

# **Budget Policy Statement 2018**

## **1. Statement of Responsibility**

The 2018 Budget Policy Statement is developed and finalised in line with the Public Finance and Economic Management (PFEM) Act (CAP 244). It incorporates the Government strategic priorities that are in line with the National Sustainable Development Plan and the Government's 100 day plan and satisfied the legal conditions set out in section 9 and 10 of the Public Finance and Economic Management Act.

Section 9 requires the Government to:

- specify its economic and financial policies, including those relating to key economic and fiscal variables; and
- state the discipline it will adhere to in its economic and financial dealings.

Section 10 requires the Government to:

- state its long term objectives for fiscal policy in terms of major economic and fiscal variables;
- specify the main strategic priorities guiding the preparation of the budget;
- indicate the Government's targets for fiscal and economic variables; and
- provide 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.

The 2018 Budget Policy Statement confirmed that the Government will continue to enhance economic growth and at the same time boost revenue and improve expenditure in both productive and social sectors in order to enhance service delivery and improve wellbeing for all the people in Vanuatu. On this note, Donor support for new and ongoing projects will continue to be implemented.

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 2018 Budget Policy Statement is in line with section 9 and 10 of the Public Finance and Economic Management (PFEM) ACT (CAP 244).



**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

The Government will continue to put more emphasis in formulating and implementing economic, financial and fiscal policies that were in line with the principles of responsible fiscal management outline in section 22 of the PFEM ACT. The economic, financial and fiscal policies, objectives and target are crucial for financial resource allocation and at the same time assist Vanuatu to withstand and manage financial crises as well as manage the economic and fiscal risks. Similarly, the Government will continue to undertake reforms and promote investment and business friendly environment that will enhance economic growth and at the same time promote service delivery, in a way that is financially sustainable and does not jeopardize future economic growth.

The implementation and achievement of the Government's policies, objectives and fiscal target will also be in line with the principles of responsible fiscal management in section 22 of the PFEM Act. 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

The formulation of the 2018 budget policies is consistent with section 9 and 10 of the PFEM Act (CAP 244). However, their implementation will be in line with the principles of responsible fiscal management stated in section 22 of the PFEM Act (CAP 244). The Budget policies, objectives and targets were crucial in the process of developing and finalising the 2018 budget. The 2018 Budget policies consist of:

1. Budget Priorities for 2018;
2. Economic and Fiscal Targets for 2018; and
3. Long Term Fiscal Objectives

#### *a) Budget Priorities for 2018*

The 2018 Budget Policy priorities is prepared in line with the PFEM ACT (CAP 244) capturing the essence of the new development plan which is the National Sustainable Development Plan or the People's plan 2030 including the Government's 100 days plan. The 2018 budget policy priorities will guide the allocation of the Government's fiscal space and it continues to put more emphases for the Government to allocate more financial resources to both the productive and social sector in order to enhance economic growth, improve service delivery and wellbeing for all the people in Vanuatu.

The core strategic policy priorities for 2018 are set out following the six expenditure priority outcomes;

#### *Priority Outcome 1: Improved business opportunities and investment environment*

The Government of Vanuatu remains committed to support the Productive Sector in 2018 as the country prepares to ratify the PACER Plus trade agreement, and as Vanuatu works towards graduation from LDC status. Support to the productive sector is aimed at increasing production and promoting value addition. This will lead to greater employment opportunities in the islands, increase investment and boost tax revenue to support the domestic economy.

Land issues such as disputes have been an obstacle for investments in the past, the current government is embarking on land reform and dealings (acquisition) to boost public investments in 2018. The government wants to continue to create an enabling environment to encourage more Public Private Partnerships and Joint Ventures in order to spread economic development and benefits throughout Vanuatu.

- **Increase rural production** – through improving farming practices with rural extension officers; by increasing farming skills through training and knowledge sharing; by facilitating access to mechanised farm equipment; and by supporting Ni-Vanuatu to embrace commercial approaches to farming and fishing.
- **Increase tourist development** – through improving facilities (seafronts, wharves, airports and roads) in key tourist destinations; by attracting foreign investment in the sector; and by developing skills of Ni-Vanuatu to develop tourist attractions, products and services in the islands.
- **Promote Trade, Industry, and Cooperatives** – through promoting a business-friendly environment for trade and investment; by supporting foreign investment in industry and

manufacturing; by promoting the cooperative movement in Vanuatu; and by increasing financial literacy to enable access to finance.

- **Expand revenue base** - through compulsory acquisition of land in Provinces to boost investment and business opportunities; by enacting income tax legislation; and by developing the capabilities needed to deliver it.

***Target Results:***

- Increased participation of Ni-Vanuatu in the formal cash economy, particularly in agricultural production, fishing, transport, retail and products and services for tourists.
- Increased foreign investment in the agricultural value chain; in hotels and tourism services; and in manufacturing.
- Increased tourist arrivals, and greater distribution of tourist revenues across the provinces.
- Increase tax revenue by 10% by the end of 2018, over a more diverse and equitable tax base.

***Priority Outcome 2: Improved Infrastructure***

Infrastructure is among other government core priority in 2018, roads, wharf and airports, including energy and telecommunication infrastructure will continue to strengthen connectivity between essential government services, agriculture, value addition, tourism and markets in the future through:

- **Improved Airport infrastructure**- through developing a Code E terminal at Bauerfield International Airports, acquiring lands for airport development, upgrading major key airfield, sealing existing air space agreement,
- **Rehabilitation and improved maintenance of high priority rural infrastructure**- through partnership with private sectors, development partners and local communities to improve rural (including feeder) roads, upgrading of wharfs and jetties, building of warehouses infrastructures, and completing transport infrastructure maintenance fund strategies.
- **Expand access, and reduced costs of telecommunication and energy**-through promoting alternative sources of energy in rural areas such as solar energy , hydropower, and other renewable sources of energy, improving accessibility and affordability of telecommunication in rural areas,

***Target Results:***

- The Code-E terminal is completed with required international facilities and appropriate system
- Improved trade and transportation within and between islands
- Effectively implement the new office and structure of the Office of the Maritime Regulator to effectively regulate the Maritime Sector.
- Improved access to energy and electricity in rural areas, and setting up of the National Green Energy Fund.

### ***Priority Outcome 3: Improved education quality and accessibility***

In 2018 the Government will continue to support increased access and quality of education for boys and girls, equip them with relevant skills and knowledge and continue the development of the national human resource to contribute to the country's economic growth through:

- **Expanding greater access to education-** through accelerating progress made in universal early child care and primary education from year 7 to year 10
- **Improving the quality of education-**through ensuring teachers are paid and trained, reforming the curriculum in line with NSDP, and upgrading school facilities and resources including those affected by TCPAM,
- **Increasing higher education opportunities-** through completing revised Vanuatu Education Strategy, developing national human resource development plan, and formalising early childhood education and life-long learning opportunities within the education system

#### ***Target Results:***

- Increased budget support to cater for ECCE and tuition fees for yr7- yr10
- Improved teaching and learning

### ***Priority Outcome 4: Improved Quality Health Care***

The Government will continue to strengthen health services and accelerate progress towards health targets in the SDGs and NSDP through:

- **Enhanced access to, and quality of, health care services,** particularly for rural communities through health systems strengthening focusing on human resources development and upgrading facilities.
- **Reduced the incidence of communicable and non-communicable diseases-** through better health promoting interventions and strengthening of outreach services.
- **Improve budgeting, financial and expenditure management-**through strengthening of financial management and process and efficiency use of resources.
- **Strengthened health information system** to track NSDP indicators and support evidence-based decision making

#### ***Target Results:***

- Increase number of qualified health workforce therefore improve health professional ratio per/area population.
- 75% of Government own facilities are compliant with Role delineation policy
- Improve access to primary health care services and especially in remote areas
- Population are practicing better healthy behavioural practices resulting in decrease in NCDs.
- Resources used according to budget and within plan by 2018
- Improved health planning and decision making by 2018

#### ***Priority Outcome 5: Improved Service Delivery***

The Government will continue to target improvements in the Public Service and support the Decentralization policy that it is currently embarking on, as to ensure that the essential services reach people in remote areas of Vanuatu through strengthening local authorities and municipal institutions.

Foreign policy plays a critical role in terms of attracting aid and investment into the country to complement government priorities. The government also aims to further strengthen the coordination of donor resources in line with national objectives.

- **Improved delivery mechanisms**, particularly reviewing the decentralisation Act to empower area council, establishing a governance accountability mechanism, and developing and rolling out a sub-national work and training manuals on planning and budgeting
- **Enhanced partnership with donors, community based organisations and non-government organisations**-through reviewing existing NGOs arrangement and institutions, developing accountability mechanism with *kastom* authority, and developing memorandum of understanding with key service providers.
- **Strengthened institutions at the head of the executive** to continue to drive and implement reforms including the National Sustainable Development Plan;
- **Improved national security services**- through strengthening of the security services, institutions and correctional facilities.

#### ***Target Results:***

- Enhanced devolution process with systematic improvements in the framework and mechanism for Service Delivery at Sub-National level
- Developed structure for Malvatumaori, provincial, area, tribe and village councils,
- Completed area council governance mechanism
- Revived VANGO /signed MOU with Government
- Greater integration of donor programmes into ministry work plans and the annual budget

### ***Priority Outcome 6: Improved Resilience and Natural Resource Management***

The government will continue to ensure the protection of the natural environment on land and at sea, upon which much of our social and economic wellbeing depends, as well as continuing to build our resilience to climate change and natural hazards through:

- Improved climate change adaptation and disaster risk management governance and practices, particularly ability to leverage access to further donor financing in these sectors;
- Increased equitable, accessible and affordable water supply and sanitation;
- Stronger institutions and governance that protect our environment and natural resources

#### ***Target Results:***

- Establishment of the Department of Climate Change
- Accreditation of the government to access climate finance to be used for development projects, and greater coordination in the sector
- Completion of the merger of the Department of Water, and increased technical capacity to support the design and contracting of water systems
- Implementation of National environmental policies and programs to promote sustainable development

### ***Allocation of Fiscal Space to Priority Outcomes***

The allocation of fiscal space to resemble as closely as possible following the six priority outcomes.

- **Priority Outcome 1:** Improved Business Opportunities and Investment Environment - 20%
- **Priority Outcome 2:** Improved Infrastructure - 20%
- **Priority Outcome 3:** Improved Education Quality and Accessibility - 20%
- **Priority Outcome 4:** Improved Quality Health Care - 10%
- **Priority Outcome 5:** Improved Service Delivery -10%
- **Priority Outcome 6:** Improved Resilience and Natural Resource Management - 10%
- **Other NPPs:** 10%

### ***Ongoing programs from the development partners***

The government and its development partners will jointly implement programs in 2018. In 2017, the government held several dialogue with development partners that have existing programs in Vanuatu and discussions on how the partners could align their programs with those of the government in 2018 through stronger working relationships and coordination at the national and at the sector level.

### ***TC Pam Recovery needs***



The government's TC Pam Recovery program will continue in 2018 rolling over unfinished work from 2017 and the recovery programs that are yet to be carried out if any. The priority needs under the recovery are the productive sector, infrastructure and public buildings, water and Sanitation, Health and Education. The economic strengthening program is expected to continue in 2018 as some of the recovery programs will still be implemented due to delay in the implementation in 2017. These programs under the recovery will be implemented in parallel and complement those of development partners and government recurrent programs.

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

The main purpose of the Government's fiscal policies is to achieve Government's fiscal policy objectives and targets, Government policy priorities and intentions. However, the implementation of fiscal policies will continue to be guided by the principles of responsible fiscal management. Together with the Government reforms and sound financial management, the implementation of fiscal policies will continue to put more emphasis in growing the economy, increase Government revenue and meet Government expenditure programs and activities in order to enhance service delivery as well as improve wellbeing for all the people in Vanuatu. On this note, the Government will continue to develop and implement new revenue initiatives, allocate more financial resource to both the productive and social sector and create a business friendly environment that will also boost private investment.

### ***C) Economic Update in 2017***

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

According to the April 2017 World Economic Outlook (WEO), the International Monetary Fund (IMF) reported that the global economic activities is projected to pick up by 0.1 percentage point in both 2017 and 2018 by 3.6 and 3.7 per cent respectively compared to the October 2016 WEO. Growth picked up in the US as firms grew more confident about the future while in the UK, strong demand had led to increase spending proving resilience after the Brexit decision. In Japan and other euro area, strong domestic demand has led to increase net exports and consumption. In the developing and emerging markets, growth forecasts remain mixed with a rebalancing in China while geopolitical factors continue to drive growth in the Middle East. Closer to home, growth in the ASIAN economies have continue to remain strong and is anticipated to remain on track over the medium term following strong commodity export prices, improved tourism and solid domestic demand.

Economic activities in advanced economies are forecasted at 2.0 per cent in both 2017 and 2018. The strong outlook in advanced economies reflects a projected cyclical recovery in global manufacturing. In addition, there is strong confidence in the recovery of the U.S. economy post-election with expectations to maintain momentum over the medium term. However, this forecast also takes into consideration potential policy changes in the new U.S. administration and their global spillovers. Growth in the emerging markets and developing economies is forecasted to rise to 4.5 per cent and 4.8 per cent over 2017 and 2018. Such a positive growth momentum reflects anticipated stable commodity exporters, after painful adjustments by some commodities exporters. Furthermore, growth in India stretched further partially offsetting the gradual slowdown in the Chinese economy.

With a robust commodity price, headline inflation rates in both advanced economies and emerging markets are projected at 2.0 per cent in 2017 compared to a 0.8 per cent growth in 2016 and this will remain over

the medium term. Inflation in emerging markets and developing economies is projected to rise to 4.7 per cent in 2017 from a 4.4 per cent in 2016 reflecting stronger demand and higher commodity prices. Global activity over the medium term is expected to be on an upward trend but potential disappointments remain high and policy makers need to implement the right set of policy mix as many economies need continued demand support and well-targeted structural reforms to lift supply potential and broaden economic activities. Beyond 2018, global growth is forecasted to reach 3.8 per cent. This is driven entirely from developments in emerging market and developing economies, with expected growth forecasted to reach 5.0 per cent. The forecast assumes solid commodity prices, acceleration of economic activity in India and successful rebalancing of the Chinese's economy. Growth in advanced economies is to remain modest reflecting structural headwinds, slowing growth in the labor market following ageing population and low productivity taking into consideration significant structural reforms effort.

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

Vanuatu's economic growth in 2016 has been revised upwards by 0.2 percentage point from 4.6 per cent to 4.8 per cent in April 2017. In its April meeting, the Macroeconomic committee (MEC), estimates that the economy will expand by 5.0 per cent in 2017 followed by a further 3.6 per cent growth in 2018 and 3.0 per cent in 2019. The strong growth estimate in 2016 reflects solid performance in the agriculture sector supported with the implementation of infrastructure development projects while on the other hand activities in the tourism sector (major player in the services sector), has cooled off as recovery in re-construction continues. In the projection period, growth is expected to be driven mainly by the services and the agriculture sectors while the industry sector in particular construction remain on the upside as the government continue to upgrade its infrastructure mainly the transport sector. Real estate and finance and insurance activities have also picked up in recent months following growing confidence in the economy while aggressive marketing in major tourist destination and news for the Bauerfield International Airport upgrade will boost tourism activities going forward.

Despite the shocks which affected growth performance, solid commodity prices boosted Vanuatu's export in 2016 and this trade pattern is expected to remain over the medium term. Partial indicators show that copra and kava production surge in 2016; driven mainly by solid increase in export price. With the stable commodity price expected over the medium term, respective commodity production is expected to remain solid benefiting farmers in the rural areas. Similarly, kava export volume had reached new record levels. Increase demand for Vanuatu kava has driven up prices which will and is expected to remain high over the medium term while 26,000 new seedlings of coconut trees have been transported to replace ageing coconut trees. Beef production for export continues its downward trend in 2016 following the scaling down of Santo Abattoir production in that year. This decline reflects the impact of the government cattle restocking program as all supply are from Sanma province. However, the program aims to revive this industry in sustaining production over the long run.

Cocoa and coffee productions continue to remain solid following viable export price conditions. The government continue to expand its programs on enhancing production in the productive sector with coconut replanting and cattle restocking, coffee, cocoa, forestry and fishing rehabilitation programs, including vegetables and potato planting in Tafea, Sanma and Penama provinces. These programs attracted financial supports from development partners which is seen as a joint effort to sustain and promote Vanuatu's productive sector over the medium term. With all these developments, the sector is estimated to have grown

by 4.9 per cent growth in 2016, before accelerating at the base of 4.7 per cent this year and then normalising at 3.2 per cent in 2018 and 3.0 per cent in 2019.

Vanuatu is currently experiencing a construction boom and is considered the main driver of the economy sustaining growth since 2015 despite impact of TC Pam. Few of the government investment projects are expected to complete in 2017 while most of these projects are expected to complete in 2018 and early 2019. With the current improved economic condition supported by the stable government, TC Pam recovery program in terms of building construction is also in its implementation stage supporting growth in the sector. The current surge in construction activities have boosted domestic demand with consumption leading to a positive spill over effects/impacts on VAT collection. Furthermore, it has created more jobs mainly in the construction sector increasing the average income both formal and informal 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 in economic growth – maintain a sustainable economic growth. Electricity and water services continue to expand in line with infrastructure investment projects and commercial business related activities mainly in the urban areas and provinces with rural electrification projects boosting growth over the medium term. On the other hand, performance in the manufacturing sector continues to remain stagnant requiring more government support as this sector has huge potential for the economy over the long run. Overall, the industry sector is estimated to register 23.9 per cent growth in 2016, 13.7 per cent in 2017 and 8.1 and 3.9 per cent in 2018 and 2019 respectively.

The services sector has been severely affected in recent years after the devastation from TC Pam. However, a rebound in this sector is indicative from partial indicators as economic conditions improved. Tourism arrivals in 2016 have been driven by cruise arrivals although air arrivals have been more or less remains flat caused by the delay in international airport apron. However, the sector is expected to rebound strongly in the projection period as more and more financial resources targeted towards aggressive marketing in major tourist destination including potential destinations. The expected rebound in tourism services will also have positive spill over effects on related services such as hotel and restaurant, retail trade, telecommunication services banking and finance insurance and transport. Furthermore, real estate activities have picked up as financial and economic conditions improve. The current government tax review if implemented will not only generate revenue but will also increase government spending on major important policy target areas boosting the economy in the medium term. Public and private sector need to work together on the financial inclusion policy – a tool which aims to properly coordinate resources and service targets to achieve sustainable growth over the medium term. With all these developments, the sector has been estimated to grow by 3.1 per cent in 2016 then surge to 4.5 per cent in 2017, 3.0 per cent in 2018 and maintain a 2.5 per cent growth in 2019.

### **Monetary update**

The Reserve Bank of Vanuatu (RBV) remains accommodative in its monetary policy stance in 2016, since March 2015 in the aftermath of TC Pam. The Monetary policy committee (MPC) during its meeting in December 2016 maintained the Banks policy interest rate at 100 basis points above the current 91 days RBV notes interest rates. The Statutory Reserve Deposits ratio and the Liquid Asset Ratio were maintained at 5 percent, respectively. Macroeconomic fundamentals were achieved in 2016, with foreign reserves at VT31.6 million which is above the minimum threshold of 4 months of import cover. At the end of 2016,

inflation was at 2.2 percent and within 0-4 percent target range of the RBV. The trend in foreign reserves remained adequate during the first three months of 2017. At the end of March, it recorded 8.7 months of import cover and is expected to reach 8.5 months of import cover at the end of 2017. Furthermore, inflation is forecasted to reach 3.2 percent in 2017. Liquidity remains high among the banking system owing to the accommodative monetary policy stance of the Bank and the persistent weak growth in private sector credit. The RBV continues to activate its two credit facilities the *Import Substitution and Export Financing Facility*; offered through commercial banks for businesses in both the export and import substitution sectors with an aim to alleviate pressure on the balance of payment and the *Natural Disaster Reconstruction Credit Facility*, with an aim to provide funds to businesses for the purpose of rehabilitation and reconstruction post TC Pam disaster. The secure advance facility interest rates set at 250 basis points above the current 91 days RBV notes

Banking sector activities remained weak in 2016 owing to the slowdown in private sector credit, however, maintains adequate capital and liquidity positions and well above the regulatory minimum requirements. The growth in the banking system net foreign assets remained robust in 2016 thus is the main driver of money growth. The uptrend in the net foreign assets of the banking system resulted from the accumulation of foreign reserves for TC Pam reconstruction and public-donor funded projects. Money supply growth in 2016 until the first three months of 2017 was mainly driven by net foreign assets and does not imply that economic activities have picked up. Overall, credit growth is expected to remain weak in 2017 due to the uncertainty the governments new tax policy, high level of non-performing loans and other structural issues. Growth in money supply in 2017 will remain stable owing to the trend in net foreign assets.

### **Balance of payments**

The balance of payments posted an overall surplus at the end of 2016 reflecting healthy reserves in the overall banking system. The current account deficit eased in 2016 supported by the improvement in the global economy causing global commodity prices to pick up hence boosting Vanuatu's exports. Tourism earnings also increased as the number of visitor arrivals increased from the level in 2015 with most hotels re-opening after Pam destruction. Domestic consumption elevated slightly causing imports to increase marginally. The capital and financial accounts continued to remain in surplus as donor grants and loan disbursements continue to be injected for ongoing capital projects as well as recovery projects.

Outlook remains optimistic in line with the expected influx of donor grants and loan disbursements which are the main source of foreign reserves. Imports are projected to increase in line with the expected pick-up in economic growth supported mainly from infrastructure projects. Tourism earnings are expected to increase in 2017 to 2019 with the improved infrastructure projects (wharf and airport upgrades) as well as forecasted growth improvements in Australia which is Vanuatu's main tourism market. Overall, foreign reserves are projected to remain above the bank's target of 4 months of import cover in 2017 to 2019 with downside risks of higher external debt repayments as well as higher import financing.

## **Inflation**

Vanuatu's headline inflation, as measured by consumer price index, for the December quarter of 2016 stood at 2.2 per cent increase, year on year. This is slightly higher than the 1.9 per cent increase recorded in the previous quarter and the 1.4 per cent increase in corresponding quarter of 2015. The major contributing item to the increase in inflation for the December quarter of 2016 mainly comes from food item followed by housing utilities and household supplies while drinks & tobacco and other items have remained relatively stable over the year. Going forward, inflation for the first quarter of 2017 is forecasted at 3.2 per cent. This growth is forecasted in line with global food prices as well as domestic price pressures. Output gap estimates shows that pressures from increased demand in the economy relating to strong pick-up in reconstruction and construction activity may put upward pressure on inflation. RBV estimated that over the medium term, headline inflation will remain within its target band of 0.0 to 4.0 per cent.

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

The finalisation and implementation of the 2018 budget will be in line with the Public Finance and Economic Management Act (CAP 244). In 2018, the Government will continue to support the revenue generating agencies in collecting the existing revenues and new revenue initiatives as well as improve the administration, compliance and enforcement of taxes and fees so that there is enough cash to meet Government expenditure programs and activities. However, the Government will continue to borrow at prudent level in the event that there is insufficient revenue to meet Government expenditures. In managing the Government budget and cash flow, the Government will continue to implement some revenue and expenditure control measures as well as managing state debt at prudent level to achieve Government's fiscal policy objectives and targets, including a balance budget in 2018.

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

Vanuatu has been embarking on new communication and transportation infrastructure projects over the past few years. The World Bank & IMF Debt Sustainability Analysis (DSA) shows that Vanuatu's risk rating for debt distress remains moderate (graduating from a low level in 2013 to moderate in 2015 due to new infrastructure projects and the estimated downgrade of GDP from the effects of Cyclone PAM. The Government's PV of Public Debt to GDP is expected to peak in 2022 at around 32% - the threshold for moderate strength in debt management policies and Least Developing Countries (LDC) is 40%. At current with the debt stock in place, the Present Value (PV) of Debt to GDP is less than 20%.

However, new revenue initiatives must be implemented to prepare for the debt repayments obligations in the near future when principal payments begin. As such, all new borrowings must be on concessional terms only. The Debt strategy management in place recommends for the Government to pursue prudent fiscal policies and recommends for spending reprioritization, including tax reform implementation, and continue to seek grant financing for infrastructure investments

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

The Government is continuously strengthening its efforts to raise additional revenue to fund necessary Government operations for the 2017 financial year and the years to come. 2016 revenue collections reached 113% of the budget target and revenue collection from taxes, fees and charges have been forecasted to contribute 21% of GDP. Additionally, there has been strong growth in the Vanuatu Economic Rehabilitation Program (VERP) in 2016 (revenue collected is 272% of initial budget target) and this is

likely to continue into 2017 financial year. However, the recent changes to the program has posed some setbacks to our initial revenue forecast for 2017 of over VT2 billion. The newly established Vanuatu Development Support Program (VDSP) and the Vanuatu Contribution Program (VCP) which now replaces VERP are yet to show that it can meet its target for this financial year. Despite these changes there is confidence that the Government's main revenue streams being VAT, Import Duties and Excise do have the potential to meet the budget target for the 2017 fiscal year.

A few other Ministries and departments have indicated a higher revenue forecast for financial year 2017 as compared to their 2016 forecast. We have seen strong commitments from the Department of Lands, Geology and Mines, Department of Fisheries, Ministry of Education and Department of Foreign Affairs. Revenue collected from these sectors will supplement the overall revenue collected from fees and charges.

In the Government's 2016 100 day plans, it was recommended for further review of possible new tax regimes implementable in Vanuatu. With the realisation that there is need for effective funding to provide vital public services to the people of Vanuatu but without sufficient revenues to provide for Vanuatu's growing population and to lift living standards, the Council of Ministers launched the Vanuatu Revenue Review Committee (RRC) to review the country's tax and non-tax revenue systems in April 2016, and focussed on the following key areas.

- Tax revenue;
- Non-tax revenue; and
- Modernisation of Vanuatu's tax and customs administration.

The Revenue Review Committee (RRC) proposed the introduction of income tax and several other suggestions to improve Government revenues and modernise Vanuatu's revenue system. The proposals were consulted on in all six provinces and formal written submissions were received from different members of the public. The final decision on the desired recommended approach to take will be made by the Council of Ministers.

Modernising the Department of Customs and Inland Revenue (DCIR) operations is key feature of the revenue reforms and its effort in building capacity and operational strength has been done over recent years. Some features of the DCIR modernisation include, service based model where taxpayers are helped to meet their obligations, electronic lodgement and payments, risk based compliance management, client charter, code of conduct and performance standards, introduction of annual reporting against key performance indicators, modernised electronic services, enhanced customs procedures aimed at improving trade facilitation., and modern appeal and review procedures. It has also been recommended that tax and revenue laws be modernised to be prepared to implement the tax and revenue reform.

The Government is reviewing all non-tax fees and charges with the objective that all fees and charges are well managed and efficiently collected and aligned to the Government's strategic objectives.

As always the case, the implementation of all approved Government expenditure programmes and activities for this financial year depends on its revenue collection. 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 in the 2017 and 2018 financial year.

On the international arena, the Government is committed to Global Forum on Transparency and Exchange of Information for Tax purposes (G20). Vanuatu has enacted the International Tax Corporation Act in June 2016- which is the necessary legislation required, to implement exchange of information for tax purposes with the possible implementation start date being June 2018. With the effective exchange of information, Vanuatu will no longer be regarded as a tax haven by the OECD since one of its criteria of being a tax haven is listed as having laws or practices in place that prevent the effective exchange of relevant information with other governments on tax payers benefiting from the low or no tax jurisdiction. Vanuatu has also confirmed its commitment to join the Convention on Mutual Administrative Assistance in Tax matters and has also affirmed its commitment to meet the OECD Automatic Exchange of information standards. These are significant progresses the government is embarking on, to ensure it maintains its international obligations in the area of Taxation.

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

In 2018 the Government's expenditure program and policies will be in line with the 2018 Budget Policies. Therefore, the allocation of Government fiscal space for New Policy Proposal (NPPs) will resemble as closely as possible following the six expenditure priority outcomes outline in the Government's strategic priorities. The Government will continue to adopt sound financial management and fiscal discipline to ensure that there is sufficient cash to implement the Government's expenditure program and policies as well as the expenditure priority outcomes.

#### **4. New Policy Proposals (NPPs)**

The 2018 budget will comprise of New Policy Proposals (NPPs) that resemble as closely as possible with the Government expenditure priority outcomes. However, the allocation of the Government's fiscal space towards the New Policy Proposal will be strictly considered for funding in 2018 if they have been approved by the head of the agency and submitted in the Government financial management systems. In addition, 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 2018 budget will also include donor funded NPPs. Therefore, the Government will continue to emphasise the importance of using the Government Financial Systems to fund expenditure programmes and policies that are in line with the Government priorities.

## 5. Economic and Fiscal Targets for 2018

The economic, financial and fiscal policies will continue to be implementing in line with the Public Finance and Economic Management Act (CAP 244) in order to achieve the following objectives and targets.

<b>2018 Economic and Fiscal Targets</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 at least 25.0 per cent of GDP	Expenditures are consistent with the budget balance objective
<b>Debt</b> Maintain present value (PV) of external debt at a maximum of 25 per cent of GDP.	PV of External Debt to GDP is to be maintained at prudent levels below 40 per cent of GDP.
<b>Economic Growth</b> Growth forecast at 3.6 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 3.2 per cent	Annual inflation rate remains below 4.0 per cent

## 6. Conclusion

The 2018 Budget Policy Statement is finalised and consistent with the legal conditions specified in the Public Finance and Economic Management Act (CAP 244). This will form the basic guiding principles of finalising 2018 Budget before parliamentary appropriation. Therefore, the Government will continue to make sure that agencies adhere to this Budget Policy statement in the process of finalising the 2018 budget.