

## Budget Policy Statement 2021

### 1. Statement of Responsibility

This statement of responsibility confirms that the Government's economic and financial policies have been included in this Budget Policy Statement which is in line with sections 9 and 10 of the Public Finance and Economic Management (PFEM) Act (CAP 244).

Section 9 requires the Government to:

- specify its economic and financial policies, including those relating to key economic and fiscal variables;
- 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.

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 2021 Budget Policy Statement is in line with sections 9 and 10 of the Public Finance and Economic Management (PFEM) ACT (CAP 244).



Hon. Johnny Koanapo Rasou (MP)  
**Minister of Finance & Economic Management**  
Ministry of Finance & Economic Management



Letlet August  
**Director General**  
Ministry of Finance and Economic  
Management

## 2. Economic and Financial Policies

The Government's highest priority in Budget 2021 is to boost Vanuatu's economic growth and improve the wellbeing of all Ni-Vanuatu, in a way that is financially sustainable and does not jeopardize future economic growth. On this note, the 2021 Budget Policy Statement incorporates the Government's economic and financial policies and priorities to achieve the policy objectives of the National Sustainable Development Plan (NSDP) 2030 and at the same time address the current challenges and activities in preparing for COVID-19 and responding to and recovering from TC Harold. These policies are essential because they will also increase investment, increase employment, boost revenue, manage state debt and at the same time enhance economic growth, improve service delivery and wellbeing for all the people in Vanuatu.

In 2021, the Government will continue to undertake reforms, as well as implement and achieve Government policies, objectives and fiscal targets that will be guided by the principles of responsible fiscal management in section 22 of the PFEM Act. The principles of responsible fiscal management, outlined in the box below, require the Government to pursue its budget

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

1. Managing total State debt at prudent levels 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.

policy objectives.

## 3. Budget Policies

The 2021 Budget policies are in line with the National Sustainable Development Plan and also comply with the legal requirements of the Public Finance and Economic Management Act (CAP 244). The Budget policies, objectives and targets are crucial in the process of developing and finalising the 2021 Budget.

The 2021 Budget policies consist of:

1. Budget Policy Priorities for 2021;
2. Economic and Fiscal Targets for 2021; and

### 3. Long Term Fiscal Objectives

#### ***A. Budget Policy Priorities for 2021***

The Government Act provides that the Prime Minister sets strategic policy priorities and planning for the Republic of Vanuatu. Accordingly, the PFM Act Section 9 provides that the determination and the allocation of the financial resources are allocated in line with the policy priorities of the Government.

In the development of the 2021 budget policy priorities, the current government captures the essence of the National Sustainable Development Plan or the People's Plan 2030.

The National Sustainable Development Plan 2016-2030 (NSDP) is an interpretation of the UN's Sustainable Development Goals that Vanuatu has developed in its own context to implement over the 15-year period. The NSDP has 3 pillars, Social, Economic and Environment, founded on Ni-Vanuatu culture, and went through extensive consultations throughout the provinces, stakeholders, and Government ministries. Therefore, the policy priorities represent important sectors of the economy that the government will support in 2021.

The country is expected to graduate from the Least Developed Country (LDC) status to Developing Country status in late 2020. However, given the current financial impacts on tourism and services sector posed by Covid-19 and TC Harold, the Government is a) dialoguing with relevant United Nations agencies in reviewing its graduation timeframe; b) refocusing its resources towards boosting the productive sector; c) strengthening health capabilities; and d) implementing sustainable recovery priorities.

#### **Core Policy Priorities Analysis and Justification for support in 2021**

The current government remains committed to public sector reforms to deliver the People's Plan 2030 while promoting capabilities for resilience and prosperity through the following priority outcomes:

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

The recent economic crisis resulting from COVID-19 and exacerbated by Tropical Cyclone Harold highlights the vulnerabilities faced by relying too heavily on any one sector for economic growth, particularly sectors such as tourism.

Similarly, land issues and disputes have been an obstacle for productive investments in the past, thus the current government is embarking on land reform and dealings (acquisition) to boost public investment in 2021. The Government wants to continue to create an enabling environment to encourage more Public Private Partnerships and Joint Ventures with local and foreign investors in order to spread economic development and benefits equitably.

The government is committed to implement policy options aimed at strengthening Vanuatu's economic resilience against external shocks through greater economic diversification, by:

- **Boosting primary production** (agriculture, fisheries, and forestry) to meet a greater proportion of domestic consumption by: increasing rural production; increasing co-investment opportunities strengthening capacity for managing biosecurity and border control risks; increasing national sustainable and climate and COVID-19 ready tourist development
- **Strengthening agriculture value chain**, such as increased processing of raw products, by increasing investment in agriculture infrastructure facilities; promoting trade, industry, and cooperatives; creating Economic Development Zones
- **Expanding the service sector**, such as businesses that serve the agricultural sector or other sectors such as financial services
- **Infrastructure and equipment with focus on regulations**, increasing and diversifying exports, strengthening the management of waste and pests at ports of entry

#### **Target Outcomes:**

- Improved participation rate of Ni-Vanuatu business in the formal cash economy
- Improved food and nutrition security across the entire archipelago
- Improved Research & Development for productive sectors
- Increased production of poultry, fish, meat, and agricultural crops
- Increased value-adding products
- Increased exports by improving Vanuatu's capabilities to compete in niche markets
- Increased number of local entrepreneurship
- Increased support to the cooperative movement
- Improved access to financial capital and financial literacy through the Vanuatu Cooperative Business Network.
- Increased earnings and volume of trade due to existing/newly trade agreements.
- Improved business performance by both local and foreign investors
- Reduced risks and incidence of pest and diseases entering Vanuatu
- Vanuatu Sustainable Tourism policy 2019-2030 implemented
- Strengthened revenue base and tax compliance system
- Reduced backlog of cases involving land disputes

- Increased land acquisition to promote investment
- Developed and strengthened appropriate regulations for trade and commerce.

## **Priority Outcome 2: Improved Resilient Infrastructure**

Resilient Infrastructure is a core government priority in 2021. Improved 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:

- **Improving airport infrastructure** – by continuing the development of the Code E terminal at Bauerfield International Airport, acquiring land for airport development, upgrading major key airfields, sealing the existing air space agreement. Strengthening the regulatory arm of the industry is also required to keep up with operational demand.
- **Rehabilitating and improving maintenance of high priority rural infrastructure** – by partnership with private sectors, development partners and local communities to improve rural (including feeder) roads, upgrading wharves and jetties, building of warehouses, and completing transport infrastructure maintenance fund strategies.
- **Expanding access, and reducing the costs of telecommunication and energy** – by 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 Outcomes:**

- Continued support to the implementation and completion of on-going infrastructure projects with required building standards, including in TC Harold affected areas.
- Strengthened regulatory arm of the aviation industry including an interactive website where clients can file applications, obtain standard information, and negotiating airspace agreement.
- Improved transport infrastructure facilities, including wharfs, roads and airports to facilitate trade within and between islands; opening and maintaining of rural feeder roads; develop road assets; and implement sustainable public road policy.
- Establishment of the Maritime Affairs Commissioner's office, with the capacity development of personnel and Safer Marine approaches through an increased installation of Marine Aids to Navigation (AToNs) network at identified locations, and development of hydrographic surveys.
- Increased number of households with access to clean energy and electricity in rural areas, by continuing support of the National Green Energy Fund.

### **Priority Outcome 3: Improved education quality, accessibility and training outcomes for children and young people**

Covid-19 Pandemic has affected a lot of school programs over the country. Due to social distancing regulations, the Government is looking at implementing home learning options. As part of the stimulus package, the Government has also agreed to increase school fee grant across all schools in the country.

In 2021 the Government will continue to strengthen access to 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 childhood education and primary education from year 7 to year 12.
- **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 the volcanic disasters in Ambae and Ambrym, TC Hola and TC Harold
- **Increasing higher education opportunities** – through completing revised Vanuatu Education Strategy, implementing National Human Resource Development Plan, supporting early childhood education and life-long learning opportunities within the education system.
- **Improving opportunities for employability and entrepreneurial skills development** – through technical and vocational skills training and increased support for out of school youth.

#### **Target Outcomes:**

- Developed and implemented Home Learning Strategies
- All Schools including private and mission schools must receive the increased School Fee Grant from the Stimulus package.
- Increased student net enrolment ratio for yr7- yr12.
- Improved support for ECCE.
- Improved training of teachers, and learning facilities.
- Improved teaching materials.
- Student-teacher ratio maintained

- Improved numeracy and literacy rate
- Reduced rate of push-outs
- Strengthened post-secondary education and training
- Improved support for training programmes through technical and vocational skills development.

#### **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 despite the challenges of COVID 19 and TC Harold through:

- **Strengthening the capacity to address COVID 19 and long –term recovery of TC Harold**
  - through specialist training and increasing workforces demand, building adequate infrastructure, having in place appropriate equipment and machines and adequate health quarantine measures at Ports of entries
  - through reconstruction of damaged health infrastructures and replacing damaged machines and equipment.
- **Reducing the incidence of communicable diseases and Non-Communicable Diseases** – through continuity of public health Programs with a strong focus on public health surveillance, Health promotion and Outreach services
- **Strengthening health service management and information system** – through up skilling of management capacity of staff and continue to improve Health Information System (HIS).
- **Implementing the role delineation policy** – through equipping health facilities with appropriate role delineation requirements.
- **Exploring opportunities of introducing personal health profile system.**

#### **Target Outcomes:**

- Specialist training for frontline health officers to handle any highly infectious diseases like COVID 19.
- Testing for COVID 19 and other related diseases is carried out in Vanuatu.
- Personal Protective Equipment (PPE) & isolation wards are available.
- Health Quarantine measures are available at ports of entry.

- Increase annual nursing in-take at the Vanuatu College of Nursing Education (VCNE) from 40 – 50 students.
- Vanuatu to have a density of 26 Health Workers per 10,000 population.
- The national maternal mortality ratio is reduced to less than 75 per 100,000 live births.
- Annual parasitic incidence rate (API) for all cases of malaria is no more than 1 per 1,000 population.
- Reduced incidence of non-communicable diseases
- 95% of population of children aged between 12 to 23 months received three doses of combined diphtheria, tetanus toxoid & pertussis vaccine in a given year, administered by a trained health professional.
- Under-5 mortality rate is reduced to at least as low as 25 per 1,000 live births.

### Priority Outcome 5: Improved Service Delivery

The Government will continue to target improvements in the public sector and continue to support the decentralization policy that it is currently embarking on, to ensure that 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 the financing of government priorities. The government also aims to further strengthen the coordination of donor resources in line with national objectives. In this context, the government will:

- **Enhance implementation of Decentralization** – by strengthening the provincial governments, adopting whole-of-government integrated approach, empowering area councils, establishing a governance accountability mechanism, and developing and rolling out sub-national work and training manuals on planning and budgeting.
- **Improve urban management** –by developing urban development policy framework and guidelines, implementing relevant legislation, establishing of appropriate oversight institutions and urban planning and service delivery systems.
- **Increase labour mobility nationally and internationally** – through enabling legislative framework and strengthening of institutional and management capabilities
- **Strengthen capacity to manage growing external relations** – to continue to expand Vanuatu’s global interests.
- **Enhance partnership with donors, community-based organisations and non-governmental organisations** – through reviewing existing NGO arrangements and



institutions, developing accountability mechanisms with kastom authorities, and developing memorandums of understanding with key service providers.

- **Strengthen public institutions at the head of the executive** – to continue to enable delivery of desired outcomes through implementation of reforms including the National Sustainable Development Plan and managing COVID-19 preparedness, responses and recovery.

#### **Target Outcomes:**

- Government Machinery reviewed to improve government service delivery.
- Enhanced devolution process with systematic improvements in the framework and mechanism for service delivery at the sub-national level.
- Completed area council governance mechanism.
- Developed structure for Malvatumauri, provincial, area, tribe and village councils.
- National Foreign Policy Framework to complement the recently launched Aid Management Policy Framework.
- Implementation of MOUs and Technical Cooperation agreements by sector agencies
- Temporary Labour Movement programs (RSE, SWP and Pacific Labour Scheme).
- VANGO establishment and NGOs governance framework.
- Enhanced regionalism through hosting the Pacific Islands Forum.
- Recovery of all forms of public infrastructure facilities that enable continuity of service delivery
- Coordination of recovery priorities relating to COVID-19 and TC Harold, and other disasters

#### **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 by:

- **Improving climate change adaptation and disaster risk management governance** – to mitigate the effects and impacts of climate change.
- **Increasing equitable, accessible and affordable water supply and sanitation** – to increase communities' access to safe and secure drinking water sources.

- **Strengthening institutions and governance that protect our environment and natural resources** – to have a strong legislation and governance framework that protect our natural based resources including ocean, land and forest
- **Increasing resilience in the productive sector** to improve sustainable production in agriculture, livestock, forestry and fisheries.
- **Improving Waste Management** services and operations to reduce pollution impacts.
- **Strengthening the enforcement of Environmental Impact Assessment (EIA) Regulations** and cultural impact assessment for major economic developments with potential threats on our natural resources and cultural heritage.

#### **Target Outcomes:**

- National Disaster Risk Management Framework to manage preparation, response and recovery developed and implemented.
- Strengthened National Advisory Board to ensure sustainability of facilitation and coordination of climate financing.
- Development and implementation of a marine spatial plan to meet goals under the National Oceans Policy
- Improved environmental and climate services in all six provinces in accordance with the decentralization policy.
- Improved safe drinking water coverage and security for all population.
- Improved sanitation coverage,
- Improved waste management and pollution control.
- Improved management and sustainable use of forestry resources for TC Harold recovery and industrial developments in compliance with the Forestry Act
- Improved sustainable management of land-based resources in compliance with Mines and Minerals Act as well as Petroleum Act
- Developed cultural impact assessment to protect sacred sites and promote heritage sites

#### **Priority Outcome 7: Social Inclusion, Security, Peace and Justice**

The Government will continue to ensure that our society is inclusive, human dignity is upheld, and that the rights of all Ni-Vanuatu including women, youth, and the elderly and vulnerable groups are supported, protected and promoted. The Government will also ensure that society upholds the rule of law and that everyone has timely access to justice through;

**Improving national security services**– through strengthening national security capabilities, including three elements of security forces (Police, Maritime Wing and Vanuatu Mobile Force), as well as enhancing related institutions and management systems of boarder control and protection

- **Implementing gender-responsive planning and budgeting processes** – to include gender in the process of planning and budgeting for all Ministries.
- **Promoting traditional governance and Christian principles for a peaceful society** – to have a peaceful society that is based on our Melanesian values.
- **Establishing anti-corruption institution.**

#### **Target Outcomes:**

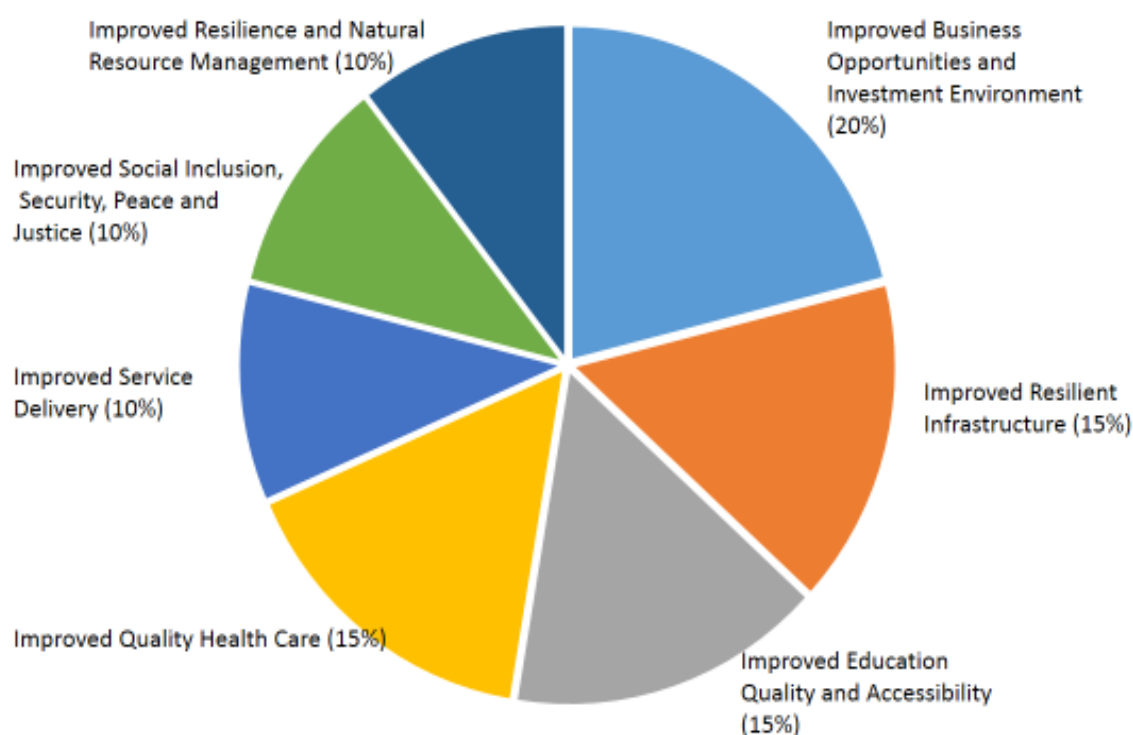
- Established National Security Council and National Security Framework.
- Reduced prevalence of crime considering all types of criminal offenses including violence against women and vulnerable groups, human trafficking, cyber-crime, drug trafficking and money laundering.
- Improved border control and protection through capacity building of human resources and the modernization of our border control systems.
- Demarcated maritime boundaries.
- Increased capacity of police security forces through proper training and resourcing. Ensuring that both men and women officers are equally supported.
- Drafted guide notes for gender-responsive planning and budgeting.
- Resources provided to improve coordination of the Human Rights activities
- Support provided for the implementation of the National Youth Authority Act.
- Anti-Corruption Institution is established.

## Allocation of Fiscal Space to Priority Outcomes

It is proposed that the overall fiscal space, once determined through analysis by the Department of Finance and Treasury, should be allocated by MBC to resemble as closely as possible the following allocation between the seven Priority Outcomes stated above:

- **Priority Outcome 1:** Improved Business Opportunities and Investment Environment - 20%
- **Priority Outcome 2:** Improved Resilient Infrastructure - 15%
- **Priority Outcome 3:** Improved Education Quality and Accessibility - 15%
- **Priority Outcome 4:** Improved Quality Health Care - 15%
- **Priority Outcome 5:** Improved Service Delivery -10%
- **Priority Outcome 6:** Improved Resilience and Natural Resource Management - 15%
- **Priority Outcome 7:** Social Inclusion, Security, Peace and Justice- 10%

**Chart 1: Allocation of Fiscal Space**



## Ongoing programs from development partners

The government and its development partners will jointly implement programs in 2021. In previous years, the government held several dialogues 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 2021 through stronger working relationships and coordination at the national and at the sector level. The dialogue will continue in 2021.

## **TC Harold and Covid-19 Recovery Priorities**

The government's TC Harold and covid-19 recovery priorities will continue in 2021. The priority needs under the recovery are the productive sector, infrastructure and public buildings, water and sanitation, health and education. These recovery programs will be implemented in parallel and complement those of development partners and government recurrent programs.

Any recovery program implemented by the Ministries, must be aligned with the National Recovery Strategy, to be delivered by the National Recovery Committee.

### ***B. Fiscal Policies***

The main purpose of the Government's fiscal policies is to achieve the Government's fiscal policy objectives and targets, Government policy priorities and intentions and to achieve a balanced budget in 2021. The implementation of fiscal policies will continue to be guided by the principles of responsible fiscal management, and together with the Government reforms and sound financial management, the fiscal policies will continue to place more emphasis on growing the economy, increasing Government revenue and meeting Government expenditure programs and activities in order to enhance service delivery as well as improve the wellbeing of all the people in Vanuatu.

### ***C. Economic Update in 2020***

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

The World Economic Outlook (WEO) of April 2020 presented the Great Lockdown for most economies around the globe, leading to negative global growth projected at -3.0 per cent in 2020, followed by a rise to 5.8 per cent in 2021. The vast downward revision from the WEO January 2020, was due to the impacts of COVID-19 pandemic, which has led to a global downturn that is much worse than the Global Financial Crisis of 2008-09. This health crisis has been a double-pronged shock to countries all over the world, harming every economy and leading to major loss of human life.

There is extreme uncertainty in economies around the world. International borders around the globe were closed, affecting the entire service sector, as well as global trade. Advanced economies are projected to contract 6.1 per cent in 2020 then surge to 4.5 per cent growth in 2021. Projections in WEO January 2020 for these advanced economies was at 1.6 per cent for both 2020 and 2021.

In the Euro area, economic growth is projected to decline by 7.5 per cent in 2020 before rebounding by 4.7 per cent in 2021. The United States economy is now expected to contract by 5.9 per cent in 2020 before growing by 4.7 per cent in 2021. This is a 7.9-percentage point downward revision from the January 2020 WEO forecast for 2020 and a 3.0-percentage point upward revision for 2021. Growth in emerging markets and developing economies has also been revised downwards to -1.1 per cent in 2020 and 6.6 per cent in 2021. The downward growth revision in the United States reflects the increasing impact of the pandemic that include

jobless claims exceeding 6.6 million during the fourth week of March compared to 280,000 two weeks before. The Chinese economy is projected to grow by 1.2 per cent this year and 9.2 per cent in 2021. The 2020 projection is a downward revision of 4.8 percentage points from the January 2020 WEO and the 2021 projection is a 3.4-percentage point upward revision from the January WEO.

The global inflation forecast for 2020 is 3.0 per cent according to the IMF WEO April 2020. Inflation in advanced economies is anticipated to be 0.5 per cent in 2020, followed by a slight increase to 1.5 per cent in 2021. Strong policy frameworks should ensure inflation expectations remain well-anchored; however, persistent weak demand may lead to considerably lower inflation expectations. In emerging markets and developing economies, the inflation forecasts show slight increases to 4.6 per cent in 2020 and 4.4 per cent in 2021.

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

The forecasts approved by the Macroeconomic Committee (MEC) meeting no. 2 of 2020 indicated that 63.8 per cent of the domestic economic growth is from the Services sector while Agricultural sector and Industrial sector respectively contributed 15.6 per cent and 13.6 per cent. The Industrial sector continue to be the fastest growing sector in Vanuatu's economy. According to MEC meeting 2 of 2020, growth of Vanuatu's economy was further revised down to 0.6 per cent in 2020 from the first quarter MEC meeting of 2019 where growth is projected at 1.9 per cent. The downward revision from a 3.4 per cent growth projected at budget 2020 reflects the initial impact of the COVID-19 pandemic as well as the TC Harold damage and recovery.

During this health and economic crisis, international borders are being closed while cargo and fuel vessels still enter the country. The impact of the pandemic resulted in a decline in the number of visitors into the country affecting the tourism sector as being the major driver of the services sector domestically. The Vanuatu Government intervention through automatic stabilizers, providing economic and financial stimulus to support domestic demand that includes employment support payment to workers who are engaged in tourism related businesses. Tropical Cyclone (TC) Harold hit Vanuatu, especially the Northern provinces in early April 2020, fuelling the already crisis to the domestic economy. The Northern provinces of Vanuatu are major producers of export commodities such as kava, copra, cocoa and beef. The COVID-19 pandemic and damage caused by TC Harold have impaired household livelihoods and businesses in Vanuatu as a result the Government immediate intervention is commendable coincide with those of its development partners is expected to mitigate massive fallout in economic production.

Following the recent economic outlook based on assessments of the impact from both disasters, growth in the agriculture sector is expected to decline by 12.3 per cent in 2020 with sluggish growth of 0.8 per cent expected in 2021. Volumes of major commodity exports such as kava, copra, cocoa, and beef will decline following damages sustained in major producing provinces such as Sanma, Malampa and Penama. A strong recovery in growth is expected in the projection period following the Government's response planned for these industries in terms

of providing subsidies to boost production as well as the 11<sup>th</sup> EDF program targeting the productive sector. Growth in the forestry and fishing sectors is expected to normalise over the medium term supported by various development partners' projects. Although households are currently affected by both disasters, it is important that response plans are implemented on time in order to offset a more drastic downturn in this sector.

The industry sector is expected to partially offset weak growth in the Services and Agriculture sector in 2020 with growth projected to surge from 6.4 per cent in 2019 (predicted at budget) to 21.9 per cent in 2020 and the sector is forecast to further expand with an average growth rate of 11.8 per cent over the next three years. However, several infrastructure projects in terms of public building projects are being delayed due to COVID-19 for instance, the Ministry of Finance and Economics Management building, Ministry of Foreign Affairs and Presidential palace. Growth in 2020 will mostly be driven by the ongoing donor - and Government-funded infrastructure projects such as Tanna and Malekula road phase two, PWD road improvement project, Vanuatu feeder road projects, TC Pam road reconstruction project, Vanuatu infrastructure reconstruction improvement projects (VIRIP). These developments will also be supported by TC Harold reconstruction by households and businesses in the second half of 2020. Other industries such as electricity and water and manufacturing will experience a decline in activities in 2020 due to the recent disasters while a rebound is expected over the medium term.

Growth in the services sector is expected to weaken drastically generating only 0.3 per cent in 2020 prior to recovery in 2021. The global COVID-19 pandemic has had a huge negative impact on the service sector globally with spillover effects domestically, as the sector makes up more than 60 per cent of national economy. The closure of international borders, restricting tourist movements from major destinations such as Australia and New Zealand, has resulted in massive decline in tourism related activities mainly hotel and restaurant, transport services, and telecommunication. However, thanks to development-partner support spearheaded by the Government economic and financial stimulus making available VT4.5 billion as total budget support in response to TC Harold has boosted economic activities in the industries such as retail trade, public administration, and transport and telecommunication services. The employment stabilization package as well as financial help for small and medium enterprises will sustain household spending power that should counter a further decline in economic activities.

### **Monetary update**

The Reserve Bank of Vanuatu (RBV) further eased its monetary policy stance on March 27th 2020. The RBV's policy rate was reduced to 2.25 per cent from 2.90 per cent following the Bank's assessment of the impact of the COVID-19 pandemic on Vanuatu's economy and the RBV's monetary policy stance. The following additional supportive policy measures were also implemented: a reduction of commercial banks' Capital Adequacy Ratio (CAR) from 12.0 per cent to 10.0 per cent, and the reactivation of the Bank's Imports Substitution and Export

Finance Facility (ISEFF)<sup>1</sup> and the Disaster Reconstruction Credit Facility (DRCF)<sup>2</sup>. Other policy tools such as the Statutory Reserve Deposits ratio and the Liquid Asset Ratio were maintained at 5.25 per cent and 5.0 per cent, respectively. Domestic macroeconomic fundamentals remained sound throughout the first three months of 2020. The RBV's twin monetary policy objectives remained within their respective targets; domestic inflation was within the target range of 0-4 per cent, and official foreign exchange reserves was above the minimum threshold of 4.0 months of import cover. At the end of March 2020, official foreign reserves were sufficient to finance approximately 13 months of the country's imports of goods and services. Similarly, annual inflation recorded 3.4 per cent during Quarter 4, 2019. The Reserve Bank is confident that it will achieve its monetary policy objectives over the medium term.

Money supply marginally contracted during the first three months of 2020, owing mainly to a downward movement in net foreign assets; however, money growth has remained higher than the same period of 2019. The decline in net foreign assets reflected net outflows of foreign reserves recorded by both the RBV and Other Depository Corporations (ODC). Domestic credit picked up in March 2020, reflecting in particular increases in net credit to the central government and growth in private sector credit. The increase in the Government's net credit vis-à-vis the banking system in March 2020 reflected in particular the reduction in Government deposits held with Other Depository Corporations (ODC). Overall, the Government's net credit position remained favourable relative to March 2019. Growth in private sector credit in March 2020 reflected slight pick-ups in loans extended to both businesses and household and personal consumption. Nevertheless, annual growth of private sector credit remained subdued reflecting weak domestic demand. Overall, monetary and financial conditions remained supportive of growth as evidenced by elevated levels of liquidity and sound capital positions of banks. Commercial banks' asset quality remained healthy with standard loans dominating the total loan portfolios. Going forward, private sector credit is expected to slow further, owing mainly to the risks and uncertainties associated with the COVID-19 and the impacts of TC Harold. Net foreign assets are expected to depict a steady growth, supported by net inflows via economic recovery towards the COVID-19 pandemic and impacts of TC Harold; and thus, will be the main driver of money supply growth throughout 2020.

### **Balance of payments**

Vanuatu's balance of payments (BOP), which records the country's transactions with the rest of the world (ROW), reported a surplus balance in 2019 reflecting major influx of foreign reserves in the banking system outweighing outflow of foreign reserves. This impressive record reflected surpluses in the services accounts, primary income and secondary income balances. Accordingly, tourism receipts continued to dominate the services accounts while the primary income account was boosted by increases in inflows of investment income abroad and income from domestic workers abroad. Both the secondary income and capital account balance

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<sup>1</sup> ISEFF is a back-to-back lending facility to businesses offered through commercial banks.

<sup>2</sup> DRCF is offered to businesses through commercial banks for the purpose of rehabilitation and reconstruction post disasters.



surpluses were supported by Government revenues from abroad. Imports of goods and services, which contributed mostly to outflows of FX, declined over the year due to subdued demand amidst a slow-moving economy. In light of these developments, foreign reserves continued to remain within target over the first quarter of 2020. As of March 2020, the official foreign reserves stood at VT 58.5 billion, and were sufficient to finance approximately 13 months of imports of goods and services.

With the current global virus outbreak, global supply chains have been disrupted along with international border restrictions and lock downs which is expected to affect Vanuatu's international trade of goods and services in 2020. Exports of goods and services are expected to decline massively should the lockdown continue over the second half of the year. Primary income and secondary income balances are also expected to reduce from 2019 levels due to the global health and economic crisis implications. Overall, the current account surplus is projected to decline in 2020. Upside developments include a slowdown in imports and other major payments and transfers abroad due to supply chain disruptions along with increases in donor grants from abroad for economic recovery related to the COVID-19 and TC Harold which will support the level of foreign reserves. Accordingly, overall foreign reserves are expected to remain within target in 2020.

## **Inflation**

Headline inflation remained well within the RBV's 0 to 4 per cent target range in Quarter 4 2019. Annual headline inflation rose to 3.4 per cent in the fourth quarter of 2019 from 2.9 per cent in the third quarter. The main contributing driver of inflation was a pickup in food inflation which rose to 7.2 per cent towards the end of 2019, although other consumer price categories remained relatively stable. The increase in food prices was mainly driven by rise in domestic price of root-crops, fruits and vegetables. International fuel prices were projected to fall from an average US\$61 per barrel in 2019 to US\$35 per barrel in 2020 and US\$42 per barrel in 2021. The lagged impact of low global fuel prices is projected to sink through to transport, and housing and utility prices in 2020. Demand pressures still remain steadily low as a result of further narrowing of the output gap, in line with the projected decelerated economic growth in 2020, although continuous effort for rebuilding post TC Harold and delayed projects may reflect additional demand-driven construction activities in the economy. On the downside, import price pressures are offset by weaker fuel prices and domestic food price pressures are projected to ease.

While Vanuatu's fixed exchange rate regime will continue to anchor inflation in the medium-term, further changes to the Government policy decision on fees and charges and market conditions remain a determinant factor of future price movements. The year-on-year inflation is projected to ease at the end of 2020, in line with projected slow-down in food and fuel prices, and remain stable in 2021. Overall, annual inflation is forecasted to remain within the mid-range of 0 to 4 per cent target in the medium term.

#### ***D. Budget Management***

The 2021 Budget is prepared during the time when Vanuatu is facing great challenges due to COVID-19 preparedness and also responding to TC Harold. With these current challenges, the Government will be putting more emphasis on economic recovery to support domestic demand. In addition, the Government will continue to work to increase revenue collections and at the same time negotiate with development partners to ensure that there is sufficient cash flow to fund its expenditure programs and activities in 2021.

#### ***E. Government Debt and Borrowing***

Vanuatu has come a long way, evolving and recovering since it was devastated by Category 5 Tropical Cyclone (TC) Pam five years ago. As the country economically improves, demand for social services continue to increase.

Total Public Debt level is expected decline from 2019 onwards, as the Government has been embarking on a momentous debt reduction plan. Over VT 3 billion worth of external loans were prepaid in 2019 and early 2020. These advanced repayments were directed towards loans from the Export Import Bank of China to fund major projects. Despite the current situation that Vanuatu is facing, the Government is faithfully making its scheduled repayments. With the current crises, the Government plans to source financing domestically, through the issuance of domestic bonds over the short term. This will contribute to a slight increase in the total public debt level.

The Debt Sustainability Analysis completed by MFEM in 2019 suggests that Vanuatu's debt-carrying capacity continues to be moderate. The granularity in the risk rating confirmed a limited space to absorb shocks. There are currently no breaches in the baseline scenario. The stress tests in this analysis show that if a natural disaster were to happen, a breach in the baseline scenario in the net present value of the external debt to GDP ratio within the near term would be expected. With current implications from COVID-19 and TC Harold thus far, this is a possibility. The baseline scenario could escalate in the medium to long-term.

Recent analysis conducted since TC Harold shows that the net present value of the debt-to-GDP ratio is increasing slightly as the overall production becomes affected as a direct result from COVID-19 and TC Harold. This strongly indicates the need for rebuilding fiscal buffers and advocating for stronger economic growth in the medium to long term, in line with prudent debt management. In addition, it highlights the need to strengthen resilience against natural disasters and create appropriate fiscal space to absorb future shocks.

With the country's debt carrying capacity, key debt management policies and guidelines have been prepared and approved to ensure prudent debt management. The recent amendments to the PFEM Act and the Debt Management Strategy covering the years 2019 to 2022 were approved in 2019 and are now being implemented. Financial Regulations related to the PFEM Act will be finalised in 2020, including improvements to public debt management regulations. Other fundamental debt policies are also in place to assist the country with its debt portfolio and management of its evolving debt dynamics.

There must be ongoing fiscal discipline in line with the available, assessed fiscal space. The Government must ensure to abide by its Debt Management Strategy, which includes the policy of external debt limited to 40 per cent of GDP in nominal terms over the medium term. All new borrowings must be carefully analysed, prioritised and must be on concessional terms, with a minimum of 35 per cent grant element. The Government's Debt Management Strategy also strongly emphasises the need to seek grant financing as much as possible for infrastructure investments, to limit and control the debt burden and the related risks.

With the country's high vulnerability to natural disasters, the Government must continue to ensure that the risks to growth correlated with natural disasters are addressed. So far, the country has been enhancing its readiness to respond and will need to continuously improve in that direction. The Vanuatu Government has also embarked on establishing ex-ante measures that require different layers of preparedness which include: strengthening risk preparedness and assessment, improving domestic fiscal buffers, upholding external buffers, and building and maintaining resilient infrastructure and investments. Identifying and disclosing fiscal risks including unprecedented viral pandemics, natural disasters and climate change form an integral part of the 2021 Budget Policy Statement.

#### ***Debt Management Policy recommendations***

- Given Vanuatu's vulnerability to natural disasters, the Government should be careful to avoid rapid debt accumulation with future major infrastructure projects.
- The Government should consider fiscal risks associated with contingent liabilities from SOEs and reduce guarantees to SOEs in order to safeguard debt and prevent abuse of public funds.
- The Government should continue to rebuild fiscal buffers over the medium term by strengthening public finance and diversifying economic development.
- The Government must continue to find new revenue sources to broaden the current revenue source and ensure that it is not relying too much on individual sources of revenue.
- The Government should strengthen its public financial management and reprioritise spending.
- The Government should keep the option of external debt prepayment open when fiscal conditions are favourable.
- The Government should ensure strong and sustainable economic growth, with the right mix of both fiscal and monetary policies. This is essential for debt management.
- Good governance is also significant, including adhering to the debt policies of the day and making the necessary structural reforms in key government sectors.

## ***F. Revenue and Taxes***

The Government must continue to raise sufficient revenue to be able to fund its entire public expenditure programs, respond to the public demands and be there to assist when unforeseen circumstances arise. Unfortunately for financial year 2020 the anticipated revenue targets are likely to be severely impacted as a result of the COVID -19 global pandemic, the TC Harold and the ash fall in Tanna. The Government will continue to monitor these situations closely to ensure their impact on national revenue is manageable.

The 2019 financial year recorded one of the best years of revenue collection for over a decade and such indicates that the ongoing reforms in revenue administration and policies are positive. At year-end 2019, revenue collections exceeded their initial budget target (VT 28,272.3 million) by 19.1 per cent pushing the total revenue to VT 34,011.7 million. The Citizenship office, the Ministry of Finance and Economic Management (MFEM), the Ministry of Internal Affairs, the Fisheries Department and few others have recorded outstanding collections, which have contributed to the higher than budgeted revenue targets in 2019.

The Citizenship office budgeted to collect VT 6.5 billion in 2019, however a total of VT 12.2 billion, was recorded at year-end. The citizenship office through its VDSP and VCP program, have successfully exceed budget target by 88.8 per cent. Together the program generated more than a third of the total government revenue and were the highest revenue earner for the government in 2019. As was the case in the previous year, total revenue earned from these programs in 2019 outweighed the collections from VAT.

The MFEM continues to see growth in revenue from taxes, fees and charges collected by the Department of Customs and Inland Revenue (DCIR) and also from the inflows recorded under Department of Finance and Treasury (DOFT). DCIR still maintains its position as the Government's main revenue collecting agency. The overall revenue collection recorded under DCIR in 2019 was 98.3 per cent of the budget target.

VAT revenue continues to increase since 2018, after the Government policy decision to increase the VAT rate, from 12.5 per cent - 15 per cent. In 2019 VAT revenue target was raised to VT 9.0 billion, but actual revenue collected exceeded its budget target by a surplus of VT 245.6 million. Other strong performances were seen in Import duties and Excise tax which exceeded their total budget target by more than 95.0 per cent in 2019. Additionally, Turnover tax, paid by the commercial banks performed as expected and slightly exceeded its budget target by 2.9 per cent.

Other major revenue administrated by DCIR such as Business License Registration and Road Tax collected more than 90.0 per cent of their budget target in 2019. And recorded good collection in 2020 before the COVID-19 pandemic arose.

A lot has been said about DCIR's compliance, and the need to strengthen collection efforts to ensure revenue continues to be collected. With the implementation of the Tax Administration Act No. 37 of 2019, we anticipate to see greater improvements in tax compliance in the coming years.

DOFT also collected higher revenue than forecast in 2019. It collected an amount of VT 970.3 million, exceeding its revenue target by VT 134.9 million, which is 116.1 per cent of its revenue budget. The major initiatives contributing to this surplus are third party lending fees, fees classified as other recoveries, tax on companies, fees collected from registration of offshore companies, company stamp duties and interest from bank deposits. There were dividends paid in from the Reserve Bank of Vanuatu (RBV) and Interchange Limited Dividends, which significantly exceeded their budget targets. The Ifira Wharf Stevedoring & Stevedoring and the Northern Island Stevedoring Company Ltd (NISCOL) also paid their dividends in 2019 although it was less than budget.

The MoIA recorded higher revenue collections from related immigration and border control activities. Actual revenue grew steadily over the year with actual collections exceeding forecast by 66.3 per cent. Fees collected by the Department of Immigration and Department of Labor have significantly contributed to this outstanding result.

Revenue initiatives such as the Work Permits and application charge and the Passport fees and residency permits, have recorded strong collection. The Land Transport Authority fees recorded under the Internal Affairs Cabinet also recorded strong revenue collections from land transport fees, which are public transport, permits, driver's permit and penalties

Several ministries did not meet their revenue targets in 2019. Revenue collected by these ministries are largely fees and charges imposed for services provided. Amongst these ministries were the Ministry of Lands and Natural resources and the Ministry of Infrastructure and public Utilities that have recorded a lower than anticipated revenue collections and revenue growth trend were seen to be stagnant over the last two years.

### ***Vanuatu Commitments with OECD Global Forum and EU Code of Conduct***

In the international arena, Vanuatu has exerted a lot of effort to complying with international standards on good tax practices. This includes those set by the OECD's Global Forum on Transparency and Exchange of Information for Tax purposes (Global Forum) and the European Union's Code of Conduct Group (EU CoCG). Vanuatu will face serious reputational damage if it does not meet these standards and requirements. Vanuatu has made good progress to get a good rating with the OECD Global Forum by having the necessary legislations in place. However, it had failed to effectively implement the legislations and must undergo a supplementary review to get off the list of non-cooperative tax jurisdictions and avoid reputational damage.

In 2019, the EU CoCG concluded that Vanuatu had not taken sufficient steps to fulfil its commitments. To tackle this issue, the Government is working on reforms that include the review of the Business License Act. The legislations must be passed by Parliament and be implemented to get Vanuatu off the black list. With the transfer of the Vanuatu Competent authority roles to DCIR, we anticipate to see greater results in the administrations of good tax practices to meet international standards as according to the OECD and EU.

## **Ongoing Revenue Policy Reforms**

### ***1. Personal Income and Corporate tax to be differed.***

Over the last 4 years the government has invested heavily in improving and strengthening its existing revenue policies to boost revenue collection. The government was not in a position to introduce major reform in its entire tax base, given the political senility of some of these policies such as the likes of Personal Income and Corporate taxation that has a potential revenue in excess of **VT 3 billion**. The government still maintains its position not to go ahead with the implementation of this major policy reform.

### ***2. The Tax Administration Act***

In its effort to improve and modernize DCIR as the Tax Administrator, the Government enacted the Tax Administration Act (TAA). This new law enacted in 2019 finally came into force on 1<sup>st</sup> January 2020 and is intended to help strengthen efforts in the collection and administration of taxes, strengthen compliance and obligate Tax payers to lodge timely payments and avoid penalties. The TAA is a service-based platform where taxpayers are helped to meet their obligation; provides for electronic payments and lodgements and enhanced customs procedures. DCIR has provided sufficient staff training and updated the Revenue Management System and processes to accommodate the new regime. The Business Community and key taxpayers have been consistently updated on these changes. Unfortunately, its full implementation has been severely challenged by the COVID -19. Staffing remains a huge need for DCIR. More qualified staff needs to be recruited to boost revenue compliance.

### ***3. Review and strengthen collection of Non-Tax Revenue***

The Government must continue in its effort to review its existing fees and charges collected by its agencies and reinforce grey areas to ensure better revenue administration and compliance. Revenue agencies should also find other ways in which revenue could be earned and ensure appropriate processes are followed to affect their policy changes.

### ***4. Other Potential Revenue Policies***

Over the last 2 years (2018 – 2019) the following revenue initiatives were discussed but are yet to be implemented. This includes:

- I. Soft Drink tax – a possible Increase in excise tax on sugary drinks and related products due to its health-related impacts such as the rise in NCD rates
- II. Increase on Tobacco tax to meet WHO bench mark
- III. Ensure SINO-VAN Project is operated to its full capacity
- IV. Citizenship by Investments program.
- V. Review of Vanuatu Air-Space agreement and shares.

## ***Outstanding Revenue***

The concerns surrounding unresolved revenue payment within line ministries and agencies will still remain until all outstanding's are cleared and that adequate policies are in place to control

accumulation of timely unpaid taxes. Several Ministries and their department have yet to show real commitments in addressing and reducing their list of outstanding revenue. Current outstanding non-tax revenue stands at VT 1.6 billion. In 2018, a total of VT 130 million worth of outstanding were written off and another VT 100 million are in their assessment stage, for final assessments by the 'National Write-off Committee' before they can be written off.

Additionally, DCIR has also confirmed a total of over VT 500 million worth of outstanding VAT revenue which were written off in 2019 and further review will continue in 2020 for further write-off.

Amongst all other factors, the following were seen to be the main reasons why the government still has not fully addressed its outstanding revenue. They include:

- I. A lot of the current outstanding debts have exceeded their status of limitation validity
- II. Accumulation of penalties and lack of stringent compliance effort from both the Departments as well as tax payers has contribute to ongoing accumulation of outstanding's
- III. Companies have closed down or liquidated and company owners may have already left the country or died and the taxes are still recorded as outstanding.

The National Write off Committee will need the ongoing support of higher authorities to ensure they can continue to address the backlog of outstanding revenue. In the past, a National Revenue Review Task force have significantly helped the Ministry of Finance in its effort to address the backlog of outstanding revenue.

As is always the case, the implementation of all approved Government expenditure programmes and activities for the budget year depends on its revenue collection. The Government will continue to boost its revenue collection by strengthening the administration, compliance and enforcement of its existing taxes through the implementation of modernised laws as well as newly introduced fees and charges to boost its revenue collection efforts.

#### ***G. Expenditure Programme and Policies***

In 2021, the Government will continue to ensure that there is enough revenue and sufficient cash flow to fund Government expenditure programs, activities and policies that fall in line with the 2021 Budget Policy Priorities. These expenditure programs and activities will also include donor funded project for 2021. Therefore, the Government will continue to ensure that both Government and Donor financing is finalised, appropriated and implemented in line with the Public Finance and Economic Management Act (CAP 244).

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

In 2021, the Government and Donor financing will fund NPPs that are related to the seven priority outcomes that were stated in the 2021 Budget Policy Priorities. These budget policy

priorities will guide the allocation of financial resource and finalisation of the 2021 budget appropriation.

However, the NPP proposals will be considered only if they have been approved by the head of the agency and submitted in the Government financial management systems with supporting documents. In addition, NPPs must be:

- able to be accommodated within the overall aggregate fiscal envelope;
- accompanied by well-researched and detailed proposals to reinforce the Government's key policies, programs and activities;
- 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
- Financially sustainable (if the activity is to become recurrent).

## 5. Economic and Fiscal Targets for 2021

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

2021 Economic and Fiscal Targets	Long term economic objectives
<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 23.0 per cent of GDP	There is a broad revenue base with sufficient revenue to meet the balanced budget objective. Recurrent revenue growth rate must be higher than the expenditure growth rate.
<b>Expenditure</b> Recurrent expenditure is forecast to be at least 23.0 per cent of GDP	Expenditures are consistent with the balanced budget objective.
<b>Debt</b> Maintain Net Present Value (NPV) of external debt at a maximum of 40 per cent of GDP.	The Nominal Public and Publicly Guaranteed Debt-to-GDP ratio remains below 60 per cent associated with disaster and climate change related risks.
<b>Economic Growth</b> Forecast Real GDP Growth rate of 4.0 per cent	The annual average economic growth rate is higher than the population growth rate.
<b>Inflation</b> Inflation forecast to be within its target range of 0-4 per cent.	The annual inflation rate remains below 4.0 per cent.



## **6. Conclusion**

Given the current situation of COVID-19 and TC Harold, Budget 2021 will continue to put more emphasis in sustainable and inclusive economic recovery to enhance economic growth, as well as raising the level of service delivery to improve wellbeing for all the people in Vanuatu. In 2021, the Government will continue to increase revenue collection and at the same time work collaboratively with its development partners to fund Government expenditure programs and activities that were in line with the seven budget policy priority outcomes in this budget policy statement. Therefore, it is imperative that the Government continues to ensure that adherence to this Budget Policy statement in order to accomplish its 2021 economic and fiscal targets. At the same time, this will create pre-conditions for attaining the Government's long-term economic objectives, leading to an overall realisation of the People's Plan 2030.