands, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Source: D. Kaufmann, et al. 2008. *Governance Matters VII: Governance Indicators for 1996–2007*. Washington, DC: World Bank.

Table 16. Vanuatu Governance Indicators, 1996–2008

Governance Indicator	No. of Sources	Year	Percentile Rank (0–100)	Governance Score (-2.5 to +2.5) ^a	Standard Error
Voice and accountability	4	2008	66.8	+0.62	0.20
	2	2003	72.1	+0.86	0.30
	1	1998	61.5	+0.44	0.42
Political stability	2	2008	94.7	+1.30	0.37
	1	2003	79.3	+0.94	0.55
	1	1998	83.2	+1.04	0.55
Government effectiveness	4	2008	43.6	-0.36	0.26
	3	2003	16.6	-0.89	0.36
	1	1998	38.4	-0.43	0.56
Regulatory quality	4	2008	21.7	-0.76	0.24
	2	2003	8.8	-1.31	0.42
	1	1998	30.7	-0.46	0.60
Rule of law	6	2008	63.6	+0.46	0.22
	3	2003	51.0	-0.05	0.43
	1	1998	27.1	-0.69	0.58
Control of corruption	4	2008	65.7	+0.33	0.29
	2	2003	32.5	-0.64	0.33
	1	1998	49.5	-0.24	0.51

a The indicators are measured in the range of -2.5 to +2.5, with higher scores indicating better governance. Source: D. Kaufmann, et al. 2008. *Governance Matters VII: Governance Indicators for 1996–2007*. Washington, DC: World Bank.

Certain institutions play a central role in ensuring good governance. These include Parliament and government offices such as those of the auditor general and the ombudsman. Budget processes and fiscal management are among the key roles of government that affect development outcomes. The relationships between the national government, provincial governments, and the municipal administrations of Port Vila and Luganville are of particular significance. The manner in which public officials are appointed can also strongly influence the effectiveness of governance.

The National Council of Chiefs has a special consultative role on matters of custom and tradition under the Constitution. It is consulted by Parliament concerning constitutional rights to land, the basis of ownership and use of land, and rights to perpetual ownership of land.¹²⁰ Each island has a council of chiefs that has special responsibility for resolving disputes according to local custom and promoting peace, stability, and harmony. The councils are also responsible for promoting and encouraging sustainable social and economic development in their respective islands or urban areas.¹²¹

Land tenure is central to development in Vanuatu, influencing government decisions on investment and service delivery. It is also the most critical factor to private sector development and investment. Government involvement in commercial activities through state-owned enterprises (SOEs) likewise affects private sector development; it is an important aspect of the approach to governance.

Public Sector Performance

Independent Public Service

An independent public service under appropriate institutional arrangements is crucial to effective governance. Such arrangements are enshrined in the Public Service Act 1998, which is intended to establish an independent public service that is efficient and effective; provide a legal framework for the effective and fair employment, management, and leadership of employees; and establish the rights and obligations of employees.

The act sets out the process for appointing staff to the public service, which, as a result, is now largely free of political interference. Appointments to the key positions of director general or director must be made by the Public Service Commission (PSC) under a process that is prescribed in the act. The provincial government is the responsibility of the provincial councils, where the secretary general is the public servant appointed under the act, but where all other staff members are political appointees. In the municipal authorities, all officers are political appointees. The lack of professional personnel with

¹²⁰ *Constitution of the Republic of Vanuatu*, Articles 73, 74, and 75.

¹²¹ *National Council of Chiefs Act 2006*, Section 13.

appropriate training and qualifications, and an independent appointment process, result in weak governance and administrations that are open to external influence. This situation has been recognized by the national government; in early 2009, the minister for internal affairs issued instructions for the drafting of legislation to require all municipal administrative staff to be appointed under the Public Service Act.

Many government departments in the provinces have limited access to financial services. Financial management by the line ministries (primarily health, education, lands, public works, agriculture, and the police force) needs to be strengthened in the provinces to ensure the effective, efficient, and equitable use of public funds and service delivery. Two examples (Box 6) commonly cited are the difficulties in ensuring that school grants actually reach schools, and in purchasing goods and services using imprests.¹²²

Box 6: The Imprest System

In the provinces, government officers purchase a range of items and services, such as cleaning supplies, fuel, transportation, power, and water. Larger purchases, such as textbooks or medicines, are managed in Port Vila at ministry headquarters. These arrangements can have a significant impact on the agency's ability to deliver services. Without fuel, the police cannot conduct patrols and agriculture officers cannot carry out extension work. Health officers may not be able to arrange and pay for transportation of a critically ill person. Due to their size and nature, most of these transactions are conducted on a cash basis, using the imprest process. These expenses must be accounted for before the imprest is topped up, but the process is subject to delays, and it can take several weeks between the time the imprest is expended and reimbursement is received.

Source: Research findings.

The introduction of finance service bureaus (FSBs) will support improved public financial management in the provinces. These new offices, to be funded under the GFG program, will focus on practical financial tasks that directly affect the ability of government departments to deliver services. The FSBs will provide departments with access to government financial systems that allow local purchase orders and that support improved financial management, bank account management, and financial reporting. For example, FSBs will result in better expenditure control and the tracking of school grants by the Ministry of Education. Leakage will be reduced, and grants will have a far greater chance of reaching the schools, improving performance and possibly resulting in reductions in school fees.

¹²² Cumbersome systems in the Department of Finance and the Office of the Prime Minister also cause nongovernment organizations to experience considerable delays in receiving funds from donors; these processes must be simplified so that grants can be delivered in a timely fashion.

Performance of Directors General

The PSC has been working on a formal performance management system for evaluating directors general for some time. The directors general, as functional heads of government ministries, have a major influence on the performance of the public sector. However, although some directors general are technically skilled, they are untrained in management and leadership.

Current training can only go so far in lifting management performance, but the alternative of using foreign technical assistance has had mixed success. The risk remains that foreign personnel end up as a substitute for the director general, frustrating the intended enhancement of national abilities. AusAID commented that “effective skills transfer from foreign advisers to national personnel is difficult to accomplish due to cultural and communication barriers, poor understanding by foreign advisers of the political and institutional context, high turnover among national staff, and other factors.”¹²³ Too often, the technical advisers are chosen solely because of their technical skills, and their training ability or lack thereof is not a factor.

The Public Service Act 1998 does not clearly set out the management of the directors general as an important function for the PSC; in the program budget narrative, the commission does not even mention the directors general. There should be a separate item in the PSC program budget narrative for the management of directors general with appropriate objectives and performance measurement targets.

The directors general sign annual performance contracts directly with their ministers, but this does not prevent the PSC from carrying out its own performance reviews. Such a review would incorporate the minister’s views on the performance of the director general and the PSC’s evaluation of the director general in light of the ministry’s performance. The PSC would reward or censure based on performance, and would take corrective action where necessary. However, the public service commissioner has few tools at his disposal for addressing poor performance.

Office of the Auditor General

The Office of the Auditor General (OAG) needs further strengthening. The previous auditor general resigned in June 2008 (and a replacement had not been appointed as of September 2009). The OAG faces challenges with staffing levels and capability as well as the efficacy of their audit methodologies and systems. Common challenges include small numbers of trained and qualified personnel, the disproportionate effects of staff turnover or absences, and difficulties in attracting and retaining staff. These issues mean public accounts are often not audited to high standards in a timely manner.

¹²³ AusAID. 2007. *The Unfinished State: Drivers of Change in Vanuatu*. Canberra.

Building the capacity of the OAG is fundamental to improving governance. However, to be effective, the auditor general must audit all entities within the audit portfolio, issue timely audit opinions and reports, and manage the OAG effectively with well-qualified staff. As a matter of urgency, a new and appropriately qualified auditor general must be appointed, along with at least one qualified and experienced auditor to assist with training. In addition, procedure manuals and checklists for audits should be prepared, and staff training provided. If a suitable local candidate cannot be found, a qualified expatriate must be hired for a transitional period. To bring the arrears of audit work up to date, additional experienced auditors should also be employed, which would permit the new auditor general to concentrate on restructuring the office and pressuring organizations to provide accounts.

The National Audit Office's 2009 appropriation of Vt33.05 million is likely to be inadequate for the restructuring of the office, and a supplementary appropriation may be required. As Augustine Garae, first political adviser to the minister of finance, stated in his opening address on behalf of the minister of finance at the Public Expenditure Framework Assessment Meeting in Port Vila in March 2009.

*We also understand and support the crucial work, which the National Audit Office has to perform. It is an absolute priority to fill the vacant position of the Auditor General and ensure that our nation's finances are audited and made public on a regular and timely basis.*¹²⁴

These outcomes require immediate action to upgrade the OAG.

In recent years, there have been a number of regional initiatives on promoting good governance in the Pacific, including Vanuatu. For instance, ADB has provided five technical assistance grants to the 25-member Pacific Association of Supreme Audit Institutions (PASAI) since 1989, some of which were supported jointly by the International Organization of Supreme Audit Institutions (INTOSAI) Development Initiative.¹²⁵ A 2002 review of efforts to strengthen Pacific audit capability concluded that intended benefits were achieved, but much more remained to be done.¹²⁶ In December 2006, ADB approved technical assistance for strengthening governance and accountability in Pacific island countries,¹²⁷ which has successfully supported the initial implementation of the second Governance and Anticorruption Action Plan (GACAP II) in the Pacific region, and assisted in the design of the Pacific Regional Audit Initiative (PRAI)—a Pacific Plan initiative. After an extensive consultation process, the April 2008 PASAI Congress endorsed the PRAI

124 Note that a new Auditor General was appointed in November 2009.

125 The INTOSAI Development Initiative was established in 1986 as INTOSAI's training arm. Its mission is to help supreme audit institutions, especially in developing countries, to improve their audit capacity and resolve audit issues through training and information sharing.

126 ADB. 2002. *Technical Assistance Performance Audit Report on Strengthening Audit Capability in the Pacific*. Manila.

127 ADB. 2006. *Strengthening Governance and Accountability in Pacific Island Countries*. Manila.

design; the initiative was also endorsed by Pacific island leaders at the August 2008 meeting of the Pacific Islands Forum. GACAP II is aimed at improving ADB performance in implementing governance and anticorruption policies in sectors where ADB is active, and designing and delivering better quality projects and programs.¹²⁸

Goals of the Pacific Plan are to enhance good governance, economic growth, sustainable development, and security through regionalism.¹²⁹ In addition, ADB approved a second phase of technical assistance for strengthening governance and accountability in Pacific island countries in November 2008, which will support the initial implementation of the PRAI and the further implementation of GACAP II in the Pacific region.¹³⁰ The Subregional Audit Support Program, implemented in 2009 under the PRAI, has potential implications for the National Audit Office. Vanuatu should consider monitoring this program with a view to potential future participation.

Expenditure Review Committee

The problems of the OAG have been compounded by the failure of the Expenditure Review Committee (ERC) to function for the past 5 years. The ERC is a key parliamentary committee whose work is essential to ensuring transparent government. Its role, set forth in section 14 of the Expenditure and Audit Act 2006, is to ensure that Parliament is informed about the scrutiny of public expenditures and the management of public money (Box 7).

The ERC is led by a chairperson, appointed by the President on the advice of the Prime Minister, who consults in advance with the leaders of all the political parties represented in Parliament and with a representative of the private sector.¹³¹ The chairperson must be a person with detailed knowledge of the law, accounting, or commerce, and may not be a member of Parliament or any other public officeholder. In addition to the chair, the committee consists of 2–4 parliamentary members, who are also appointed by the President on the advice of the Prime Minister following consultations similar to those for the appointment of the chairperson.¹³² There must be an equal number of members from the government and from opposition parties.

The Expenditure Review and Audit Act 2006 emphasizes the importance of the committee by specifying that “the Committee shall meet at least once in every month, whether Parliament is in session or not.”

The ERC has effectively been in recess for several years even though funds have been appropriated for it annually. However, the government has acknowledged the importance of the ERC. In his opening address, Mr. Garae

128 ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

129 Pacific Islands Forum Secretariat. 2005. *The Pacific Plan for Strengthening Regional Cooperation and Integration*. Suva.

130 ADB. 2008. *Strengthening Governance and Accountability in Pacific Island Countries*. Manila.

131 *Expenditure Review and Audit Act 2006*, Section 5.

132 *Expenditure Review and Audit Act 2006*, Section 9.

stated that the government is “keen to get the Public Accounts Committee [ERC] working” and that the committee “has an important task to fulfill with regards to public finance management.” The government increased the budget appropriation for the ERC from Vt6.0 million to Vt8.6 million for 2009 and appointed a new chairperson.

Box 7. Objectives and Functions of the Expenditure Review Committee

14. (1) In the performance of its duties, it shall be the objective of the Committee with the assistance of the Office of the Auditor General to ensure that adequate public accountability is achieved by:

- (a) confirming that the obligations under the Act are met, in particular:
 - (i) required economic and financial statements are produced and are reviewed;
 - (ii) adherence to fiscal disciplines is explicit;
 - (iii) statements of responsibilities are completed and sufficient undertakings exist in order to rely on them;
 - (iv) that all obligations of directors general of ministries are met;
- (b) providing a mechanism for public consultation about budget and expenditure matters;
- (c) undertaking or supervising all audits in order to ensure the reliability of systems and procedures and the integrity of information produced;
- (d) the pursuit of legitimate issues of public concern that affect the management of public money;
- (e) review the efficiency and effectiveness of the financial performance of those persons, organizations or entities managing, collecting, expending or administering public money.

Source: Expenditure Review and Audit Act 2006.

ERC personnel should be trained in the methods of scrutinizing public accounts and conducting performance reviews of ministries and state agencies. The ERC should also require each ministry and government agency to provide an annual report of expenditures. Each ministry should be required to appear annually before the ERC to provide an account of its performance in pursuit of its corporate objectives.

Ombudsman’s Office

The Office of the Ombudsman is enshrined in the Constitution and its roles and responsibilities are set forth in the Ombudsman’s Act 1998.¹³³ The ombudsman’s office conducts independent investigations of complaints from the public about allegedly unfair treatment by government ministries or agencies. The ombudsman’s primary responsibility is to inquire into the conduct of any government agency, whether or not a complaint has been made.

The present ombudsman’s office functions competently. In recent years, it has prepared a number of reports and has delivered introductory programs to parliamentarians on the purpose of the Ombudsman’s Act 1998 and the principles of the Leadership Code. Despite this good work, the ombudsman’s

¹³³ *Constitution of the Republic of Vanuatu*, Articles 61–65.

office is not achieving its intended aims. Rather, the ombudsman is treated as a figurehead that gives the appearance of good governance.

The investigators in the ombudsman's office are employed by the public service commissioner and not by the ombudsman. By placing additional stress on the investigators, this could undermine investigations of senior public servants. The investigators should be employed directly by the ombudsman to ensure the independence of the office. A review of the Ombudsman's Act 1998 and the Leadership Code was undertaken in 2004; the recommendations made at that time should provide the basis for a new review to remove the roadblocks that prevent action from being taken on the ombudsman's reports.

In summary, the Office of the Ombudsman, like the OAG and the ERC, needs further strengthening. The government has indicated its intention to address the problems confronted by the OAG and to reactivate the ERC. These are initiatives that should be implemented as a matter of priority. In addition, the independence of the ombudsman's office should be reasserted, and reports from the ombudsman submitted to Parliament and to the public prosecutor should be acted upon. This will require amendments to the Ombudsman Act among other actions.

Performance of State-Owned Enterprises

The SOE sector in Vanuatu is comprised of 20 SOEs, 14 of which are corporatized and structured to operate along commercial principles (Table 17). The remaining six SOEs are government entities performing various noncommercial functions for government.¹³⁴ Of the 14 corporatized entities, 9 are majority-owned by the central government, while the remaining 5 are minority shareholdings.¹³⁵ According to the Ministry of Finance and Economic Management (MFEM), only six SOEs regularly submit financial accounts to the ministry, despite their obligation to do so under the Public Finance and Economic Management (PFEM) Act, and in some cases under their own founding acts. The absence of current financial data makes it impossible to measure the full fiscal or economic impact of the SOE sector, although the MFEM can account for the direct payments made to and dividends received from the SOEs each year. The MFEM confirmed that the SOEs represent a net drain on the budget on a consolidated basis.

The governance arrangements for Vanuatu's SOEs do not encourage transparency or accountability, and the framework for monitoring their performance does not function effectively. SOE director appointments are rarely made on the basis of professional qualifications, and directors' fees and expenses are well above prudent standards. Moreover, in the absence of performance contracts or statements of corporate intent, directors are not held accountable

134 Asset Management Unit, National Tourism Office, Reserve Bank of Vanuatu, Utility Regulatory Authority, Vanuatu Commodities Marketing Board, and Vanuatu Financial Services Commission.

135 One of the minority holdings, Northern Islands Stevedoring, has the remaining 90% of its shares held by various provincial government agencies. While it is considered a minority shareholding for the central government, the government accepts that it carries the ultimate risk and ownership responsibility for the entity.

for their performance on the boards nor for the performance of the SOEs. While the MFEM has created a unit that is nominally responsible for overseeing the SOE portfolio as a whole, it has not been able to enforce the obligation of the SOEs to submit financial statements to the MFEM.

In view of these challenges, the government is commended for taking important steps to address some of the most problematic SOEs, particularly its efforts to liquidate the Vanuatu Commodities Marketing Board (VCMB) and its ongoing work to privatize Air Vanuatu. Other priority SOEs identified by the MFEM as needing restructuring include Metensel Estates, National Housing Corporation, and Vanuatu Livestock Development. There will be substantial potential benefit from placing these initiatives into a comprehensive SOE reform program that would be structured to allow early “wins” to demonstrate the benefits of the reforms while strengthening the legal, governance, and monitoring framework for the SOEs that remain in the government portfolio. As is the case in any country embarking on SOE reform, success will be dependent on the ability of the government champions (in this case MFEM and the Prime Minister’s office) to provide the needed political commitment to the program.

Table 17. Vanuatu State-Owned Enterprises

Commercial SOEs under the Companies Act	Government Shareholding (%)	Year of Most Recent Financial Statement	Shareholding Ministry
Air Vanuatu	100	2006	MFEM, MIPU, PMO
Airports Vanuatu	100	2005	MFEM, MIPU
Global Trading and Manufacturing	31	n.a.	PMO
Ifira Warf and Stevedoring	34	2008	MIPU
Metensel Estates	99	1993	MFEM, MAQFF
Northern Islands Stevedoring	10	2004	MIPU
Vanuatu Livestock Development	100	1987	MFEM, MAQFF
Vanuatu Post	100	2007	MFEM, MIPU
Vanuatu Abattoirs	33	2006	MFEM
Commercial SOEs under Their Own Acts			
National Bank of Vanuatu	100	2007	MFEM
Vanuatu Agricultural Development Bank	100	n.a.	MFEM
National Housing Corporation	100	1997	MIA
Vanuatu Broadcasting and Television Corp	100	1995	PMO
Vanuatu National Provident Fund	100	n.a.	MFEM
Noncommercial SOEs under Their Own Acts			
National Tourism Office	100	2005	MTNVB
Vanuatu Financial Services Commission	100	2004	MFEM
Reserve Bank of Vanuatu	100	n.a.	MFEM
Asset Management Unit	100	2004	MFEM
Utility Regulatory Authority	100	n.a.	MFEM
Vanuatu Commodities Marketing Board	100	2001	MTNVB

MAQFF = Ministry of Agriculture, Quarantine, Forestry and Fisheries, MFEM = Ministry of Finance and Economic Management, MIA = Ministry of Internal Affairs, MIPU = Ministry of Infrastructure and Public Utilities, MTNVB = Ministry of Trade and Ni-Vanuatu Business, n.a. = not available, PMO = Prime Minister’s office.
Source: Ministry of Finance and Economic Management.

Fiscal Management

Accountability and Fiscal Targets

The PFEM Act 1998 was introduced to ensure effective and responsible economic, fiscal, and financial management by the government. It also requires compliance with the arrangements for accountability, including regular reporting of fiscal and economic outcomes. MFEM applies the PFEM Act rigorously, and oversees good governance in its sphere of influence.¹³⁶

The PFEM Act sets forth certain principles of fiscal responsibility, under which the government is to reduce and manage state debt at prudent levels, maintain the state's net worth at a level that provides a buffer against unexpected events, manage fiscal risks prudently, and pursue policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

The PFEM Act refers to the total overall revenue and expenditures of the state when determining the budget surplus, but the government has adopted a more limited definition based on recurrent revenue and expenditures, with targets actively managed by MFEM. In the 2009 budget policy statement (BPS), the government reiterated its long-term objective of maintaining a positive recurrent balance.¹³⁷ This definition does not, however, include such items as the purchase and sale of fixed assets, borrowing, grants, and development expenditures. Since 2005, the recurrent balance of the state budget has remained positive.

In the *2009 Budget Commentary*, the government announced that its “short term fiscal objective is to accrue surpluses in order to meet the long-term aim of reducing the stock of government debt.”¹³⁸ While sound fiscal policy is of paramount importance, Vanuatu has very low indebtedness as a result of sound debt management over the past few years. The domestic debt of Vt2.58 billion amounts to less than 5% of gross domestic product (GDP), and the external debt is correspondingly low, around 15% of GDP. While the International Monetary Fund (IMF) Article IV consultation analysis indicated that debt sustainability is sensitive to exchange rate shocks, even under the most adverse assumptions, the level of debt lies well within the threshold ceilings. Given Vanuatu's stage of development and the fact that it appears to be weathering the global economic crisis without too many adverse effects, the continued need for the financing of infrastructure improvements suggests that moderate amounts of borrowing could be undertaken without risking fiscal stability or unmanageable levels of debt.

Fiscal aggregates have improved significantly since 2000 on the back of better macroeconomic performance, improved fiscal management, and

136 MFEM has been receiving AusAID technical assistance for capacity building since 2000. The training and systems established under the technical assistance underpin the governance outcomes achieved by the ministry.

137 Government of Vanuatu. 2009. *Budget Policy Statement*. Port Vila.

138 Government of Vanuatu. 2009. *2009 Budget Commentary*. Port Vila.

strengthened public financial management (PFM) arrangements. The government prepares reports using both International Public Sector Accounting Standards and Government Finance Statistics 86 standards. Programmatic budgeting was introduced in 1998. The use of program budgeting has increased budget transparency and coverage. Vanuatu PFM arrangements were most recently assessed in 2006 using the Public Expenditure and Financial Accountability (PEFA) Performance Management Framework, which found that while budget execution and reporting standards were generally sound, audit, planning, and transparency issues needed further improvement.¹³⁹

Budget Process

The budget process is managed by MFEM and commences in February each year with a preliminary estimate of GDP. The government investment program is reviewed to identify the key projects that can be funded from aid or government revenue. The information from the GDP estimate is used to calculate the percentage of revenue to be allocated to each ministry; a small margin is retained as a reserve for adjustments later in the budget process. The allocations are approved by the Council of Ministers and then provided to the ministries.

The ministries prepare their own initial budget estimates, including for new initiatives, which are usually higher than MFEM's allocation. After MFEM reviews the proposals, they are considered by the Ministerial Budget Committee, which returns the budget to the Council of Ministers for approval. Finally, the council submits the budget to Parliament for appropriation.

The PFEM Act specifies that the BPS must set out the government's long-term fiscal policy objectives and specify the broad strategic priorities by which government will be guided in preparing the estimates for the next financial year. Before 2008, the BPS was released late in the budget preparation cycle. Since then, the BPS has been prepared early in April, before the budget. Also, as of 2008, the BPS has been prepared collaboratively by MFEM and the Prime Minister's office, ensuring that government policy priorities are effectively translated into the budget process. The final editing of the BPS is undertaken by MFEM, which is mandated under the PFEM Act to ensure prudent fiscal management.

The PFEM Act also provides that any member of the public may make a submission to the chairperson of the ERC concerning the BPS. This provision is intended to encourage good governance and transparency, and is now more relevant because the BPS is now being timely prepared.

¹³⁹ C. Pretorius and C. Certan. 2006. *Vanuatu Expenditure and Financial Accountability*. Rotterdam: ECO-RYS Nederland BV. Under the internationally accepted PEFA framework, Vanuatu's performance was assessed in relation to seven dimensions of public financial management: (i) credibility of the budget; (ii) comprehensiveness and transparency; (iii) degree to which the budget is prepared with due regard to government policy; (iv) predictability and control in budget execution; (v) accounting, recording, and reporting; (vi) external scrutiny and audit operations; and (vii) appropriateness of donor practices in the country.

A supplementary appropriation bill was passed retrospectively in February 2009, authorizing the expenditure of Vt548,396,952 incurred during 2008. Retrospective appropriation is only allowed under the PFEM Act when there has been a natural disaster or in unforeseen exceptional circumstances. The government acknowledged that this appropriation was inappropriate and passed an amendment to the PFEM Act in 2009 to address the issue. The amendment makes it explicit that a supplementary bill “must be passed by the Parliament before an amount specified in the Bill is issued from the Public Fund.”

In the BPS for the 2009 budget, the government acknowledged that the development budget would become an integral component of the national budget, allowing better management of donor funding in accordance with national policy priorities. Donor resources will be considered during the budget preparation cycle; beginning in 2009 (in time for the 2010 budget), the development budget will integrate the Government Investment Program with the annual recurrent budget. This will overcome the weakness in the links between national and sector policies.

Government Revenue

Fiscal performance of Vanuatu has improved substantially in recent years. The budget surplus for 2008 is estimated at 2.3% of GDP (Appendix Table A.8). The primary sources of government revenue are the value-added tax (VAT) and import duties. Reflecting improved tax compliance (due in part to additional staffing in the tax office and to the Department of Customs and Inland Revenue’s increased efforts to enforce compliance and its extension of coverage of the outer islands) and continued strong growth, total revenues, especially from VAT and trade taxes, were up by 16% from 2007. Even so, the country still depends on a narrow base for its income. Vanuatu has a relatively low ratio of tax revenue to GDP among Pacific island countries. This reflects the existence of large tax exemptions (especially on interisland shipping and tourism), estimated at 3.5% of GDP on average.

The discretion available to the minister of finance to grant tax and duty exemptions has had a significant adverse effect on revenue collection. This issue should be addressed by removing such discretion and clearly defining the circumstances under which exemptions may be granted.

The government remains heavily reliant on external aid flows. Aid funds are 20.0%–30.0% of the budget (1.5%–2.2% of GDP), depending on the cycles of the larger projects and most capital investments. The aid flows have significantly increased, from 1.9% of GDP in 2007 to 6.8% of GDP in 2008, as the long-awaited donor financing from the Millennium Challenge Corporation began to feed into capital projects.¹⁴⁰

140 Of the total \$66 million that Vanuatu is to receive from the Millennium Challenge Account, about \$29 million has been disbursed, with the remaining \$37 million to be disbursed by March 2011, the bulk of which is expected in 2009.

Recommendations have been made to widen the tax base over the longer term through a combination of direct taxes, indirect taxes, improved taxation compliance, and implementation of user-pays systems.¹⁴¹ While the government appears comfortable with the current revenue sources and has given no indication of widening the tax base in the near future, it should ask the Pacific Financial Technical Assistance Centre to help develop proposals to reform the tax system to ensure sufficient future revenue flows.

Government Expenditure

Although the aggregate fiscal position has improved in recent years, the effectiveness of public spending remains compromised by the crowding-out effects of public sector wages and civil service capacity gaps. For instance, 2008 actual expenditures were higher compared with the budget figures, although the strong revenue performance resulted in a sizable fiscal surplus. Furthermore, expenditures remain skewed toward nonproductive spending, with all revenue collections going toward meeting recurrent expenditures. The wage bill continued to constitute about half of recurrent expenditures, and allocations for emergency spending were, in part, used to finance election-related spending. Vanuatu's wage bill (as a percentage of total expenditure) is the highest among Pacific island countries, while the share of public employment in total employment is broadly the same as in other Pacific island countries. Furthermore, this ratio has increased from 10.5% of GDP in 2005 to an estimated 12.0% of GDP in 2008 (footnote 40).

The targets set for fiscal responsibility address recurrent income and expenditures, but not the size of the public sector. A ratio or benchmark (such as percentage of GDP, revenue, or total expenditure) should be considered to ensure careful monitoring of the growth of wages and salaries. It is preferable to manage staff numbers so as to prevent the need to resort to layoffs at a later stage, with the resultant social and economic upheavals. The Public Service Commission (PSC) has a responsibility to consider the fiscal effects of its decisions on wages and salaries, and more oversight of the PSC is required to ensure this responsibility is met.

Service Delivery and the Provinces

The disparities in service delivery and the standard of living between Port Vila and other areas have led to concerns about favoritism in the annual appropriation bill.

The ministries of health and education are the only ministries whose accounting and reporting are detailed enough to analyze their expenditures.

141 ADB and AusAID. 2002. *Vanuatu: Economic Performances and Challenges Ahead*. Manila; Government of Vanuatu, Department of Trade, Industry and Development. 2008. *Vanuatu: Diagnostic Trade Integration Study, 2008 Report*. Port Vila; and Pacific Financial Technical Assistance Centre. 2007. *Developing New Sources of Revenue and a High-Level Implementation Plan*. Suva.

In both ministries, analysis of the financial figures shows that most funds appropriated are being spent on direct services. Such analysis can show how and where the funds are spent, but it cannot indicate the quality or adequacy of the services provided. In education, for example, data on the qualifications and training of teachers and student attendance levels raise serious issues. Vanuatu has a reasonable attendance rate at the primary school level, but there are high dropout and absentee rates at the secondary level due to high fees and the limited availability of places for students.

The aggregate recurrent expenditure in the provinces by all ministries is 20% of the gross appropriation. While development and capital spending might increase in the provinces, it is unlikely that the 20% provincial figure will markedly increase for some time. Increased investments in the provinces, coupled with decentralization policies, may have some impact, but the reality remains that most recurrent expenditures will occur in the main urban areas.

Development partners, including the European Union, have reviewed PFM arrangements and are beginning to provide direct budget support to Vanuatu. Through the Priorities and Action Agenda (PAA) 2006–2015, the government has identified good governance and public sector reform as a reform focus (footnote 9). It is working with donor support, particularly from the AusAID-supported Governance for Growth PFM subprogram, which is supporting a PFM capacity-building program that is expected to include the establishment of provincial financial controllers to establish greater accountability and oversight, and to facilitate deconcentration of decision-making authority (footnote 27). Nevertheless, ongoing efforts are required to improve public enterprise efficiency and strengthen the budget framework to establish transparency and accountability.

Land Management

Land Tenure and Access to Land

Upon Vanuatu's independence in 1980, land was formally restored to the customary owners. The new Constitution proclaimed, "All land in the Republic of Vanuatu belongs to the indigenous custom owners and their descendants."¹⁴² It further proclaimed that the rules of *kastom* would form the basis of land ownership and use. Land is, therefore, closely linked with heritage, power, and spirituality. Custodianship and the exchange of rights are central to *kastom* practice, ensuring that harmony, authority, relationship networks, and social responsibility are maintained.

In Vanuatu, land has traditionally served as a source of subsistence, a source of power and status, and a source of identity and culture. The traditional land tenure system has ensured that all family and clan members have access

¹⁴² *Constitution of the Republic of Vanuatu*, Article 73.

to land; it is consistent with the country's strong kinship bonds and with customs that encourage traditional sharing of economic wealth. This communal approach provides an informal social support network that has allowed ni-Vanuatu to avoid deep poverty. Nevertheless, the pressures of development and the growing desire of ni-Vanuatu to participate in the country's market economy have led to radical changes in patterns of landholding in some parts of the country, particularly Efate.

Under the current law, government or private investors can negotiate long-term leases with the customary owners.¹⁴³ These leases are deemed to be incontestable by law, providing legal protection for the lessee, but potentially leading to disputes with and between customary owners, particularly when not all landowners were fully consulted or did not fully appreciate the implications of the lease.

The inherent subtleties of custom law, the uncertainty of custom authority, and the lack of recognition of the customary group as a legal entity have led to many reports of inequitable land dealings. Not all landowners have benefited from leases, and some ni-Vanuatu have been estranged from their land because their lease terms and conditions include unfavorable clauses for renewal or because the lease provides for a one-time payment at commencement rather than an economic return over the life of the lease. Furthermore, current land policies and tenure arrangements are economically inefficient, and often result in disputes among landowners and between landowners and lessees.¹⁴⁴

Vanuatu Land Sector Framework 2009–2018

The government recognized the overwhelming need for land reform and the growing concerns expressed by both landowners and investors. It held a land summit in 2006 at which the existing laws and policies were assessed. The summit gave prime consideration to determining who will be involved in governance and what their roles will be, and to strengthening stakeholders' capacity. Twenty resolutions were formulated and later grouped into the following three categories:

- resolutions concerning the need to build landowners' knowledge and skills to a level that supports informed decisions about land use options beyond leasing to other users;
- resolutions to ensure that the governance system for land is participatory at the family, community, national, and government levels; and
- resolutions germane to the creation of a new enabling environment to achieve these outcomes.

The participants agreed to build on existing laws, policies, and systems, including strengthening the Lands Tribunal to make ownership more certain.

¹⁴³ Such leases can have a term of as long as 75 years and are renewable.

¹⁴⁴ Economic efficiency, as the term is used here, requires that the nation's resources, including land, are allocated and used in a manner that provides the greatest benefits to the nation.

They also agreed to use technology to facilitate the replacement of the cumbersome manual records system.

The Land Sector Framework (LSF), involving all stakeholders and services, enables priorities to be set for actions and resources. Its purpose is to “provide an enabling environment for multistakeholder participation in the effective use, management, and stewardship of Vanuatu’s land resources.”¹⁴⁵ Under the LSF, plans will be developed to integrate climate change risk management with town and regional planning issues. The LSF contains four principles to guide decision making and ensure that land sector activities are aligned with the government’s development agenda:

- Management of land resources must comply with social and economic objectives.
- Stewardship of land resources must guarantee environmental sustainability.
- Land agencies must be relevant, cost effective, efficient, and sustainable.
- Planning, implementation, decision making, and monitoring of activities must be participatory, transparent, and accountable to protect the rights and interests of all stakeholders.

The LSF provides a roadmap for land sector development over a 10-year period. Its fundamental premise is that all stakeholders should share responsibility for land management. The LSF encompasses 2 periods of 5 years. It will be aligned with the government budget cycle and planning horizons to facilitate its integration into the corporate and annual planning activities of government agencies and other stakeholders involved in its implementation.

The Ministry of Lands will administer the LSF through a Land Sector Coordination Unit. The unit will be responsible for day-to-day LSF implementation, including monitoring and evaluation. Its oversight of land policy development, planning, and resource allocation will be facilitated by a multistakeholder Vanuatu Land Governance Committee (VLGC). A National Lands Forum is expected to be launched in late 2009, with a focus on land reform through consultation with stakeholders. This will be an important initiative under the LSF.

Conclusions

Public Sector Management

Vanuatu PFM arrangements were most recently assessed in 2006 using the PEFA PFM Performance Management Framework, which found that while budget execution and reporting standards were generally sound, audit, plan-

145 Government of Vanuatu, Department of Lands. 2009. Land Sector Framework 2009–2018. Draft for Discussion. Unpublished.

ning, and transparency issues needed further improvement (footnote 138). In addition, in terms of comprehensiveness and transparency, the government's ability to oversee fiscal risk remains a concern, as many of the state-owned enterprises (SOEs) and statutory bodies have not submitted accounts for several years.

Progress has recently been made on public sector management with support from the AusAID-supported Governance for Growth PFM subprogram, which is providing a program of PFM capacity building that is expected to include the establishment of provincial financial controllers as a means to establish greater accountability and oversight, and to facilitate deconcentration of decision-making authority (footnote 27).

Nevertheless, ongoing efforts are required to strengthen public sector management. The most important actions to overcome the major weaknesses in public sector management would be revitalization of the Office of the Auditor General (OAG) and the Office of the Ombudsman; training support for members of the Expenditure Review Committee (ERC); and establishment of an effective performance management system for directors general. The government is currently seeking to revitalize the OAG and is proposing amendments to the PFEM Act.

Reform of State-Owned Enterprises

SOE reform should begin with the collection of updated financial data to immediately identify those SOEs that represent the greatest strain on the budget. Individual restructuring analyses should be undertaken for each SOE, with a review of their mandate and activities, the degree of competition in their respective sectors, their regulatory environment, and any market failure or structural issues that might need to be addressed. The rationale for government involvement should be also reviewed. The output of each review would be a set of recommendations for operational and financial restructuring of the SOE, including recommendations on any regulatory reforms needed to support the restructuring measures.

While the SOE restructuring program is being implemented, a parallel effort to strengthen the legal, governance, and monitoring frameworks should also be undertaken. This work would include (i) drafting a SOE act; (ii) establishing a robust process for the selection, appointment, and accountability of directors; (iii) establishing a framework for the contracting and financing of community service obligations; and (iv) clarifying the role and responsibilities of the monitoring agency within the MFEM.

ADB and AusAID have agreed to provide assistance to the government for SOE reforms. Some of the SOE reforms will be politically challenging; prioritization and sequencing will require ongoing discussion at the political level to ensure that required leadership exists. The government has expressed

its commitment to a comprehensive reform of the sector, and has emphasized the importance of securing broad political support for the program.

Fiscal Management

Vanuatu's fiscal position has stabilized in the past few years and has been consistent with macroeconomic stability and debt sustainability. As a good example, the overall fiscal surplus increased to 2.2% of GDP in 2008, following a small surplus in 2007. Improved VAT and trade taxes, reflecting an improvement in tax compliance, more than offset the additional (election-related) spending on goods and services. Nevertheless, the following structural reforms are needed for a more effective fiscal policy over the medium to long term.

Widening the tax base. Improvements in tax administration and widening the tax base would help finance development expenditure as foreign aid begins to gradually taper off as the economy matures. For instance, the government should look into streamlining the large tax exemptions, especially in the tourism sector, and rationalizing exemptions in interisland shipping. In addition, tax administration could be further rationalized by better integrating VAT and customs duty collection.

Reorienting expenditures. The prioritization of spending is crucial to promoting growth while keeping expenditure pressures manageable. In particular, the need to monitor the large public sector wage bill and loss-making public enterprises is important. More than half of the recurrent budget is spent on the wage bill, crowding out expenditures in areas that could help improve the productive capacity of the economy. Most development expenditure is currently financed by aid inflows. While aid inflows are expected to remain strong over the next few years, the government could increase development spending in priority areas by restructuring expenditures. These measures include

- streamlining the wage bill by eliminating vacant positions and avoiding ad-hoc increases in wages;
- enhancing monitoring and accountability of SOEs to improve their efficiency, and restructuring those that continue to require government subsidies; and
- improving the budget framework to establish transparency and accountability, including through the passage and implementation of the PEFM Act.

Land Management

Land issues in Vanuatu, as in other Pacific island countries, are especially difficult to deal with because land is not only communally held, but is also closely related to identity.¹⁴⁶ As discussed in section on Land Management, land issues

¹⁴⁶ This feeling is encapsulated in the phrase "when you look at the person you see the land; when you look at the land you see the person."

pervade development efforts and continue to present difficulties for investors. AusAID is currently engaged in a long-term land administration project that should improve recordkeeping for land and land transactions. A New Zealand Agency for International Development (NZAID)-funded project has also been established to assess the functioning of customary land tribunals. Nevertheless, Vanuatu should not delay tackling contentious issues related to land leases. Unless these problems are solved, the country's long-term prosperity will be compromised.

The guiding principles for any changes in land policy should be developed by the ni-Vanuatu themselves. Regardless of how the system evolves, it is important that predictability and certainty be attached to land holdings, land leases, and land investment. Continued promotion of the *LSF 2009–2018* to develop policies that allow landowners to benefit while facilitating access to land for development purposes is also important in tackling land issues in Vanuatu.

ENVIRONMENT

Introduction

Sustainability is the central theme that underpins the national vision for Vanuatu. Most programs and projects espouse sustainability in one form or another. Yet little more than lip service has been paid to environmental sustainability—despite the promulgation of the Environmental Management and Conservation (EMC) Act 2002—and the environment’s role in underwriting livelihoods for the rapidly growing population and supporting key export industries, particularly tourism and agriculture.

Despite the obvious importance of the environment, it was recently concluded that there is “a distinct lack of political commitment to the environment, a tiny allocation of the budget to environmental issues, a virtually defunct Environment Unit...and widespread evasion or abuse of the carefully crafted laws.”¹⁴⁷ This conclusion is reinforced by the government’s failure to include actions to strengthen environmental management in its policy priorities for 2009–2012, despite its commitment to “equitable and sustainable development of land.”

Issues, Causes, and Constraints

Poverty reduction is inextricably linked to the sustainable management of Vanuatu’s natural resource base. The country is extremely vulnerable to natural disasters; the Commonwealth Vulnerability Index assessed it as the most vulnerable country of 111 assessed.¹⁴⁸ Vanuatu is located in the “ring of fire” and the “cyclone belt” of the Pacific. It is vulnerable to a wide range of climate-related hazards, more than most other Pacific countries. Key environmental management challenges include (i) climate change and sea-level rise; (ii) soil erosion and land degradation; (iii) coastal erosion; (iv) loss of forests; (v) loss

¹⁴⁷ ADB. 2007. *Vanuatu Country Environmental Analysis*. Manila.

¹⁴⁸ UNESCAP. 1999. *The Commonwealth Vulnerability Index*. Report on the Meeting of Vulnerability of Small States. Brussels, 26 March.

of biological diversity; (vi) water pollution; (vii) waste disposal and recycling; (viii) reef destruction and overexploitation of marine resources; and (ix) natural disasters. In addition, rapid economic growth, a young and rapidly growing population, urban drift, urban land speculation, agricultural intensification, deforestation, weak coastal management systems, poor sewage and waste disposal, and the use of diesel for power generation threaten the integrity of the natural resource base. While environmental laws and regulations are broadly sufficient, enforcement is lacking due to inadequate political commitment, the understaffing of the Environment Unit in the Ministry of Lands, and inconsistent implementation of environmental laws and legislation.

Global warming will have an impact on the poor. Since the beginning of temperature recording on the main island in 1949, annual mean temperatures have increased by about 0.5°C, average rainfall levels have decreased, and extreme weather events have been more frequent. The expected impact of global warming on Vanuatu is a drier and warmer climate, with more frequent extreme climatic events, and warmer seas. A national action program for climate change adaptation was completed and approved by the government in 2007. Further details on the Vanuatu Environmental Indicators are in Appendix Table A.9.

Population growth (exacerbated in some areas by rural–urban drift) is one of the main causes of environmental change; the rapidly growing population puts increasing pressure on agricultural land, marine resources, and water. Population growth also increases pressure to produce export commodities for the income needed to provide more and better services. Real estate and tourism developments, deforestation, invasive species, imported energy and transportation needs, and increasing tourist numbers are all causes of environmental change.

Environmental management is shaped in a number of ways and by certain realities in Vanuatu. The widespread islands, scattered population, and geographic diversity make it a complex and expensive undertaking, and the *kastom* land tenure system adds to the difficulties of implementing policies such as land use controls. The Department of Environment and Conservation mandated by the EMC Act (and recommended by the comprehensive reform program [CRP] in 1997) has not yet been created, inhibiting environmental activities. Furthermore, the present Environment Unit has insufficient personnel and budget, hobbling the government's ability to develop and implement environmental policy; the 2009 budget includes Vt10.1 million for the Environment Unit, Vt7.0 million of which goes to the salaries of its five employees.

The limited capacity of the Environment Unit results in a disregard and lack of enforcement of environmental laws (such as the environmental impact assessment laws) and bylaws (such as the bylaw in Port Vila that prohibits the use of plastic bags). For example, the preliminary environmental impact

assessment for the fish-processing plant under construction on the shores of Mele Bay was legally required to be prepared internally by the Environment Unit or some other government-approved agency, but it was prepared by a consultant. Provisions for preventing inappropriate development in coastal and foreshore areas are also abused because of these limitations. The Physical Planning Act 1986 is administered by provincial governments or municipal councils; under the Foreshore Development Act 1975, the minister for internal affairs has considerable discretionary powers.¹⁴⁹

The growing population and increased consumption of imported goods add to waste disposal and local pollution burdens. Rural–urban migration and increasing urbanization raise sanitation issues such as the protection of water catchments and the reduction of vehicle emissions caused by uncontrolled expansion of urban transportation. Peri-urban residents face increasing risk from tidal surges and other natural events. There is no established system of fees and charges, performance bonds, and other incentives for land developers and other groups. There is no system for the disposal of toxic waste such as batteries. All of these conditions result in further potential for environmental degradation.

Vanuatu has signed a significant number of international and regional agreements, many of which have reporting requirements (Appendix Table A.10). Staff of the Environment Unit spend considerable time on such reporting activities rather than on environmental management activities. The government also relies heavily on foreign funding for the environmental functions it undertakes, but this renders environmental management itself unsustainable; funding under the Global Environment Facility (GEF) is available on a competitive basis for national projects (Table 18), while Vanuatu is also involved in a number of regional GEF projects, particularly dealing with biodiversity and climate change.

Natural disasters, including cyclones and earthquakes, occur regularly, yet the government does not provide funding to ensure that its natural disaster risk reduction and management plan can be quickly implemented.¹⁵⁰ Instead, it takes a passive approach, seemingly based on the proven willingness and ability of donors to provide support and reconstruction quickly following natural disasters.

149 For example, the Ministry of Lands and Ministry of Internal Affairs, not the Environment Unit, gave permission for the development that is occurring in Erakor Lagoon, which has resulted in the removal of mangroves and infilling of the lagoon.

150 Government of Vanuatu, Ministry of Finance and Economic Management. 2006. *Supplementary Priorities and Action Agenda: Disaster Risk Reduction and Disaster Management for a Safe, Secure and Resilient Vanuatu*. Port Vila.

Table 18: Projects Funded by the National Global Environment Facility

Project Name	Project Type & Focal Area	Agency	Date Approved	Grant (\$'000)
National biodiversity strategies, action plan, national report	Enabling activity; biodiversity	UNEP	15 January 1997	207
Clearinghouse mechanism	Enabling activity; biodiversity	UNEP	10 June 1988	13
Assessment of capacity-building needs for biodiversity and participation in clearinghouse mechanism	Enabling activity; biodiversity	UNEP	7 September 2000	132
Facilitating/strengthening the conservation initiatives of traditional landowners to achieve biodiversity conservation objectives	Medium-sized project; biodiversity	UNDP	10 March 2004	771
National adaptation program of action	Enabling activity; climate change	UNDP	7 April 2003	200
National capacity needs self-assessment for global environmental management	Multifocal areas	UNEP	5 May 2004	225
Persistent organic pollutants (POPs) enabling activities for Stockholm convention on POPs; national implementation plan	Enabling activity; POPs	UNEP	24 March 2003	393

UNDP = United Nations Development Programme, UNEP = United Nations Environment Programme, POP = persistent organic pollutant.

Source: ADB. 2007. *Country Environmental Analysis*. Manila.

Staff of the Environment Unit, faced by severe resource limitations, have been attempting to set realistic priorities and focus on areas where a real difference can be made. This indicates the downside with the GEF programs shown in Table 18. The GEF programs consume staff time but are not sustainable or likely to make much of a difference to environmental outcomes in Vanuatu. They also suffer from the common affliction of being driven by international agencies rather than by demand from the recipient country. The nation can ill-afford such diversionary activities and must focus on its critical needs.

Mainstreaming the Environment

The natural environment is central to livelihoods and the commodity export industries of Vanuatu. It also underpins tourism, the nation's leading sector. Environmental management should, therefore, be accorded preeminence in all planning and development activities.

First, the government must establish the institutional arrangements that will support a country-driven process for giving priority to environmental issues, and must provide adequate human and financial resources for routine

environmental activities. A department of environment and conservation, as provided for under the EMC Act 2002, should be created as soon as practically possible. The department needs to be properly staffed and given the resources required for it to meet its responsibilities. Capacity building for the department, with donor support, is important to ensure that it can meet the requirements of the act and undertake its enforcement responsibilities.

The cross-disciplinary responsibilities of the department make its location in the government important. For example, it might be located within the office of the Prime Minister so that the staff can work closely with the Prime Minister's aid planning, negotiation, and coordination staff.

The new department must establish priorities for its work. This important process should involve consultation. To this end, the recommendation in ADB's *Country Environmental Analysis* to establish a National Council on Sustainable Development is supported (footnote 146).

The government must also consider the mix of skills required in a department of environment and conservation. The department will have responsibility for developing and implementing an environmental policy, which requires skills beyond those called for in the physical sciences. Policy development also requires that other professional skills, such as those in resource economics, are brought to bear on issues such as environmental fees and charges. Examples include performance bonds for new developments or the use of natural resources (Box 8), fees for accepting toxic materials, charges for inspection services, charges on developers for the preparation of a preliminary environmental impact assessment, and so on. An appropriate use of such fees and charges could make the department largely self-funding, although care must be taken not to introduce fees and charges simply to raise money.

Based on this discussion, three immediate actions are recommended:

- Establish the department of environment and conservation with an appropriate level and mix of professional staff and carefully consider its location within the government structure.
- Seek donor support for technical assistance to examine the potential for sustainable environmental financing through fees, charges, and performance bonds.
- Seek donor support for technical assistance to undertake a strategic environmental assessment in Vanuatu and to develop a system for examining policies, plans, and programs for their environmental consequences before their approval. This activity should involve the establishment of a national council on sustainable development and might also support a national environment summit (footnote 146).

Box 8: Performance Bonds

A performance bond is a surety bond, usually issued by an insurance company or a bank—although it may be issued by the company itself—to guarantee satisfactory completion of a project by a contractor or other person. Performance bonds are sometimes used as a permit requirement where there is potential for environmental damage. The bond provides a guarantee that if the activities of the holder cause environmental damage, funds will be available to cover the costs of cleanup or removal of structures. A well-known example is the use of performance bonds by Australia's Great Barrier Reef Marine Park Authority as a requirement of permits for construction and use of structures such as pontoons on the reef. The bond ensures that rehabilitation of the reef can be undertaken if an operator fails to meet environmental standards, or if there is damage from an accident or an event such as a cyclone. The proposed fish-processing plants in Mele Bay and Port Vila Bay are the sorts of developments for which a performance bond would be suited.

Source: Research findings.

Conclusions

The natural environment provides the basis for livelihoods and the principal economic activities in Vanuatu. It must be accorded the highest possible priority by

- upgrading the Environment Unit to a department of environmental management and conservation, as provided for in legislation;
- reviewing the position of the department in the government structure, ensuring that it can meet its cross-departmental responsibilities—at the least, it should be moved from the Ministry of Lands; and
- ensuring that the department has sufficient resources to meet its mandate.

CONCLUSION AND KEY RECOMMENDATIONS

Conclusion

Vanuatu has made significant economic and social gains since 2003, with the annual rate of economic growth averaging 6% from 2003 through 2008. Construction activity, tourism, services, and a robust real estate sector were the main drivers of this growth. Vanuatu's improved economic performance can be attributed to improvements in economic policy and fiscal management, and gradual progress in the quality of institutions. Policy initiatives such as the opening of telecommunications to competition and the open skies policy for airlines have contributed significantly to economic growth. Prudential regulation in the financial sector has been strengthened; a new commercial bank entered the market in 2008; credit to the private sector has steadily increased; and market-oriented microfinance programs have been introduced.

Since 2003, economic growth has exceeded population growth, meaning that gross domestic product (GDP) per person also increased throughout this period. However, the distribution of the benefits of economic growth and development across the nation currently remains a cause for concern. This is partly due to the inherent difficulties and high cost of providing services and other benefits to a small population that is dispersed across some 65 inhabited islands. The United Nations Conference on Trade and Development reports that Vanuatu is 20% more remote than other developing countries, and that the remoteness of its population exacerbates its exposure to shocks and contributes to its vulnerability.¹⁵¹

¹⁵¹ United Nations Conference on Trade and Development. 2009. *Vulnerability Profile of Vanuatu*. Port Vila.

As a consequence, most rural and peri-urban inhabitants suffer from poverty of opportunity with limited health, education, and transport facilities; poor standards of governance; few employment opportunities; and restricted income and expenditures. Geographic isolation also contributes to the narrow economic base and high costs, and limits opportunities to exploit economies of scale and scope and opportunities for domestic and international trade.

Sustainability of economic growth also depends on private sector investment. Policies for private sector development have improved in recent years, but difficulties remain. Constraints to private sector development stem from inadequate physical infrastructure, poor governance, an outdated legal and regulatory environment for private sector investment, corruption, and government involvement in inefficient enterprises that crowd out the private sector. Difficulties with land tenure create problems for foreign investors as well as local businesses.

Tourism is Vanuatu's leading export industry; it has grown continually since 2004. Travel receipts cover most of the gap arising from trade in goods and have been the largest source of foreign exchange revenue. Tourism-related sectors (wholesale and retail trade, hotels and restaurants, and transport and communication) play an increasingly important role in the domestic economy. These three sectors account for more than two-thirds of GDP, and about 70% of the increase in real GDP in the 3 most recent years.

Tourism relies on political and social stability to ensure continued market growth. Further economic reform and greater public investment in physical and social infrastructure are required to make the country an easier place to do business and to visit. Careful attention to environmental management is also needed to preserve natural assets (footnote 19). Government must set the policy context and operating environment for developing tourism, but the private sector must drive investment and employment.

Agriculture remains fundamental to the traditional and cash economies and involves all but a small percentage of the population. It is the second-largest contributor to GDP and provides virtually all of the goods exported from Vanuatu. It also provides subsistence for most of the population. Despite its importance, the sector is underperforming, particularly its commercial component. As the nation tries to broaden its economic base and meet the needs of a rapidly growing population, it will be still more critical for it to develop its agriculture sector through structural adjustments and productivity gains. There is a pressing need to develop real vision, institutional structures, and service delivery that will support more productive and vibrant agricultural enterprises.

Infrastructure plays a vital role in generating economic growth. For many years, Vanuatu has suffered from inadequate physical infrastructure as a result of insufficient government investment. For instance, costs for electricity, water, and port services in Vanuatu remain among the highest in Pacific

island countries. The state of infrastructure and provision of associated services in Vanuatu is mixed, although in some areas policy reform and private sector participation have reduced costs and increased efficiency through competition. The geographic dispersion of Vanuatu's islands means that communications and interisland transport are extremely important to the provision of services to rural inhabitants and to opportunities for them to engage in economic activity. Island communities rely on marine transport and infrastructure to bring the commodities they produce to market; to transport agricultural inputs, consumer goods, and other items; and to transport people from island to island. While domestic maritime services are adequate for many parts of the country, more needs to be done for remote areas and to support the movement of goods to markets.

Vanuatu performs better than the Pacific islands average on all six standard governance indicators. Positive trends are discernible for 1996–2008, particularly for political stability, rule of law and control of corruption (footnote 118). Vanuatu joined the ADB/OECD Anti-Corruption Initiative for Asia–Pacific on 30 November 2001. In 2004, an in-depth study of national integrity systems concluded *inter alia* that “since the commencement of the comprehensive reform program (CRP) in 1997, Vanuatu has made significant steps in developing a strong legal framework designed to foster accountability, transparency and responsibility especially in the public sector.” However, certain institutions that play a central role in ensuring good governance, such as offices of the auditor general and the ombudsman, need further strengthening. The governance arrangements for Vanuatu's SOEs also do not encourage transparency or accountability, and the framework for monitoring their performance does not function effectively.

Vanuatu's natural environment is critical to livelihoods and is the basis of the nation's key export industries, particularly tourism and agriculture. Vanuatu is geographically located in the “ring of fire” and the “cyclone belt” of the Pacific. It is vulnerable to a wide range of climate-related hazards—more than most other Pacific countries. Key environmental management challenges include climate change and sea-level rise; soil erosion and land degradation; coastal erosion; loss of forests; loss of biological diversity; water pollution; waste disposal and recycling; reef destruction and overexploitation of marine resources; and natural disasters. Global warming is another factor that will affect the poor. The country is extremely vulnerable to natural disasters and is the world's most vulnerable country out of 111 countries assessed according to the Commonwealth Vulnerability Index. While Vanuatu's environmental laws and regulations are in place, efficient implementation and enforcement of these laws require urgent attention.

While Vanuatu's challenges are formidable, its opportunities are manifold. The country has a young and talented work force, a relatively open

economy, and a government committed to fostering private sector development. Thanks to the economy's positive growth momentum, Vanuatu has a favorable reputation among investors and holidaymakers, particularly in the Australian and New Zealand source markets. It has tremendous scope for expanding production of high-value cash crops, and for extending tourism and recreational-property development to new islands. New developments in mass communications and the internet will help to overcome barriers posed by remoteness, and Vanuatu's development partners remain firmly committed to fostering development and reducing the nation's vulnerability.

Key Recommendations

The overarching principle in this report is the importance of government focus on its core roles of setting and administering the policy context for economic growth and development and establishing an enabling environment for private sector investment and employment creation. This economic review makes the following key recommendations:

Public Sector Management

- Fiscal structure reforms should be further advanced to widen the tax base and restructure expenditures.
- Repeal the recent amendments to the Employment Act.
- Review the government's approach to wage fixing and the current level of wages.

Health and Education

- Formulate a national human resources development strategy.
- Make increased use of nongovernment organizations to deliver primary health care under an outsourcing approach.
- Accelerate efforts to improve teaching quality in the nation's schools.

Private Sector and Productive Sectors

- Press forward with current initiatives to modernize the commercial legal framework.
- Continue to focus on improving access to credit, especially for small businesses.
- Focus on improving the land leasing system to make land property rights more secure for both customary landowners and those leasing land.
- Support the tourism sector through further economic reform, infrastructure development, and establishment of a sound enabling environment for private sector investment.
- Prioritize formulation of a national agriculture policy.

Infrastructure

- Focus infrastructure reforms on lowering costs, upgrading quality, and strengthening local contracting services for infrastructure maintenance.
- Improve roads, ports, wharves and jetties, and other transportation infrastructure in the rural areas and outer islands to enhance interisland transport. Prepare master plans for port and harbor development in Port Vila.
- Continue planning for rural airport maintenance and prepare a master plan for upgrading Bauerfield Airport.
- Effectively implement the rural electrification plan.
- Improve provision of rural and urban infrastructure services such as water supply, sanitation and waste management facilities.
- Implement the Vanuatu National Water Strategy 2008–2018.
- Develop a national urbanization policy and planning guidelines. Increase capacity in urban planning and management.

Governance

- Restructure the state-owned enterprise (SOE) sector, with a particular focus on inefficient and expensive monopoly arrangements, through the establishment of a new legal framework, enhanced governance, and improved oversight arrangements.
- Continue land reform efforts and support the Land Sector Framework.
- Appoint an auditor general and upgrade staffing and administrative arrangements.
- Ensure that reports and recommendations of the ombudsman are acted upon.

Environment

- Establish a department of environment and conservation and position it effectively in the government structure, possibly in the Office of the Prime Minister.
- Give far greater priority to the natural environment, and mainstream environmental issues in policy decisions.
- Ensure robust environmental management and monitoring plans as a prerequisite to the operation of fish-processing plants in Port Vila Bay and Mele Bay.

Appendix

Table A.1: Country Poverty and Social Indicators

Item	Period		
	1990	1995	Latest Year
A. Population Indicators			
1. Total population (thousand)	196.9 (2000)	223.5 (2006)	235.0 (2008)
2. Annual population growth rate (% change)	2.7 (2000)	2.6 (2006)	2.4 (2008)
B. Social Indicators			
1. Total fertility rate (births/woman)	4.9	4.7	3.8 (2006)
2. Maternal mortality ratio (per 100,000 live births)	—	96.3 (1998)	70.0 (2006)
3. Infant mortality rate (below 1 year/1,000 live births)	48	38 (2000)	28 (2008)
4. Life expectancy at birth (years)	63.5	65.7	70.0 (2008)
a. Female	65.0	67.3	72.1 (2008)
b. Male	62.0	64.2	68.3 (2008)
5. Literacy rate of 15–24 year olds (%)	34.0 (1989)	—	87.0 (1999)
6. Adult literacy (%)	—	65.5 (1994)	78.1 (2006)
a. Female	—	62.5 (1994)	76.1 (2006)
b. Male	—	68.4 (1994)	80.0 (2006)
7. Primary school gross enrollment (%)	104.1 (2005)	99.3 (2006)	93.8 (2007)
8. Primary school net enrollment (%)	74.5 (1989)	78.2 (1999)	93.0 (2004)
9. Secondary school gross enrollment (%)	42.9 (2005)	47.5 (2006)	53.3 (2007)
10. Child malnutrition (% below age 5)	—	—	12.1 (1996)
11. Population below poverty line (%)	—	—	16.0 (2006)
12. Population with access to safe water (%)	—	—	—
a. Urban	93.0	—	75.0 (2006)
b. Rural	53.0	—	52.0 (2006)
13. Population with access to sanitation (%)	—	—	—
a. Urban	—	—	78.0 (2000)
b. Rural	—	—	42.0 (2000)
14. Public education expenditure (% of GDP)	—	—	9.6 (2002–05)
15. Human development index rank	140 (1998)	—	120 (2005)
16. Gender-related development index rank	—	—	103 (2006)
C. Poverty Indicators			
1. Poverty incidence (basic needs, %)	—	40.0 (1998)	15.9 (2006)
2. Percent of poor to total population (basic needs, %)	—	—	—
a. Port Vila	—	—	32.8 (2006)
b. Luganville	—	—	10.9 (2006)
c. Rural	—	—	10.8 (2006)
3. Poverty gap	—	30.5 (1998)	5.6 (2006)
4. Poverty severity index	—	—	—
5. Inequality (Theil L Index)	—	—	—
6. Human poverty index	—	—	24.6 (2006)
Rank	—	—	56 (2006)

— = not available, GDP = gross domestic product.

Sources:

Asian Development Bank. 2008. *Key Indicators*. Manila.

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Table A.2: Changes in Gross Domestic Product by Industry (Constant 1983 Prices)
(% change)

	Year					
	2002	2003	2004	2005	2006	2007
Agriculture, Fishing, and Forestry	(3.4)	6.5	7.2	(4.4)	2.3	2.3
Custom/traditional agriculture ^a	2.2	2.3	2.2	2.2	3.1	2.6
Export agriculture ^b	(10.0)	14.4	17.6	(20.7)	6.4	2.4
Other commercial agriculture ^c	(14.6)	(1.1)	(3.8)	27.7	7.5	(13.2)
Forestry and logging	(11.6)	3.9	(23.1)	118.8	(38.7)	9.1
Industry	(5.8)	3.5	5.4	7.1	7.0	10.4
Manufacturing	(13.1)	4.5	5.0	6.1	1.4	4.2
Electricity and water	(1.0)	(1.0)	3.5	4.1	2.8	6.6
Construction	(0.2)	6.2	7.2	10.5	15.7	18.3
Services	(8.6)	2.3	5.1	9.4	8.7	7.4
Wholesale and retail trade	(11.7)	0.1	(1.7)	11.4	12.2	7.5
Hotels and restaurants	(9.7)	(8.8)	13.6	6.1	11.0	13.4
Transport and communication	(15.7)	3.7	15.5	13.8	8.5	13.1
Finance and insurance	(4.1)	9.0	6.3	19.6	6.0	2.4
Real estate and business services	(7.2)	12.2	17.6	9.7	11.4	7.7
Government services	0.7	3.6	0.7	1.8	0.5	5.4
Personal services	0.7	(0.4)	0.7	1.7	6.3	13.3
Domestic services	4.2	4.2	4.2	4.2	4.2	4.2
Less imputed bank service charge	(9.1)	5.4	(1.0)	21.0	9.1	14.7
Gross Domestic Product	(7.4)	3.2	5.5	6.5	7.4	6.8
Resident population (midyear estimate)	2.6	2.6	2.6	2.6	2.6	2.6
GDP per capita	(9.7)	0.6	2.8	3.8	4.7	4.1

() = negative number

^a Includes production of fruit, vegetables, kava, and other food items, and of livestock, poultry, fishing, and household forestry activities.

^b Includes copra, kava, beef, cocoa, and coffee.

^c Includes fishing, poultry, fruit, and vegetables.

Source: National Statistics Office, Government of Vanuatu. 2008. *National Accounts of Vanuatu 2007*. Port Vila.

Table A.3: Gross Domestic Product by Industry (Constant 1983 Prices)
(Vatu million)

	Year					
	2002	2003	2004	2005	2006	2007
Agriculture, Fishing, and Forestry	2,894	3,083	3,305	3,161	3,235	3,308
Custom/traditional agriculture ^a	1,706	1,745	1,784	1,823	1,879	1,928
Export agriculture ^b	1,026	1,174	1,380	1,095	1,165	1,194
Other commercial agriculture ^c	74	74	71	90	97	84
Forestry and logging	87	91	70	153	94	102
Industry	1,489	1,542	1,625	1,741	1,862	2,056
Manufacturing	569	595	625	663	672	701
Electricity and water	414	410	424	442	454	484
Construction	506	537	576	636	736	871
Services	11,061	11,311	11,883	13,005	14,139	15,185
Wholesale and retail trade	4,849	4,854	4,773	5,316	5,967	6,417
Hotels and restaurants	890	812	922	979	1,086	1,232
Transport and communication	1,459	1,512	1,747	1,988	2,157	2,439
Finance and insurance	1,162	1,266	1,346	1,609	1,706	1,746
Real estate and business services	1,005	1,129	1,328	1,456	1,622	1,747
Government services	2,131	2,207	2,223	2,263	2,274	2,397
Personal services	157	157	158	160	171	193
Domestic services	137	143	149	155	162	169
Less imputed bank service charge	(730)	(769)	(762)	(922)	(1,006)	(1,154)
Gross Domestic Product	15,444	15,936	16,813	17,907	19,236	20,549
Resident population (midyear estimate, persons)	201,222	206,454	211,822	217,329	222,980	228,777
GDP per capita (Vt)	76,751	77,189	79,373	82,396	86,268	89,821

() = negative number, GDP = gross domestic product, Vt = vatu.

^a Includes production of fruits, vegetables, kava, and other garden products, as well as livestock, poultry, fishing, and forestry output by households.

Table A.4: Exchange Rates, 2000–2009 (Annual Average)
(Vatu per unit of foreign currency)

Currency	Year											
	2000	2001	2002	2003	2004	2005	2006	2007	2008	Jun 2009 ^a	Jan 2009 ^b	Feb 2009 ^b
Australian Dollar	80	75.19	75.76	81.3	86.96	87.72	87.72	90.09	90.09	81.22	77.58	77.21
US Dollar	136.99	144.93	140.85	126.58	116.28	113.64	116.28	107.53	104.17	109.85	118.03	119.1
NZ Dollar	62.89	61.35	62.89	72.99	77.52	80.65	75.76	79.37	76.34	65.97	60.58	60.6
Euro	n.a.	n.a.	131.58	140.85	142.86	140.85	142.86	144.93	151.52	n.a.	152.87	151.69
UK Pound	208.33	212.77	208.33	204.08	208.33	204.08	208.33	208.33	192.31	n.a.	n.a.	n.a.
Japanese Yen	1.270971	1.206709	1.114454	1.087075	1.0819	1.046353	1.003714	0.920471	1.002104	n.a.	1.3114	1.2102

n.a. = not available, NZ = New Zealand, UK = United Kingdom, US = United States.

^a June 2009 data annualized.

^b Data for January and February 2009 are for the end of the month.

Source: National Statistics Office, Government of Vanuatu.

Table A.5: Credit to Private Sector Credit
Vatu million

Sector	Year					
	2003	2004	2005	2006	2007	2008
Agriculture	240.70	244.60	304.20	400.20	354.80	393.70
Fisheries	30.90	26.60	26.90	23.20	37.20	79.20
Mining and Quarrying	-	11.20	-	46.40	48.40	102.20
Manufacturing	852.40	487.60	1,117.40	1,069.30	1,387.20	1,357.00
Tourism	1,313.70	1,314.60	1,706.80	2,271.70	1,576.20	2,187.40
Entertainment and Catering	163.30	205.40	58.50	48.30	33.90	81.60
Transport	588.90	667.00	625.50	842.20	1,061.00	1,458.40
Public Utilities	9.90	7.50	6.60	5.70	11.20	10.00
Construction	2,731.30	2,710.00	2,917.60	2,180.10	2,151.60	3,645.20
Financial Institutions	48.60	138.70	121.60	154.30	128.50	170.70
Professional and Other Services	917.10	915.70	916.40	953.80	1,147.60	1,576.40
Housing and Land Purchases	2,260.50	3,592.70	4,386.50	5,453.80	7,599.00	10,518.60
Distribution	1,780.60	1,600.60	1,862.90	2,179.40	1,069.00	2,899.20
Personal: Other	3,423.90	3,147.30	3,736.50	3,377.40	5,350.90	6,563.80
Miscellaneous	203.80	933.20	828.40	1,602.80	1,377.30	2,504.00
Total	14,565.60	16,002.70	18,615.80	20,608.60	23,333.80	33,547.40

- = no data available

Source: Reserve Bank of Vanuatu. 2009. *Quarterly Economic Review, December 2008*. Port Vila.

Table A.6: Principal Exports and the Balance of Payments
Vatu million

Item	Year						
	2002	2003	2004	2005	2006	2007	2008
Copra	174	282	446	126	381	485	1,077
Coconut oil	470	382	1,026	732	282	492	728
Beef, veal, and hides	191	287	283	302	117	180	386
Cocoa	141	295	160	181	184	222	240
Timber	197	249	247	203	39	80	80
Kava	253	228	440	477	273	443	487
Re-exports	661	652	874	1,217	635	810	662
Other ^a	802	877	696	886	245	321	571
Total exports	2,889	3,252	4,172	4,124	2,156	3,033	4,231
Total imports (c.i.f)	12,433	12,703	14,303	16,314	17,746	20,582	29,023
Trade balance	(9,544)	(9,451)	(10,131)	(12,190)	(15,590)	(17,549)	(24,792)

() = negative number, c.i.f = cost, insurance, freight.

^a. Includes vanilla, coconut meal, root crops, shells, and other domestic products.

Source: Reserve Bank of Vanuatu.

Table A.7: Gross Domestic Product by Industry and Per Capita (Current Prices)
(Vatu million)

	Year					
	2002	2003	2004	2005	2006	2007
Agriculture, Fishing, and Forestry	5,030	5,213	5,588	5,668	6,633	7,480
Custom/traditional agriculture ^a	3,340	3,419	3,552	3,676	4,256	4,803
Export agriculture ^b	1,395	1,495	1,786	1,529	1,992	2,258
Other commercial agriculture ^c	130	127	121	166	188	204
Forestry and logging	165	172	128	297	197	215
Industry	2,962	3,002	3,180	3,565	3,953	4,583
Manufacturing	1,167	1,244	1,341	1,438	1,477	1,605
Electricity and water	701	683	675	810	917	1,037
Construction	1,094	1,075	1,164	1,317	1,559	1,941
Services	23,965	25,970	28,094	31,154	35,358	39,916
Wholesale and retail trade	9,219	10,523	11,122	12,611	14,436	16,076
Hotels and restaurants	2,372	2,163	2,461	2,633	2,940	3,462
Transport and communication	3,785	4,115	4,704	5,368	5,922	6,677
Finance and insurance	2,664	2,991	3,225	3,908	4,241	4,511
Real estate and business services	1,961	2,189	2,547	2,794	3,134	3,473
Government services	4,825	4,955	4,973	5,147	6,195	7,601
Personal services	383	391	403	422	450	525
Domestic services	429	459	485	509	535	562
Less imputed bank service charge	1,673	1,816	1,825	2,238	2,494	2,970
Gross Domestic Product	31,957	34,185	36,862	40,387	45,944	51,979
Resident population (mid-year estimate)	201,222	206,454	211,822	217,329	222,980	228,777
GDP per capita (Vt)	158,815	165,582	174,023	185,833	206,045	227,204

GDP = gross domestic product, Vt = vatu.

a Includes production of fruit, vegetables, kava, and other garden products, as well as livestock, poultry, fishing, and forestry output by households.

b Includes copra, beef, kava, cocoa, and coffee.

c Includes fishing, poultry, fruits, and vegetables.

Source: National Statistics Office, Government of Vanuatu. 2008. *National Accounts of Vanuatu 2007*. Port Vila.

Table A.8: Country Economic Indicators

Item	Fiscal Year ^a				
	2004	2005	2006	2007	2008 Projection ^d
A. Income and Growth					
1. GDP per Capita (\$, current)	1,555.2	1,701.3	1,863.1	2,159.5	2,384.5
2. GDP Growth (% constant prices)	5.5	6.5	7.4	6.8	6.6
a. Agriculture	7.2	(4.4)	2.3	2.3	3.7
b. Industry	5.4	7.1	7.0	10.4	13.7
c. Services	5.1	9.4	8.7	7.4	6.3
B. Saving and Investment (current and market prices, % of GDP)					
1. Gross Domestic Investment	–	–	–	–	–
2. Gross National Saving	16.4	20.2	23.8	–	–
C. Money and Inflation (annual % change)					
1. Consumer Price Index ^b	0.8	1.9	1.9	4.1	5.8
2. Total Liquidity (M2)	9.8	11.6	7.0	16.1	13.2
D. Government Finance (% of GDP)					
1. Revenue and Grants	21.5	21.7	21.8	23.1	28.6
a. Revenue	19.2	19.9	19.9	21.3	21.8
b. Grants	2.3	1.7	1.9	1.9	6.8
2. Expenditure	20.7	19.7	21.3	22.9	26.4
a. Current expenditure	18.6	17.9	19.0	20.2	19.6
b. Capital expenditure	2.0	1.8	2.2	2.7	6.7
3. Overall Fiscal Surplus (Deficit)	0.9	2.0	0.5	0.3	2.2
E. Balance of Payments					
1. Merchandise Trade Balance (% of GDP)	(20.9)	(23.4)	(23.2)	(27.3)	(34.5)
2. Current Account Balance (% of GDP)	(5.0)	(7.4)	(4.1)	(5.9)	(7.4)
3. Merchandise Export (\$) Growth (annual % change)	43.3	0.1	(1.1)	(21.3)	40.7
4. Merchandise Import (\$) Growth (annual % change)	22.9	16.9	7.7	25.0	42.4
F. External Payments Indicators					
1. Gross Official Reserves (including gold, in months of current year's imports of goods) ^a	5.8	5.4	7.8	7.1	4.8
2. External Debt Service (% of exports of goods and non-factor services) ^a	1.6	3.1	1.4	1.3	1.3
3. Total External Debt (% of GDP) ^a	24.2	19.8	16.7	14.1	14.1
G. Memorandum Items					
1. GDP (current prices, Vt billion)	36.9	40.4	45.9	52.0	58.1
2. Exchange Rate (Vt/\$, average) ^c	111.9	109.2	110.5	102.4	101.3
3. Population (million)	0.212	0.217	0.223	0.229	0.235

– = data not available, () = negative number, GDP = gross domestic product, M2 = broad money, Vt = Vatu.

^a 2008 data are projections. 2006 and 2007 are preliminary estimates.

^b As at period end.

^c Period average.

^d Data as of May 2009.

Sources: International Monetary Fund. 2009. *Vanuatu: 2009 Article IV Consultation*. Washington, DC: Government of Vanuatu, National Statistics Office. 2008. *National Accounts of Vanuatu 2008*. Port Vila; International Monetary Fund. 2009. *World Economic Outlook Datab*. Washington, DC.

Table A.9: Country Environment Indicators

Item	1990	2000	Latest Year
1. Energy Efficiency of Emissions			
GDP / energy use (2005 PPP \$ / koe)	—	16.0	16.0 (2000)
Traditional Fuel Use (% of total energy use)	—	—	—
2. Air Pollution			
Carbon Dioxide (CO ₂) Emissions			
- Total ('000 metric tons)	66.0	80.7	88.0 (2004)
- Per unit of GDP (kg/PPP\$ GDP)	—	—	—
Metric tons per capita	—	0.2	0.4 (2004)
Per kg p/ 2000 (\$ of GDP)	—	0.1	0.1 (2004)
Sulfur Dioxide (SO ₂) Emissions	—	—	—
NOx emissions (1000 metric tons of CO ₂ equivalent)	—	—	—
- Total ('000 metric tons)	—	350	350 (2000)
3. Water and Sanitation			
Access to improved water source			
- % of rural population with access	—	52.0	52.0 (2006)
- % of urban population with access	—	86.0	75.0 (2006)
Access to improved sanitation facilities			
- % of population with access	—	50.0	50.0 (2000)
- % of rural population with access	—	42.0	42.0 (2000)
- % of urban population with access	—	78.0	78.0 (2000)
4. Land Use and Deforestation			
Total Land Area (km ²)	12,190	12,190	12,190 (2005)
Agricultural Land (% of land area)	—	12.1	12.1 (2005)
Average Annual Deforestation	—	—	—
- Area (remaining km ²)	—	4,440	4,440 (2004)
- % change ^a	—	(0.1)	(0.1) (2000)
Arable Land (% of total land)	—	—	1.64 (2005)
Cropland, Permanent (% of total land)	—	—	6.97 (2005)
Population Density, Rural (people per km ²)	—	—	522 (2002)
5. Biodiversity and Protected Areas			
Nationally Protected Area(s)	—	—	—
- Area (% of total land area)	—	—	1.5 (2004)
- Number	—	—	28 (2003)
Mammals (number of threatened species)	—	—	5 (2002)
Birds (number of threatened species)	—	—	7 (2002)
Higher Plants (number of threatened species)	—	—	9 (2002)
Reptiles (number of threatened species)	—	—	2 (2002)
Amphibians (number of threatened species)	—	—	—
6. Urban Areas			
Urban Population (total)			
- % of total population	18.0 (1989)	21.7	23.5 (2006)
Per Capita Water Use (liters/day)	—	—	—
Wastewater Treated (%)	—	—	—
Solid Waste Generated per Capita (kg/day)	—	—	—

— = no data available, CO₂ = carbon dioxide, GDP = gross domestic product, kg = kilogram, km² = square kilometer, koe = kilograms of oil equivalent, PPP = purchasing power parity.

^a A positive number indicates a loss of forest area, a negative number indicates a gain.

Sources:

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Table A.10: International and Regional Environment Agreements Ratified by Vanuatu

Agreement or Treaty	Status
Regional Agreements and Treaties	
South Pacific Nuclear Free Zone Treaty	Ratified 1995
Convention on the Prohibition of Fishing with Drift Nets in the South Pacific	Ratified 1991
Niue Treaty on Cooperation in Fisheries Surveillance and Law Enforcement in the South Pacific Region	Ratified 1995
Multilateral Agreements	
United Nations Convention on Biological Diversity	Ratified 1993
United Nations Framework Convention on Climate Change	Ratified 1992
Kyoto Protocol: Greenhouse Gas Reductions	Acceded 2001
Montreal Protocol on Substances that Deplete the Ozone Layer	Acceded 1994
Vienna Convention for Protection of the Ozone Layer	Acceded 1994
United Nations Convention on the Law of the Sea	Ratified 1982
Protocol of 1978 Relating to the International Convention for the Prevention of Pollution from Ships	Ratified 1989
Convention on International Trade in Endangered Species of Wild Fauna and Flora	Ratified 1989
International Convention on the Establishment of an International Fund for the Compensation of Oil Pollution Damage	Ratified 1989
International Convention on Civil Liability for Oil Pollution Damage	Ratified 1983
International Convention for the Prevention of Pollution of the Sea by Oil	Ratified 1983
Treaty on the Non-Proliferation of Nuclear Weapons	Ratified 1995
Plant Protection Agreement for South East Asia and the Pacific	Ratified 1997
Agreement on the International Dolphin Conservation Program	Ratified 2003
Millennium Development Goals	Adopted 2000
International Tropical Timber Agreement	Ratified
Stockholm Convention on Persistent Organic Pollutants	Ratified 2006
United Nations Convention to Combat Desertification	Ratified 1998

Source: ADB. 2007. *Vanuatu Country Environmental Analysis*. Manila.