

# Budget Policy Statement 2017



## 1. Statement of Responsibility

As the Minister and Director General responsible for deciding and implementing the economic, financial and fiscal policy of the Government, it is our honour to confirm that 2017 Budget Policy Statement is prepared in line with the Public Finance and Economic Management (PFEM) ACT (CAP 244) as it reflects Government's economic, financial and fiscal policies and also mention measures and discipline the Government will adhere to in order to achieve its policies and objectives.

The Budget Policy Statement is consistent with section 10 of the PFEM ACT:

- stating the Governments **long term objectives** for fiscal policy in terms of major economic and fiscal variables;
- specifying the Government's main **strategic priorities** guiding the preparation of the budget;
- indicating the Government's **targets** for fiscal and economic variables; and
- providing an assurance that the long term objectives outlined in the statement are:
  - a. consistent with the Principles of Responsible Fiscal Management laid down in section 22 of the PFEM Act; and
  - b. Consistent with the previous year's Budget Policy Statement – that is, policies have remained consistent over time or, otherwise, justifications have been made for their departure.

Pursuant to section 10 of the PFEM ACT, the Government confirms that the fiscal policy objectives, strategic priorities and intentions are consistent with the Principles of Responsible Fiscal Management specified in section 22 of the PFEM Act and that there is broad consistency with the 2016 budget policy.



**Hon. Gaeton Pikioune (MP)**  
**Minister of Finance & Economic Management**  
**Ministry of Finance & Economic Management**



**Tony Amos Sewen**  
**Acting Director General**  
**Ministry of Finance & Economic Management**



## 2. Economic and Financial Policies

In 2017, the Government will continue to undertake reforms, implement economic, financial and fiscal policies and create an environment that encourage economic growth and promote service delivery to improve the wellbeing of all Ni-Vanuatu, in a way that is financially sustainable and does not jeopardize future economic growth. The Government will achieve this by following the principles of responsible fiscal management in Section 22 of the PFEM Act as stated in the box below.

The principles of responsible fiscal management require the Government to pursue its budget policy objectives that:

- Maintain Government borrowings at manageable levels;
- Maintain public assets in good condition;
- Manage fiscal risks prudently;
- Maintain stable and predictable tax rates.

### **Principles of Responsible Fiscal Management**

1. Managing, total State debt at prudent levels so as to provide a buffer against factors that may impact adversely on the level of total State debt in the future, by ensuring that, unless such levels have been achieved, the total overall expenditures of the State in each financial year are less than its total overall receipts in the same financial year;
2. Achieving and maintaining levels of State net worth that provide a buffer against factors that may impact adversely on the State's net worth in the future;
3. Managing prudently the fiscal risks facing the State; and
4. Pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

### 3. Budget Policies

Government's Budget Policies come from the application of the "Principles of Responsible Fiscal Management" Section 22 of the PFEM Act (CAP 244). The Budget Policies consist of:

1. Budget Priorities for 2017;
2. Economic and Fiscal Targets for 2017; and
3. Long Term Fiscal Objectives

#### *a) Budget Priorities for 2017*

The 2017 Budget priorities are prepared in line with the national planning documents (PAA and PLAS) and 100 days priority list issued by the honourable Prime Minister. In addition, it also acknowledges the continuous support from development partners especially for the major Government Infrastructure project and cyclone PAM recovery projects. In 2017, The Government will continue to support the productive sectors, complementary sector and social sectors to enhance economic growth and improve wellbeing for all Ni-Vanuatu citizens.

The 2017 Budget will allocate 50 per cent of the fiscal space to the productive sectors while 50 percent will be shared among the complementary and social sectors.

The core strategic policy/resource allocation priorities for 2017 are set out as follows:

#### **Recurrent:**

#### **Productive Sector (50 percent)**

- ✓ Increased allocations to increase production, specifically in Agriculture, Fisheries, Livestock and Forestry.
- ✓ Increased allocations to support Tourism sector recovery, marketing and product development.
- ✓ Increase allocation to Cooperative, Trades Development and industry to increase market access, processing and value addition.
- ✓ Increase allocation of resources by having lands properly registered in compliance and enforcement of land laws (fair land dealing processes) throughout Vanuatu.
- ✓ Strengthen support to foreign policy to continue enhance dialogue abroad and attract more aid in to the Country.



### **Complementary Sectors (25 per cent)**

- ✓ Increase allocation to the Head of Executive to strengthen policy formulation and implementation.
- ✓ Provide ongoing support to ensure Decentralisation Initiatives are fully pursued to improve mechanisms of Service Delivery to the people.
- ✓ Strengthen government support to contributions on public projects, Ports and Harbour and increase support to civil aviation sector, for equitable, social and economic development.
- ✓ Increased allocations to support Customs and Revenue collection and compliance, and developing and implementing new revenue streams.

### **Social Sectors (25 percent)**

- ✓ Provide support to human rights and infrastructure to boost the law and justice services to all citizens of Vanuatu.
- ✓ Increase support to Police and Security to improve governance and management within the force and at the same time address the massive debt burden.
- ✓ Increase allocation and access to quality youth services and programmes at all levels throughout Vanuatu.
- ✓ Increase support to Climate change to strengthen management of disaster and risks.
- ✓ Increase support for population of Vanuatu to continue to have equitable, accessible and affordable health care to improve the health status of the population, including access to Water supply.
- ✓ Maintain support to the development of the national human resource focused on maximising Vanuatu's economic growth. Support in 2017 will also be targeted to the rebuilding of classrooms.

### **Recovery needs**

#### **Donor:**

Continued support to the Cyclone Pam recovery programme, and its stated priorities, until the end of the official recovery. Continued support for Health, Water, Education, and Productive sector and infrastructure development should remain top priorities for the donor support during the recovery phase.



## ***(b) Fiscal Policies***

In 2017, the Government will continue to implement sound fiscal policies that reflect Government's fiscal policy objectives, Government policy priorities and intentions that are consistent with the principles of responsible fiscal management. These policies will continue to enhance Government revenue, meet Government expenditure programs and activities as well as encourage private sector led growth throughout the communities of Vanuatu. These policies will also ensure that the State-Owned Enterprises remain productive over the long term.

## ***(c) Economic Update in 2017***

### **World Economic Outlook (WEO)**

The Global economic growth baseline projection in 2016 is a modest 3.2 percent, broadly in line with last year, a 0.2 percentage point downward revision relative to the January 2016 World Economic Outlook (WEO) Update. The recovery is projected to strengthen in 2017 and beyond, driven mainly by emerging market and developing economies, as conditions in stressed economies start gradually to normalize.

The recent estimates released by the International Monetary Fund (IMF) in April 2016 suggest that the global recovery has weakened further amid increasing financial turbulence. Activity softened toward the end of 2015 in advance economies, and stresses in several large emerging market economies showed no signs of narrowing. China's economy has seen a transition to a more balance growth path, however, its impact on global economy has been slowing down after decade of strong credit and investment growth, along with signs of distress in other large emerging markets, including falling commodity prices. The outlook for advance economies is projected to remain modest, in line with 2015 outcomes, while growth in emerging market and developing economies still accounts for the lion's share of projected world growth in 2016, prospects across countries remain uneven and generally weaker than over the past two decades. Others, including several oil-exporting countries, also face a difficult macroeconomic environment with sharply weaker terms of trade and tighter external financial conditions.

Growth in major advanced economies (AEs) is now projected to rise by 1.9 per cent in 2016 and slightly increase to 2.0 per cent in 2017 – with US and Spain being ahead of others. Meanwhile; growth in Emerging Market Economies (EMEs) is forecasted to grow by 4.1 per cent in 2016 and 4.6 per cent in 2017. The projected pickup in growth in 2017 (3.5 percent) and over the rest of the forecast horizon depends crucially on rising growth in emerging market and developing economies, as growth in advanced economies is expected to remain modest, in line with weakened potential growth. China and India's growth has been broadly in line with projections; however trade growth has slowed down noticeably. In the euro area, the risk of a de-anchoring of inflation expectations is a concern amid large debt overhangs in several countries. Moreover, in UK the planned June referendum on European Union membership has already created uncertainty for investors; a "Brexit" could do severe regional and global damage by disrupting established trading relationships.

Headline inflation has decline in AEs in 2015, at 0.3 percent on average, was the lowest since the global financial crisis, reflecting the decline in commodity prices. Core inflation remained broadly stable at 1.6-1.7 percent but was still well below central bank targets. In many EMEs inflation also faces lower prices for oil and other commodities which generally contributed to reduction in inflation in 2015.



Overall global growth outlook is weaker than that in January 2016 WEO update for both advanced economies and emerging markets. Relative to the October 2015 WEO, global growth has been revised downward by 0.4 percentage point in 2016 and 0.3 percentage point in 2017. However, heightened downside risk stems from both an intensification of the hazards highlighted in the January 2016 WEO update and further bouts of financial turbulence leading to a tightening in financial conditions, including in advanced economies. Raising actual and potential output therefore will continue to be a general policy priority.

### **Vanuatu Economic Outlook (VEO)**

Vanuatu's economic growth in 2015 has been revised downward by 1.1 percent from 2.4 forecasted in July 2015 to 1.3 percent in April 2016. The recent economic growth forecast in April by the Macroeconomic committee (MEC) estimated that the economy will expand by 4.0 percent in 2016, with a projection of 4.4, and 5.0 percent in 2017 and 2018 respectively. The increase in the forecasted growth will be driven mainly by the implementation of public infrastructure projects that are currently underway.

Vanuatu's economy has been hit hard in 2015 after TC Pam including the el-Niño effects which have redirected policy makers to refocus on policy priority that will assist with the recovery, rehabilitation and reconstruction over the medium term. The agriculture sector (mainly fruit trees, root crops, cocoa, coffee and forestry) has been severely affected in Malampa, Shefa and Tafea province affecting farmers' income in both medium and long term. On the upside the favourable external conditions of commodity prices in early 2016 continue to add value to domestic production with incentives to raise production for export. The Government has helped in implementation of priority policy measures rolled out in late 2015 and 2016 going forward to address sectors affected by the natural disasters through the National sustainable development plan goals and objectives (2016-2030). With these developments, the agriculture sector is expected to grow by 0.9 and 0.3 percent in 2016 and 2017 respectively and return to normalcy in 2018-2019. As normalcy in business cycle starts to gather momentum, correction in market forces are expected at play supported with stable domestic demand that should drive domestic production going forward.

The Industry sector is expected to offset the downward impact to growth caused by tropical cyclone Pam and El-Niño in the medium term. Buoyed by on-going structural reform headed by the Government, fiscal policy is expected to drive economic growth with public projects kicking in early 2016 and over the next few years as the Government public projects are expected to acquire more fixed assets through concessional external borrowings with a surge in economic growth to reach 4.3 percent in 2017. These planned activities will boost domestic demand with consumption expecting a positive spill over effects/impacts on VAT collection. Furthermore, there will be more jobs created mainly in the construction sector that should raise the average income of the formal working group. However, it is vitally important for the government to monitor economic fundamental indicators of concern of large projects over the years to manage inflationary expectation and minimise volatility of economic growth – maintain a sustainable economic growth. Robust growth is expected in 2016 at 19.0 percent before expanding by a further 20.7 in 2017 and 22.8 percent two years from now.

On a more positive note, the services sector is expected to pick up in 2016 after sustaining serious damages to tourism related infrastructure such as hotels and resorts in 2015. Reconstruction in the tourism industry continues to recover as some hotels are opening up again to accommodate tourists' arrival. On



this note, both Government and donor have injected extra financial resources to embark on aggressive marketing in promoting Vanuatu as a major tourist destination in 2016. Moreover, information, communication, real estate and government services are expected to echo the same developments in the tourism industry.

Balance of payments development in 2015 performed in line with the domestic shock of tropical cyclone (TC) Pam causing shortage of domestic supplies hence increased demand for imported goods abroad as well as declined tourism earnings hence leading to a deteriorating current account deficit. This deficit was financed by surpluses in the capital and financial accounts mainly from financial assistance in the form of grants as well as loans from abroad as part of TC Pam recovery.

The strong growth in imports in 2016 estimated to take into account the implementation of major projects driven mainly by Government public projects in 2016 and continue (TC) Pam reconstruction. This expected trend would be maintained in the forecasted period worsening the current account deficit in 2017 before normalisation commencing 2019. The value of cement imports and (TC) Pam project related goods remain to be the main underlying items in increased imports. Exports earnings are projected to slightly improve in 2016 due to better international commodity prices supported by improved external supply conditions. Forecasted tourism earnings are likely to offset the increasing volume of imports in 2016 to 2018 due to improved infrastructure projects (wharfs and airport upgrade) and reopening of major hotels in Port Vila. Aid in terms of cash & grants are likely to double starting in 2016 compared to past years. Despite the reduction in tourism earnings and expanded trade deficit, the impact on the official reserves is expected to be minimal but expected to decline significantly in 2016 onwards. Growth in this sector is expected to contract by 0.7 per cent this year and recovery is expected in the projection period at 7.7 per cent and 2.8 per cent in 2016 and 2017 respectively.

The Reserve Bank of Vanuatu (RBV) Monetary policy committee (MPC) continues to hold an accommodative stance, ever since the monetary policy changes in the aftermath of cyclone PAM in March 2015 mainly to support the economy and to provide liquidity support to the banking system. In the monetary sector, money growth was weak in 2015, owing to the already subdued economic conditions exacerbated by the impact of TC Pam and El-Niño on the banking sector. The growth in Money supply from April 2015 to March 2016 was mainly due to substantial net inflows for Post Pam reconstruction and donor projects and not implying that economic activities have picked up. Liquidity remains high among the banking system but credit growth remained constrained. Reserve requirement and the liquid asset ratios were lowered. Foreign reserves is expected to remain within threshold in the short term mainly due to current healthy reserves stock in the banking system and to expect influx of grants for current infrastructure projects. As a result, official reserves performed well above initial forecasts, being able to finance around 8 months of imports at end December 2015. On another note, official reserves less TC Pam donor contributions less other government donor grants is able to cover 5.8 months of imports, yet well above RBV's threshold.

Banking sector activities is expected to pick up once reconstruction and major infrastructure projects are implemented. The RBV also adopted an Import Substitution and Export Financing Facility; a credit facility through commercial banks for businesses in both the export and import substitution sectors with the aim to alleviate pressure on the balance of payment. The MPC have recently approved the rediscount rate set 100 basis points above the current 91 days RBV notes interest rates and secure advance facility interest rates set at 250 basis points above the current 91 days RBV notes. This therefore represents a



significant reduction in the RBV policy rate. The RBV also continue to activate the Natural Disaster Reconstruction Credit Facility to all businesses for the purposes of rehabilitation and reconstruction after the disaster.

#### ***(d) Budget Management***

The 2017 Budget will be executed and implemented in line with Public Finance and Economic Management Act (CAP 244). To achieve the 2017 fiscal targets and long term fiscal objectives, the Government will continue to ensure that there is effective administration, compliance and enforcement of the existing tax to provide enough funding to meet Government expenditure programs and activities. In addition, the Government will continue to implement new revenue initiatives and impose revenue and expenditure control measures as well as managing state debt at prudent level to achieve a balanced budget in 2017.

#### ***(e) Government Debt and Borrowing***

Over the past years, state debt continues to increase mainly due to the implementation of Government major infrastructure projects. Vanuatu is currently at the moderate risk of debt crises and the Government will continue to borrow to implement new infrastructure projects including Cyclone Pam related projects in 2016. However, the Government will remain cautious so that future borrowing will continue to be prioritising towards productive purpose such as capital investment projects that will enhance economic growth as well as improve the wellbeing of Ni Vanuatu citizens and also generate future capacity to repay the loans bestowed upon future generations. On this note, the Government will continue to manage State debt at a prudent, sustainable and manageable level in 2017 and years thereafter and put more emphasises on raising more revenue to meet debt repayments when they due.

#### ***(f) Revenue and Taxes***

The Government will continue to strengthen its efforts into raising additional revenue that is necessary for the entire government operations for this financial year 2016. In 2015, despite the damage caused by TC PAM, VAT has shown a strong growth and has actually exceeded its initial forecasted target and is likely to continue into 2016. In addition, we have also seen a strong growth in the Vanuatu Economic Rehabilitation Program (VERP) in 2015, which also exceed its initial target and this positive trend is likely to continue into 2016. Both VAT and the VERP program have already shown the potential that they can collect additional revenue beyond their initial forecasted targets for 2016. This is also evident with other major revenue sources that come from Import Duties and Excise tax.

With the effort that the Department of Treasury is doing together with line Ministries who are also collecting other revenue from fees and charges, the government is confident that current outstanding revenue debts is likely to reduce to some extent. Certainly, this can aid to bring the additional desired revenue that the government needs to fund its most desirable services.

The Government in its 100 days plans has also recommended for the further review of possible new tax regimes that are implementable in Vanuatu. A Revenue Review Project Team, (RRPT) together with a higher level Governance Committee (GC) are currently working to provide further advice to the government on various revenue initiatives that are recommended for Vanuatu .



As always the case, the implementation of all approved Government expenditure programmes and activities for 2016 will depend very much on how much the Government can raise, (revenue) and how much it plans to borrow. For 2016, the Government will continue to boost its revenue collection through strengthening the administration of compliance and enforcement of its existing taxes as well as newly introduced fees and charges from its revenue collecting agencies. Additionally, the government will continue to implement the outcomes of the 2013 national revenue forum matrix initiatives and the outcomes of the non-tax Revenue forum held in 2014. These efforts are intended to assist the Government in its effort to raise the desired revenue that the Government needs to meet its every increasing public service and operational needs.

On the international arena, the Government has now committed to OECD Automatic Exchange of information for tax purposes with possible implementation in 2018. The Government also plans to enact it legislations on Tax Information Exchanges Agreements by June 2016. These are huge progress the government is embarking on, to ensure it maintains its international obligations in the area of Taxation.

#### ***(g) Expenditure Programme Policies***

The Government will continue to make sure that there is available funding to meet its expenditure plans and activities. In 2017, the Government expenditure programmes and activities will be consistent with the 2017 budget priorities and they will be managed in line with the PFEM Act.

On this note, if there is not enough revenue to meet Government expenditure programs and activities then the Government might borrow from the market to fund its expenditure programs and activities or enforce strict fiscal discipline and expenditure control measures to control expenditure in line with Budget targets.

#### **4. New Policy Proposals**

The Government will continue to allocate recurrent funding for New Policy Proposals (NPP) that are consistent with the Government's strategic priorities identifies in 3 (a).

The NPPs will be strictly considered for funding in 2017 if they are:

- able to be accommodated within the overall aggregate fiscal envelope;
- well researched and detailed proposals to reinforce the Government's key policies and programs;
- within the capacity of the Ministry to implement over the suggested time frame;
- able to expand and develop the economic capacity and growth rate of the country; and
- Must be financially sustainable if it is to become a recurrent activity.

The 2017 budget will include donor funded NPPs. Therefore, the Government will continue to emphasise the importance of using the Government Financial Systems to fund expenditure programmes that are in line with Government priorities.



## 5. Economic and Fiscal Targets for 2017

In line with the Public Finance and Economic Management Act, the Government will continue to pursue policies towards achieving a balanced budget in 2017. The economic growth rate for 2017 is forecasted to be 4.3 per cent in real terms, while the inflation rate is projected to be around 2.5 per cent.

<b>Budget Targets for 2017</b>	<b>Long term fiscal objectives</b>
<b>Budget balance</b> Balanced Budget	Recurrent balance is positive over the medium-term
<b>Revenue</b> Recurrent revenue is forecast to be at least 25.0 per cent of GDP	There is a broad revenue base with sufficient revenue to meet the budget balance objective. Recurrent revenue growth rate to be higher than expenditure growth rate
<b>Expenditure</b> Recurrent expenditure is forecast to be 25.0 per cent of GDP	Expenditures are consistent with the budget balance objective
<b>Debt</b> Public debt to reach 33.0 per cent of GDP	Debt maintained at prudent levels so its average share of GDP remains below 40 per cent
<b>Economic Growth</b> Growth forecast at 4.3 per cent	Annual economic growth rate averages at least more than population growth rate (2.3 per cent)
<b>Inflation</b> Inflation forecast between 2.0 and 3.0 per cent	Annual inflation rate remains below 4.0 per cent

## 6. Conclusion

The 2017 Budget will be finalised and appropriated in line with the Public Finance and Economic Management ACT. In addition, the Government will continue to implement economic, financial and fiscal policies to meet Government priorities reflected in the expenditure programs and activities.

The PFEM Act (CAP 244) will also guide the implementation of Budget 2017 and the Government will remain cautious in every decision making and may enforce strict fiscal discipline to ensure that both revenue and expenditure target are met to achieve a balance budget in 2017.