

**Government
Of the
Republic of Vanuatu**

BUDGET 2011

VOLUME 1

FISCAL STRATEGY REPORT

**INCORPORATING THE ECONOMIC AND FISCAL UPDATE AND THE
BUDGET POLICY STATEMENT**

Forward by the Minister

The Government's 2011 Budget is presented to Parliament amidst a tight financial position, the like of which hasn't been experienced since 2005. To date, evidence suggests that Vanuatu's economy – which has thrived over the last seven years – has experienced difficulties in its revenue collections and a slowdown in economic growth. Our main sector of tourism has been affected deeply and output from both the industrial and services sectors have experienced slower growth.

However, reflecting the recent commencement of a number of large infrastructure projects, a pick-up in economic activity is underway. These infrastructure projects, once completed, are expected to build on the supply side reforms the Government (in partnership with donors) has implemented over the last ten years. These are positive developments, which will promote future growth, and will help shelter us from future uncertainties.

Nevertheless, we now face exceptional risks. In recognition of this and, in line with my duty as Minister of Finance to comply with the Principles of Responsible Fiscal Management as required by the Public Finance Act, the 2011 Budget has been designed to deliver a more prudent budget. The projected budget is indeed needed to help buffer the risk of an extended fall in revenue resulting from reduced economic activity. It covers other risks and contingent liabilities that may also arise over 2011, including natural disasters.

What this means, however, is that Ministries must operate within their appropriated budget ceilings; guard their resources; avoid wasteful or frivolous expenditure; and look to their own budgets first before requesting supplementary or additional appropriations. The Ministry of Finance and Economic Management, is taking a hard line against supplementary appropriations this year. So far, we have been experiencing impacts of the global economic crisis but this will be worse should all ministries requesting supplementary simply for consumption rather than investments

Budget 2011 is presented to you at a turning point. The world is now at the recovery phase of the recent global economic crisis. We are a small, vulnerable economy. Sound financial management of public resources, and appropriate investment of public donor resources to strengthen our economy, has never been as important as it is now. We are however, optimistic about what the future holds for Vanuatu. Against this backdrop and prospects and it is my honor to commend to the Parliament the Budget for year 2011.



Hon. Sela Molisa
Minister of Finance and Economic Management



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1. Fiscal Responsibility Statement

The following commentary and financial statements are presented in terms of Sections 9, 10, 11, 13, 14, 17, 18, 23 and 24 of the Public Finance and Economic Management Act 1998 (the Act). These sections require the tabling of a fiscal strategy report, current year fiscal update and economic and fiscal update at the time of the introduction of the first Appropriation Bill for the forthcoming year.

This report presents updated fiscal and economic forecasts for the fiscal year (2010) and examines the economic outlook and financial projections for the country up to 2013.

This Fiscal Strategy Report, required under Section 11 of the Act is consistent with the Budget Policy Statement that was released last year as required by Section 10 of the Act. The policies contained within the Budget Policy Statement have been used to prepare the 2011 Budget. The Act requires that the Budget Policy Statement be tabled in Parliament. Therefore, the Budget Policy Statement, as previously published, is presented in this report.

Statement of Responsibility

There have been no significant changes to the Government financial and economic policy or in the Government's strategic priorities since the Budget Policy Statement was published.

Pursuant to Sections 11, 13, 14, 17, 18, 23, and 24 the Government confirms that the fiscal policy objectives, priorities and intentions are consistent with the Principles of Responsible Fiscal Management specified in section 22 of the Act and that there is broad consistency with the Budget Policy Statement published earlier this year.



Honourable Sela Molisa
Minister of Finance &
Economic Management



George Maniuri
Director General
Ministry of Finance &
Economic Management

2. Budget Overview

2.1. Budget Overview

Vanuatu's economy continued to expand at a healthy pace through 2010, led by private sector growth and supported by sound macroeconomic policies. GDP growth is forecast to be 3.0 per cent in 2010.

The Government recognises that Vanuatu is not immune to external economic developments. Indeed the 2010 growth is a downgrade, as expansion of 4.6 per cent had been projected at the start of the year. Nevertheless, the fact that Australia – Vanuatu's leading export market for services – has avoided both recession and rapidly rising unemployment has mitigated the shock somewhat. Indirectly, ongoing success in the emerging Asia markets led by China and India has also been a positive influence for Vanuatu's economy. In addition, news that the economies of major European countries (France and Germany and Japan in Asia), have exited recession and returned to growth. This has been reflected in Vanuatu's GDP forecast for 2011, which has been revised upwards from 4.0 per cent at budget to 4.2 per cent current. The expectation is that this will lead to higher than expected fiscal revenues in 2010.

The pursuit of higher and sustainable economic growth is the Government's leading policy aim, and is articulated in the overarching *Priority Action Agenda (PAA)* and the related *Planning Long Acting Short (PLAS)* policy matrix. The PLAS was launched in March of 2009 and sets out the Government's policy priorities through to 2012. Higher levels of economic growth, with appropriate government action, will secure tangible benefits across the country for all the people of Vanuatu. For the Government, this necessitates improved and more efficient service delivery. Ensuring that children are healthy and properly educated will add to the level of human capital in Vanuatu, thus making for a more productive workforce in the future, which is capable of driving economic growth higher. In addition, the Government is encouraging the promotion of business friendly policies, which facilitate private sector development.

As a measure of the Government's eagerness to improve social outcomes, the education and health sectors will in 2011 both obtain significant funding boosts through New Policy Proposals (NPPs) and donor support.

Finally, in maintaining the institutions of governance the Government is committed to contribute on a phased basis towards funding the new court house and a contribution towards the new State Law building in 2011.

The Government will deliver its NPP commitments within a fiscally responsible framework. Consequently, it is expected that over the medium-term domestic financing may have to be exploited to restore the budget balance with external financing being used to fund projects with a financial return and thereby maintain or enhance the Governments overall net worth.

3. Economic Update and Projections

Overview

The on-going recovery in the global economy which began towards the end of 2009 has taken some time to flow through to the Vanuatu economy, with household consumption and business investment remaining subdued throughout most of 2010. This development, coupled with decline in visitor arrivals is expected to result in an easing in growth in 2010. However, the impact of the slowing household consumption, investment, and tourism is expected to be partially offset by an increase in the agriculture, forestry and fishing sector.

Overall, Vanuatu's economic growth is projected to ease from 4.0 per cent in 2009 to 3.0 per cent in 2010, before accelerating to 4.2 and 4.5 per cent in 2011 and 2012, respectively. The pick-up in activity in 2011 and 2012 largely reflects the anticipated commencement of a number of large infrastructure projects. In addition, private investment which slowed throughout most of 2010 is showing tentative indications that a recovery in investment is underway.

In line with the recovery in the global economy, commodity prices have risen. As a result inflation is expected to increase to around 4.0 per cent in 2010, before easing to 3.2 per cent in 2011.

The Current Account Deficit (CAD) is projected to be 3.0 per cent of GDP in 2010, unchanged from the previous year, before widening to 3.2 per cent in 2011 and 3.4 per cent in 2012. The relatively low CAD projection in 2010 largely reflects a decline in imports as a result of household and investors scaling back on expending plans as uncertainties surrounding global economic developments persist. The widening in the CAD over the projection years reflects the anticipated pick-up in private domestic demand associated with the recovery in household and business investment. The growth in imports is expected to outpace the projected increase in tourism services exports in 2011.

The risks to the outlook are on the downside, given that there are still uncertainties concerning the sustainability of the global economic recovery. In particular, concerns remain pertaining to recent financial markets turbulence in the Euro area affecting confidence about the future sustainability of fiscal stimulus. Moreover, unexpected bad news in the financial sector could have negative consequences on household and business confidence which in turn could see a slowing in consumption and investment. Finally, given that the outlook is being underpinned by a number of large construction projects, any unforeseen delays in their commencement will see growth shift into the following projection years.

3.1. World Economic Outlook

According to the International Monetary Fund (IMF), the global economy recovered strongly throughout the first half of the year, thanks mainly to robust growth in emerging Asia. Indicators of real economic activity were strong as industrial production and trade rebounded positively. In addition, consumer confidence showed signs of recovery and growth in employment has occurred in most advanced economies. However, since the middle of 2010, concerns about the European sovereign debt and uncertainties around the impacts of managing fiscal consolidation across the advanced economies when global growth is still fragile; has caused a slow down in recovery. Despite this development, the IMF expects world growth to increase by 4.8 per cent in 2010, before moderating to 4.2 per cent in 2011 (Table 1). The easing pace of growth in 2011 is in line with the expectation that the slowing that has occurred the middle of 2010 will continue into the first half of 2011. Table 1 below lists GDP

growth projections for a selected number of economies, including Vanuatu's major trading partners (Australia, New Zealand, Japan and the Euro Area).

Table 1: International GDP Growth Forecasts (a)

	Actuals		IMF Projections(b)	
	2008	2009	2010	2011
World economy	2.8	-0.6	4.8	4.2
Advanced economies	0.2	-3.2	2.7	2.2
United States	0.0	-2.6	2.6	2.3
Euro area	0.5	-4.1	1.7	1.5
Japan	-1.2	-5.2	2.8	1.5
Australia	2.2	1.2	3.0	3.5
New Zealand	-0.1	-1.6	3.0	3.2
Emerging and developing economies	6.0	2.5	7.1	6.4
China	9.6	9.1	10.5	9.6
India	6.4	5.7	9.7	8.4

(a) Year average per cent.

(b) Source: International Monetary Fund, World Economic Outlook (WEO), October 2010

Robust although moderating global growth is expected to continue led by the emerging and developing economies (in particular China and India), while the advanced economies (such as the United States and Japan) are projected to ease. The expansion of output growth in the Australian and New Zealand economies is expected to accelerate in 2011.

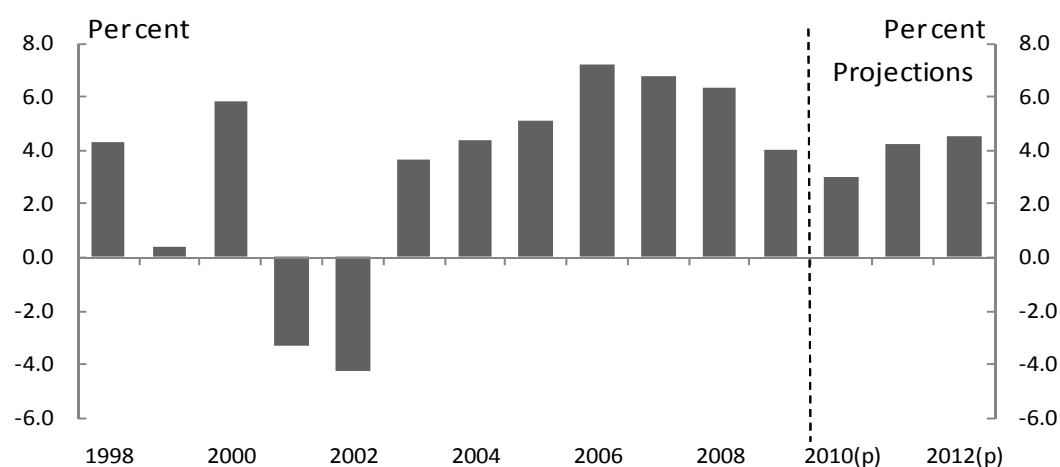
The medium term outlook remains on the upside from 2011 but with output growth expected at a slower rate than the original forecasts. The outlook is consistent with robust global growth led by the emerging and developing economies but with different pace and drivers. Accordingly, global growth remains favorable for many developing countries as well as for commodity producers in all regions. Careful policy responses and stronger focus on key fundamentals are helping to repair financial sector balance sheets and attract capital flows. The ongoing rebound in global trade will also support recovery in many developing and emerging economies.

Nevertheless, uncertainties associated with the recent financial market turbulence in the Euro area remains and are expected to affect confidence about the future sustainability of fiscal stimulus, policy responses, and future growth prospects. Funding pressure reemerged as concerns about sovereign risks spilled over to the financial sector in Europe. The possibility of such risks spreading through the interbank markets remain high and coinciding with uncertainties in policy responses, pose further threats to global economic recovery.

3.2. Vanuatu's Economic Outlook

Following strong economic growth in recent years, growth in Vanuatu is expected to moderate from 4.0 per cent in 2009 to 3.0 per cent in 2010, before accelerating to 4.2 per cent in 2011. The slowdown in 2010 reflects slower growth in both the services and industrial sectors. On the other hand, a pick-up in growth in the agriculture, forestry and fishing sector is anticipated to partially offset the slowdown in the services and industrial sectors in 2010. The acceleration in the pace of growth through 2011 and over the medium term is largely being underpinned by the commencement of a number of public and private funded infrastructure projects. These projects, once completed, are expected to build on the supply side reforms the Government (in partnership with donors) has implemented over the last ten years which has resulted in a marked rise in Vanuatu's GDP per capita outcomes (see Box 1).

Figure 1: Real Annual GDP Growth



Source: Ministry of Finance and Economic management

Increasing commodity prices arising from the ongoing global recovery has resulted in an increase in the rate of growth in the agriculture and fishing sector (in particular, the production and exports of copra and beef over the first half of 2010). However, this development is being outweighed by the decline in the rate of growth in the services and industrial sectors, consistent with the decline in visitor arrivals over the first eight months of 2010, as well as slow expansions in both household consumption and business investment. Moreover, infrastructure projects that were initially anticipated to commence in 2010 have been delayed, resulting in an overall slowdown in growth in 2010.

However, the infrastructure projects that were postponed in 2010 are now expected to start in 2011. This has resulted in growth in the industrial sector being shifted ahead one year from now. Furthermore, recent indications are that a pick-up in private investment is underway with the commencement of a large retail as well as a few commercial and residential projects. Coupled with a number of large donor funded projects, investment is expected to support strong growth in the construction sector in 2011 and in 2012. Additionally, the commencement of the tourism advertisement campaign coinciding with the appreciation of the Australian dollar could see activity solidify in this sector. The key economic projections are summarised in Table 2.

Table 2: Major Economic Indicators (a)

	Actual	Estimate	Projections			
	2008	2009	2010	2011	2012	2013
Agriculture, fishing & forestry	3.8	1.0	3.0	2.2	2.0	2.0
Industry	15.5	13.7	2.0	8.8	12.6	7.0
Services	4.3	4.3	2.6	3.9	3.8	3.7
Real GDP	6.3	4.0	3.0	4.2	4.5	4.0
Nominal GDP	12.5	8.0	6.7	7.3	7.8	7.3
Consumer price index (b)	5.8	2.3	4.0	3.2	3.0	3.0
Current account balance (c)	-6.4	-3.0	-3.0	-3.2	-3.4	
Months of import cover (goods & services)	4.5	5.0	4.6	4.0	4.0	

(a) Annual percentage change

(b) Year-ended percentage change, 2008 figure is an actual outcome

(c) Expressed as a per cent of nominal GDP

Box 1: Latest Estimates of Vanuatu's GDP per Capita

Every ten years, the Vanuatu National Statistics Office (VNSO) conducts a national census in order to gather key demographic and social indicators on Vanuatu's population. This information is important as it is used by the Government for planning and decision making purposes. Moreover, it is also crucial for monitoring Vanuatu's economic progress. In August 2010, the VNSO released preliminary results of their 2009 census.

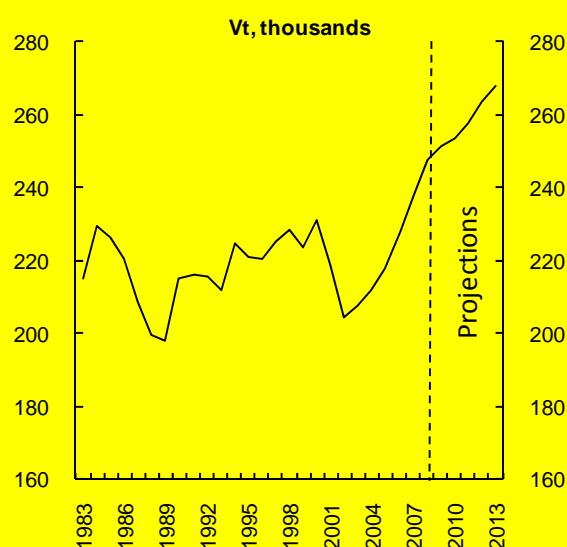
According to their estimates, Vanuatu's population in 2009 was around 234,000. This finding implies that Vanuatu's population grew on average, by 2.3 per cent per year since the last census in 1999; which is slightly slower than 2.7 per cent growth per annum recorded between the periods of 1989 and 1999.

One of the Government's objectives (as outlined in the 2011 Budget Policy Statement) is to manage the economy in such a way that it grows at least in line with the population growth to ensure that ni-Vanuatu enjoys a healthier and wealthier living standards. A comparison of the population and economic (or GDP) growth over the same period shows that Vanuatu's per annum GDP growth rate was 3.5 per cent over one and half times higher than its population growth rate. As a result, Vanuatu's real GDP per population (or per capita) rose markedly from VT 218,600 in 2001 to VT 251,600 in 2009 (or US\$ 1,490 in 2001 to US\$ 2,384 last year, a 60 per cent increase). Moreover, it is now at its highest level since independence (Chart A). Therefore, not only have living standards been maintained over the last decade, they have risen strongly over this period.

Much of this improved economic performance since 2002 can be attributed to a number of factors such as political stability, improved public financial management, and deregulation of the airline (in 2005) and telecommunication industries (in 2007-2008).

GDP per capita over the next few years is projected to be maintained largely reflecting ongoing reform measures being implemented by the Government (with assistance from donors). Measures such as the construction of roads in outer islands, the new wharf rehabilitation, telecommunications submarine cable, the Vanuatu Transport Sector Program and the inter-Island Shipping Program.

Chart A: Real GDP per capita*



Source: Vanuatu National Statistics Office and Treasury

*Note: GDP per capita is indicator of the average standard of living of individual members of the population. As such it does not reflect the actual distribution of national income. Nonetheless organisations such as the IMF and World Bank use this indicator to monitor economic progress.

3.3. *Agriculture, Fishing and Forestry*

Based on partial indicators, the agriculture, fishing and forestry sector is expected to register positive growth in 2010, following low growth in 2009. The growth in 2010 is anticipated to occur across most commodities (in particular production of coconut oil, copra, beef, cocoa, coconut meal and export of live fish).

The improved growth prospects for the **coconut** industry are being driven by a recovery in the price of copra which has risen from VT 31,000 per ton (early part of 2010) to the current price of VT 41,000 per ton. The increase in the price of copra is a result of rising international demand for commodities (such as copra) following the recovery in the global economy. Another significant development in the coconut industry was the establishment of new coconut oil mills. The combined effects of these developments saw exports of coconut oil and coconut meal for the second half of 2010 reached a level above that recorded in the first half of 2009. The outlook over the medium term for copra production is to be further supported by improvements in hot air driers and transport. However, the outlook for copra in the long run remains vulnerable to ageing stock of coconut trees.

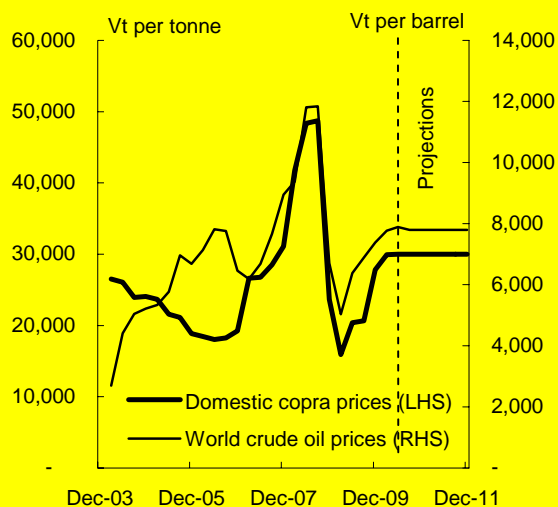
Box 2: Outlook for Copra Prices

Copra is widely utilised as a source of energy (mainly as an input to biodiesel production). As a result, it is an alternative source of energy to other fuel commodities such as crude oil, which is the most widely used source of energy. Therefore, any changes in the price of crude oil will generally result in corresponding movements in copra prices. Chart A confirms this relationship to hold since 2007. However, between 2003 and 2006, there appears to be an inverse (or negative) relationship. Possible explanations for this divergence may be attributable to specific global developments in coconut sector. However, the global prices of refined coconut oil (a much closer proxy) is inconsistent with movements in domestic copra prices (Chart B).

Nonetheless, despite this apparent divergence, econometric analysis confirms that over the 2003 to 2010 period, a positive relationship existed between price series. A 10 per cent increase (decrease) in world crude oil prices translating (on average) to a 7.0 per cent increase (decrease) in domestic copra prices.

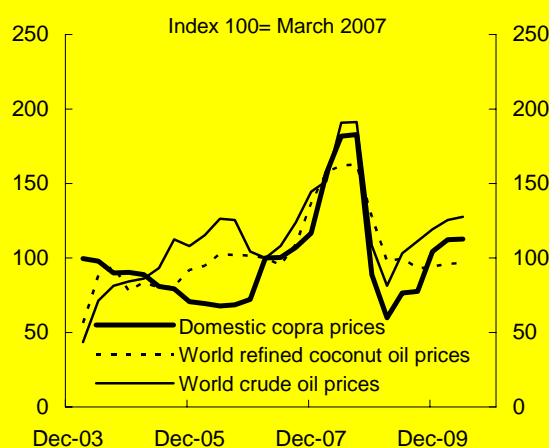
The International Monetary Fund (IMF) is projecting that the world crude oil prices to more or less remain at around Vt 7,800 (or US\$78.75) a barrel in 2011. Assuming that the IMF forecasts for crude oil is realised and barring any unforeseen circumstances, the domestic copra prices is projected not to fall below the level of VT 28,000 a ton in 2011.

Chart A: Copra (crushed) and crude oil prices^{^*}



*Note: Projections are based on an exchange rate assumption of 98 Vatu per US dollar.

Chart B: Copra (crushed), crude oil, and refined coconut prices[^]



[^]Source: Vanuatu National Statistics Office and International Monetary Fund.

Total **beef** production in 2010 is estimated to be higher than its 2009 level. This is due mainly to increasing international demand especially Japan and Papua New Guinea, (who are Vanuatu's biggest markets) as well Australia and the Solomon Islands. In addition, robust local demand for beef is also contributing to the rise in beef production. Total beef exports for the first half of 2010 reached 619 tons. This compared to 463 tons in the first half of 2009. The outlook for beef production in the medium-term is to maintain steady growth.

Cocoa production is anticipated to increase in 2010 due to a rise in smallholder farms as well as improvements at the Metenesel cocoa estates. The reopening of Metenesel estate with plans of diversification is also expected to boost cocoa production, even though there are issues of low yield due to old trees. The improving prospects of the cocoa industry is reflected in the quarter two 2010 exports data of 929 tons compared to the average of 370 tons in 2009.

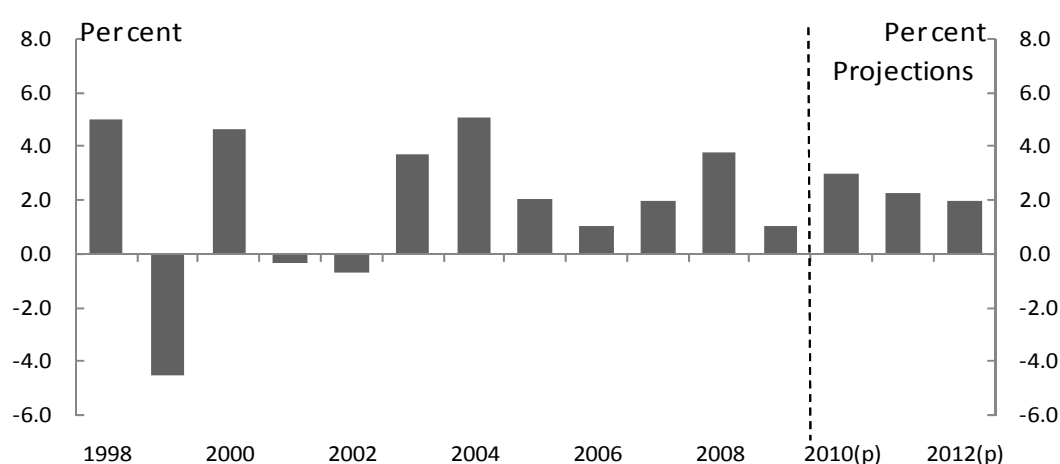
Kava production (according to the Agriculture Department) remains high with the domestic market maintaining a large market share. However, overall production is anticipated to decline due to the recent introduction of the high price floor of VT 1,000 per kilogram (kg) imposed on buyers. In addition, the devaluation of the Fiji dollar in April 2009 has made Vanuatu kava more expensive and as such impacted on kava exports to Fiji.

The export of **live fish** is contributing to the export sector. Total export of live fish estimated for 2010 is expected to be higher than that recorded in 2009. This growth was based on recent statistics showing solid increases in the first and second quarters of 2010 with 47 tons and 45 tons respectively.

The share of **coffee** production consumed domestically is about 80 per cent while 20 per cent is exported. The coffee industry is expected to record an increase in production in 2010 due to increase in the number of plants in recent years and improved access to financial services. The financial assistance and micro-loans provided by the Department of Cooperatives, has resulted in increase production of coffee. The outlook is for production to remain solid with annual increased in the number of new farms.

Rice production in Vanuatu has increased recently following interest from farmers in this promising product. According to the Department of Agriculture, rice production in 2010 has reached 60 tons, mostly from Tanna, Santo, Malekula and Ambae. Rice production is expected to hit 70 to 80 tons between 2011 and 2012.

Figure 2: Annual Agriculture, Fishing and Forestry Growth



Source: Ministry of Finance and Economic management

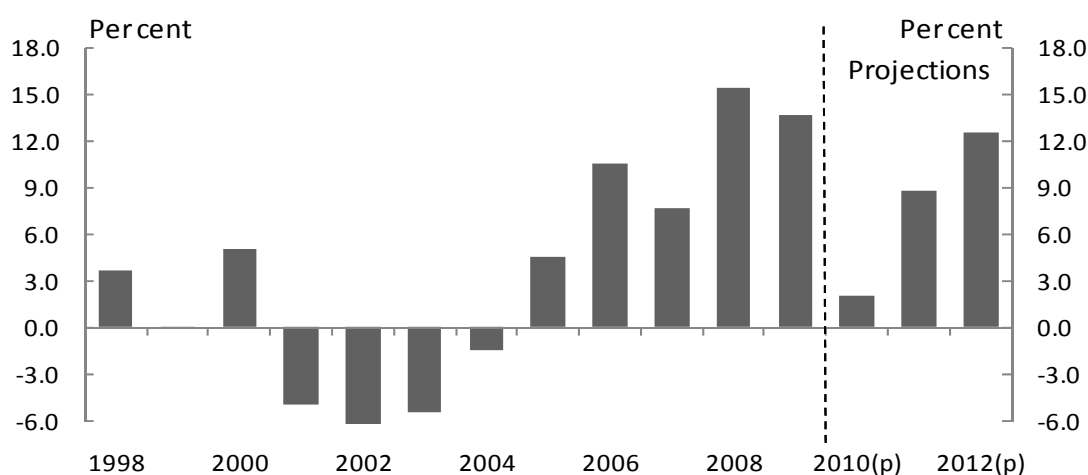
3.4. Industrial Sector

Following an estimated growth of 13.7 per cent in 2009, growth in the Industrial Sector is anticipated to ease to 2.0 per cent in 2010. In 2011 and 2012, growth is projected to accelerate to 8.8 per cent and 12.6 per cent respectively.

The slowdown in growth in the Industrial sector this year is in line with developments in the construction sector. After averaging strong growth in excess of 10 per cent since 2005, growth in the construction sector is expected to ease in 2010. The negative growth is largely due to the delay in the commencement of privately and publicly funded construction projects which is also consistent with the slowing in imports of construction materials and the weak growth in lending to the construction sector.

However, most of the projects that were initially expected to commence in 2010 have now been shifted to 2011 and 2012 (Figure 3.0). Moreover, construction activities are expected to be boosted by a number of new projects such as the submarine cable telecommunications project (SPIN) and the Port Vila wharf rehabilitation as well as privately funded projects (such as the Tana Russet shopping centre located in Melcofe, the White Sands sub-division and the Akiriki resort).

Figure 3: Real Annual Industrial Sector Growth



Source: Ministry of Finance and Economic management

Growth in the manufacturing sector is expected to remain solid in 2010 and 2011 supported by the re-opening of the oil mill in Luganville in 2010. Growth in this sector is expected to be driven by the schedule opening of new oil mills scheduled to open towards the end of 2010 (such as the one in Epi and in Efate).

3.5. Service Sector

The subsequent effects of the downturn in the global economy, combined with the decline in tourism arrivals is expected to result in growth in the service sector moderating from an estimated 4.3 per cent in 2009 to a 2.6 per cent in 2010. However, following improving conditions in the global economy, commencement of a new tourism advertisement campaign, and the reinstatement of the Melbourne route;

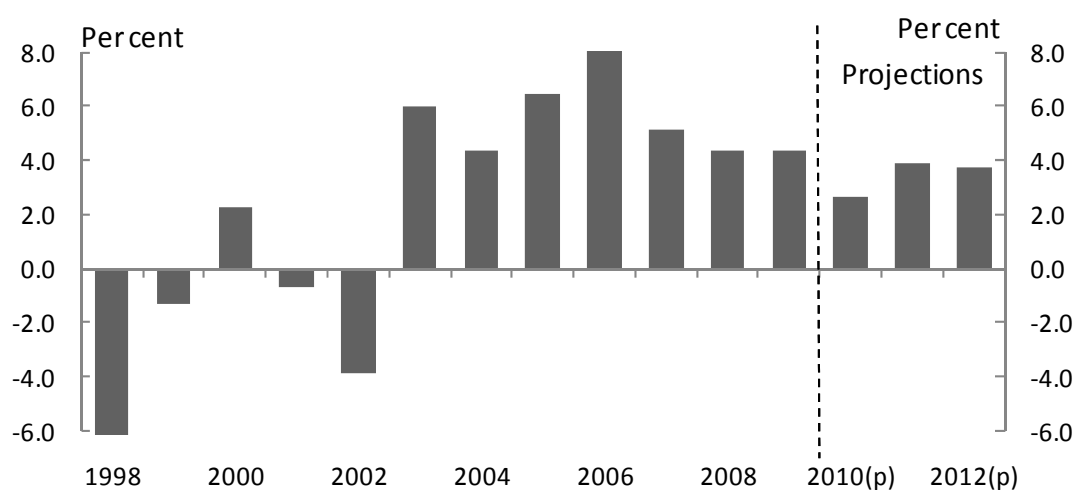
the combine effects of these activities is expected to boost growth in this sector to 3.9 per cent in 2011 (Table 2).

The projected slowdown in 2010 is expected to occur across all components that make up the service sector with the other wholesale trade, retail trade, accommodation and food services, real estate and finance and insurance sectors experiencing the largest declines in growth.

Growth in the tourism related sectors have been very weak compared to 2009. The weaker than anticipated growth in visitor arrivals is being attributed to a number of factors –see Box 3 for detail discussions. However, activity in this sector is expected to recover in 2011, reflecting the implementation of a new advertising campaign by the Vanuatu Tourism Office (VTO) combined with low airfares from and to certain destination by Air Vanuatu. However, capacity constraints (in terms of the number of beds) especially during peak seasons are likely to hamper growth in visitor arrivals over the coming years.

Indications are that consumer and business confidence have been negatively affected by the global slow down, coupled with the weak visitor arrival numbers; saw very weak import volumes and lower than anticipated collection of VAT and Duty collections over the first half of this year. These developments are expected to see a slow down in other wholesale and retail sector (which is an indicator of domestic consumption). Activity in these sectors is expected to improve in the medium term following improvement in the world economy and recovery in visitor arrival. As a consequence, growth across almost all components of the service sector (particularly in the other wholesale trade, retail trade and accommodation and food services) is projected to increase in 2011.

Figure 4: Real Annual Service Sector Growth



Source: Ministry of Finance and Economic Management

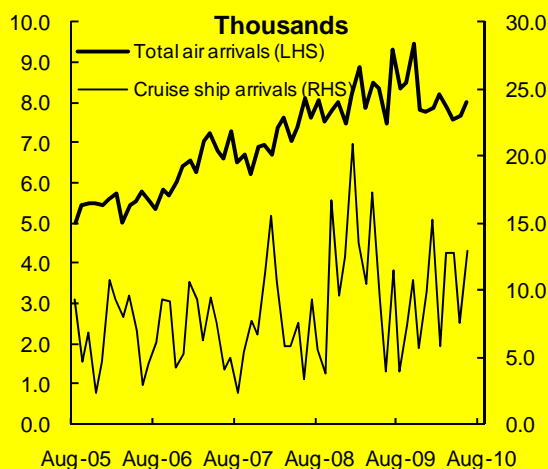
Box 3: Latest trends in Visitor arrivals

Between 2005 and middle of 2009, visitor arrival numbers (for both air and cruise ships) were strong. However, since then, arrival numbers (in particular via air) have been weak (Chart A).

The weaker than anticipated growth in visitor arrivals is being attributed to lower airfares and accommodation in other travel destinations that are in close competition with Vanuatu. Reports are that Fiji in particular has heavily discounted travel and accommodation fares (including devaluing the Fiji dollar) in an attempt to regain its market share from Vanuatu. Moreover, the recovery in the level of disposable income from countries such as Australia (makes up a large share of Vanuatu's tourist arrivals at around 60 per cent) coupled with the strong the Australian dollar saw a shift in holiday destinations by Australian travellers from less expensive short haul destinations such as Vanuatu, to more expensive long haul destinations like the United States (Chart B).

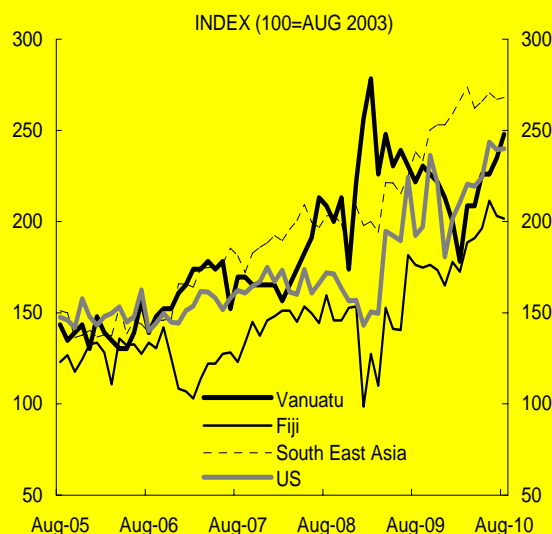
Since the beginning of the second quarter of 2010, arrival numbers from Australia to Vanuatu have began to rise. This increase appears to be at the expense of Asia, which saw a levelling-out in arrival numbers from Australia. Going forward, reflecting the commencement of a new marketing campaign undertaken by the Vanuatu Tourism Office (VTO) coupled with low airfares being introduced Air Vanuatu, tourist arrivals is expected to increase in 2011.

Chart A: Visitor arrivals



Source: Vanuatu National Statistics Office.

Chart B: Australian Visitor arrivals to the rest of the world



Source: Australian Bureau of Statistics.

The Government vision of investing in people by the introduction of the Universal Primary Education (UPE) program has alleviated parental burdens financially. According to a recently conducted survey; enrolments mainly in rural areas have shot up. However, there are real challenges in terms of capacity constraints, shortage of teachers and the quality of education taught.

Moving on to health, aid funded projects on public health vector borne diseases such as malaria is currently been undertaken in the rural areas and they are expected to improve the health of Ni-Vanuatu.

The Government's commitment to embark on these important services will also result in Vanuatu achieving the Millennium Development Goals (MDG) by 2015.

The on-going deregulation of the telecommunication industry should continue to underpin growth in the telecommunication sector and in other sectors of the economy. The recent increase of number of internet providers will in turn allow competition in this sector and expected to drive prices down. The end result will be a faster and wider coverage for consumers and businesses.

The global downturn has also caused Australia and New Zealand house prices and disposable incomes to fall which in turn saw a slowing in the real estate sector and to a lesser extent the financial services sector in 2010. However, the ongoing recoveries in the Australian and New Zealand economies have seen an increase in property prices in Australia and New Zealand. This coupled with favourable exchange rates is expected to spill over to the domestic economy, particularly in property investment. As a result both the real estate and construction sectors are expected to record solid growth in 2011 and the medium term.

3.6. *Monetary Developments*

The Reserve Bank of Vanuatu (RBV) is responsible for the formulation and implementation of monetary policy. The monetary policy stance of the Bank has been maintained at a rediscount rate of 6.0 per cent since December 2008, when the Bank revised its monetary policy tools to address the tight liquidity situation in the banking system. Recently, liquidity in the banking system has increased significantly beyond the level considered adequate. Therefore, the RBV responded by mopping up this excess liquidity through an increase in its Statutory Reserve Deposit requirements.

On the Bank's monetary policy targeting, the year on year inflation eased to 2.7 per cent during the June quarter 2010, from 2.8 per cent in the March quarter. However, domestic inflation is expected to pick up towards the upper end of the Bank's target range towards the end of the year, driven by higher import costs and the impact of excise tax changes. Official reserves have reached VT14.7 billion as at the end of September, which was sufficient to accommodate for approximately 6.1 months of import cover. Official foreign exchange holdings are forecast to remain well above the minimum comfortable threshold of four months of import cover throughout the remainder of the year, although holdings are expected to come under increasing pressure as imports increase from the low levels recorded during the first half of the year.

Commercial banks' liquidity¹ increased substantially during the first and second quarters of 2010. The increase was due to the transfer of government deposits from a government account at the Reserve Bank to a commercial bank and most recently reflecting the RBV's conduct of its open market operations, bringing down the level of excess reserves to VT2.7 billion. However, the level was still above the amount the RBV considered appropriate given its analysis of the financial system and the wider economy.

The growth in excess reserves reflected the slowdown in lending as commercial banks tightened their lending practices, and the deterioration in the government's net credit position in the banking system. From the 1st of August, the RBV relaxed some of its monetary stimulus through the increase in the SRD requirement of commercial banks by 1.0 per cent to 6.0 per cent. Despite the increase in the SRD ratio, excess reserves have remained at elevated levels; as at end August, excess reserves were recorded at almost VT2.6 billion. The increase in the excess reserves of commercial banks can be attributed to

¹ Consists of commercial banks' excess reserves and holdings of RBV notes with the Reserve Bank

(i) the decline in outstanding RBV notes (ii) the deterioration in the governments net position with the Reserve Bank (iii) net inflows of foreign exchange and (iv) the offsetting effect of the decline in currency in circulation from seasonally high level in July.

Private sector credit², which makes up the largest share of domestic credit, recorded increases of 2.6 per cent and 3.3 per cent in the first and second quarters respectively. In year-on-year terms, growth slowed to 12.6 per cent in the first quarter and 13.4 per cent in the second quarter, as compared to 20.3 per cent recorded at the end of 2009. The growth in private sector credit during the first and second quarters of 2010 was mainly due to increase lending to individuals and households, partially offset with slow down in lending to businesses. In August 2010, private sector credit declined by 0.6 per cent from July to VT42,732.9 million. The annual growth rate moderated to 11.0 per cent in August from 14.5 per cent over the year to July. The month-on-month decline could be partly explained by the increase in the Statutory Reserve Deposit (SRD) requirements at the beginning of August. Growth in private sector credit has continued to slow progressively since 2009, as commercial banks tightened their lending standards, as can be seen in the improvement in the proportion of high-quality loans.

The Government's net credit position vis-à-vis the banking system improved in the first quarter of 2010, due to an accumulation of government deposits held with both the commercial banks and Reserve Bank. However, in the second quarter, its overall net credit position deteriorated, reflecting an increase in commercial banks holding of government bonds.

3.7. *Balance of Payments*

The balance of payments (BOP) moved in line with these developments, tempered by robust donor support during the period. The current account deficit reduced significantly, driven by inflows from services exports and official grants, including the Millennium Challenge Account transfers.

In the financial account, inflows of foreign direct investment, particularly in the real estate sector, were slow during the first half of 2010. However, overall inflows of FDI showed clear signs of recovery during the September quarter, with real estate showing a more modest recuperation. In spite of the above developments, official reserves at end September 2010 stood in a position to finance a projected 6.1 months of import, which is comfortably above the Reserve Bank's minimum target level of 4.0 months. Import cover is one of the key monetary stability objectives for the Reserve Bank, and is expressed in terms of an adequate level of foreign reserves to meet Vanuatu's balance of payments obligations.

The medium term balance of payments outlook is healthy. Increasing international demand will push up prices for key agricultural exports, which is likely to support growth in Vanuatu's export sector over the years, even with the depreciation of the US dollar against the Vatu during recent months. In addition, the appreciation of the Australian dollar against the Vatu is expected to boost tourism spending, and contribute to maintaining Vanuatu's competitiveness abroad. Imports are expected to pick up in the second half of 2010, following seasonal trends, which is likely to put downward pressure on official reserves. However, official grants are expected to help balance the strain.

² Includes data from commercial banks, Credit Corp and RBV

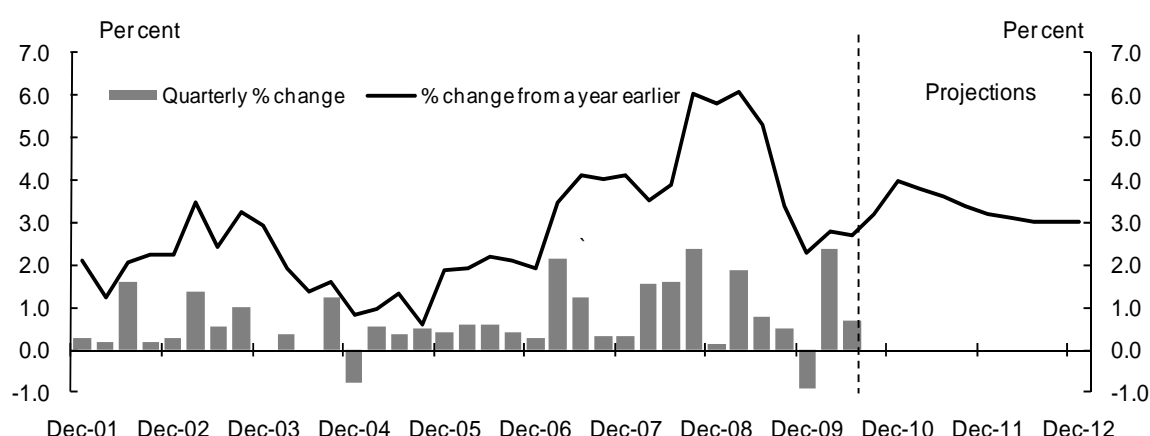
3.8. Prices

In June 2010, the Consumer Price Inflation (CPI) rose 2.7 per cent over June 2009 compared to 2.8 per cent for the year-ended March and 2.3 per cent for the year-ended December 2009. The CPI developments show an increase of 0.7 per cent during the June quarter of 2010, compared to the 2.4 per cent increase in the March quarter. The increase in the price level during the first 6 months of 2010 was partially explained by an increase in excise tax rates (effective January 2010) mainly relating to beer and wine, tobacco and various excised food items, and the high prices of seasonal vegetables and fruits. Accordingly, the major CPI components showing increases over the year include drinks and tobacco (8.9 per cent), followed by food (4.6 per cent), transport (2.6 per cent), recreation (1.9 per cent) and housing and utilities (1.7 per cent).

Partial indicators showed signs of slowing domestic demand during the first half of the year that may have contributed to a slight slowdown in price pressures, with the year-ended CPI growth rate easing in the June quarter across the major expenditure components, with exceptions to transport and housing and utilities. The negative year-end growth rate for the communication, health, household supplies and education expenditure components of CPI slightly offset the price increases in food, drinks and tobacco and transport components, implying inflation remaining subdued in the first six months.

Despite the slowing in price increases during the first half of the year, inflation is expected to increase towards the upper half of the RBV's target of 0.0-4.0 per cent range towards the end of the year. Crude oil prices, which largely determine energy prices, reached US\$78 per barrel in September 2010, supported by the weakening of the US dollar against other major currencies. Countering the impact of increased excise tax on domestic food prices in the March quarter and high prices of seasonal fruits and vegetables towards the June quarter, world prices for major import food items such as rice eased in the first half of the year. However, prices of wheat and sugar began to pick-up during the mid-year and much of the impact is yet to be reflected through to domestic prices. A further risk comes from the appreciation of the Australian dollar against the Vatu, which is likely to increase the cost of imported goods. However, a weakening US dollar may help to cushion the impact of imported inflation.

Figure 5: Inflation



Source: Vanuatu National Statistics Office and Reserve Bank of Vanuatu

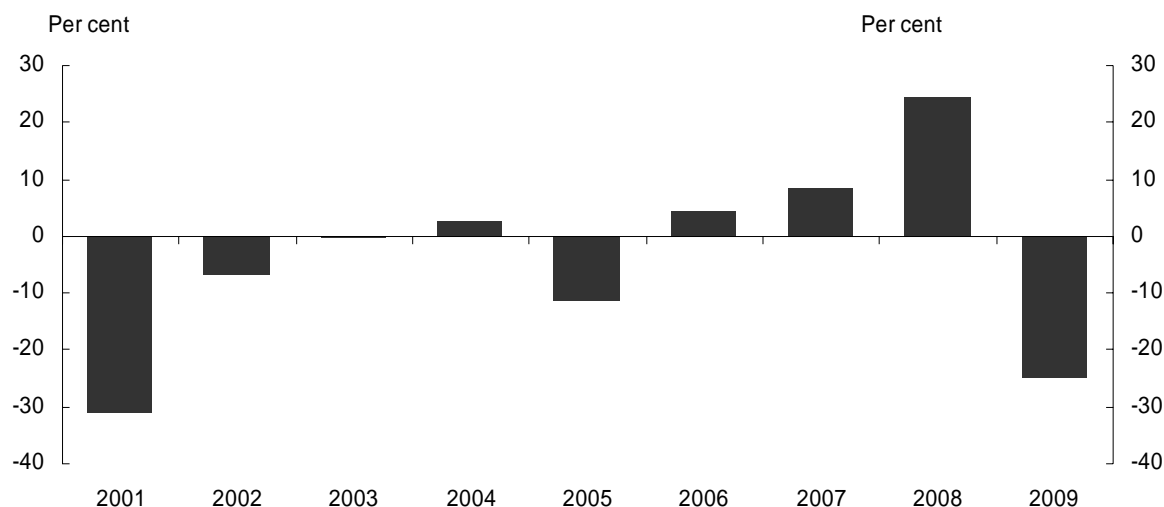
3.9. *Employment and Wages*

Over the period of 2005 through to 2008, formal employment rose in line with above average economic growth but fell in 2009. This decline can be attributed to the effects of the global economic crisis which created uncertainty and is anticipated to have caused investors and consumers to scale back on investment plans. This development in turn is expected to have led to an easing in GDP growth and as such, a reduction in formal employment. In addition, an increase in the number of Ni-Vanuatu employed in New Zealand and Australia as part of the Regional Employment Scheme may have also contributed to the decline somewhat.

The projected level of employment for 2010, according to the partial indicator from the National Statistics Office (NSO) indicates that the level of employment is likely to be contained as that in 2009, given the slowdown in the retail sector, weak tourist arrivals and very limited construction activities taking place.

The outlook for 2011 to 2012 will see a boost in the level of employment as major projects get kick started. Consistent with the moderation in economic growth and inflation, it is likely that wages will remain steady overall in 2009 before possibly falling in 2010. The likely decline in wages in 2010 may be due to decline in construction activity which appeared to be more pronounced in 2010. In addition, the combined effects of slowing household consumption and tourist arrivals (particularly at the beginning of 2010) may have also contributed to the decline in wages in 2010 in the retail sector.

Figure 6: Annual Formal Sector Employment Growth



Source: Vanuatu National Provident Fund

4. Fiscal Update and Projections

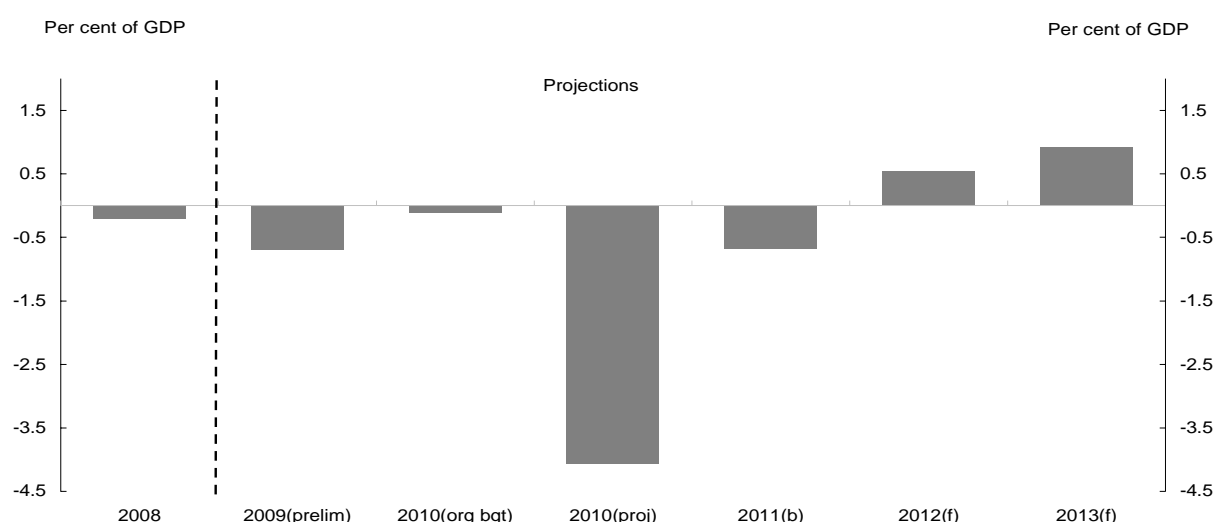
4.1. Budget Balance

The Public Finance and Economic Management (Amendment) Act 1998 obligates the Government to target a budget that maintains ‘net worth’ balanced or surplus budget. Further, the Government’s fiscal objective is to accumulate surpluses in order to reduce the stock of government debt creating fiscal space and to build reserves for times of difficulty. In line with the legislative requirement and consistent with fiscal policy, the overall budget position published in Budget 2010 predicted a slight deficit of VT 82.6 million (equal to 0.1 per cent of GDP; Figure 7). This is part of the overall strategy to return the Government budget into surplus into the medium term.

The planned expenditures for 2010 have been performing to target, it is expected that all funds appropriated for Budget 2010 will be expended by year end. On the other hand, revenue in 2010 initially anticipated recovery in growth and performance via compliance. However, towards the end of the third quarter budgeted forecasts had to be significantly revisited and revised. With three months remaining, the newly projected budget for 2010 will experience an unanticipated shortfall of around VT 2.5 billion (3.8 per cent of GDP). This is largely due to weak receipts of fiscal revenue and compliance problems.

With respect to Budget 2011, the expected position will be a slight deficit, as the Government aims to build up its depleted surpluses. In the medium-term the Government is anticipating reviewing its revenue acts, beefing up compliance and expanding its coverage across the archipelago to ensure that it retains its credibility in producing budget surpluses for future investments. Furthermore, the Government may consider the option of external financing being used to finance projects with positive rate of financial returns thereby maintaining or enhancing the Governments overall net worth.

Figure 7: Overall Budget Balance



Source: Ministry of Finance and Economic Management

4.2. Revenue 2010

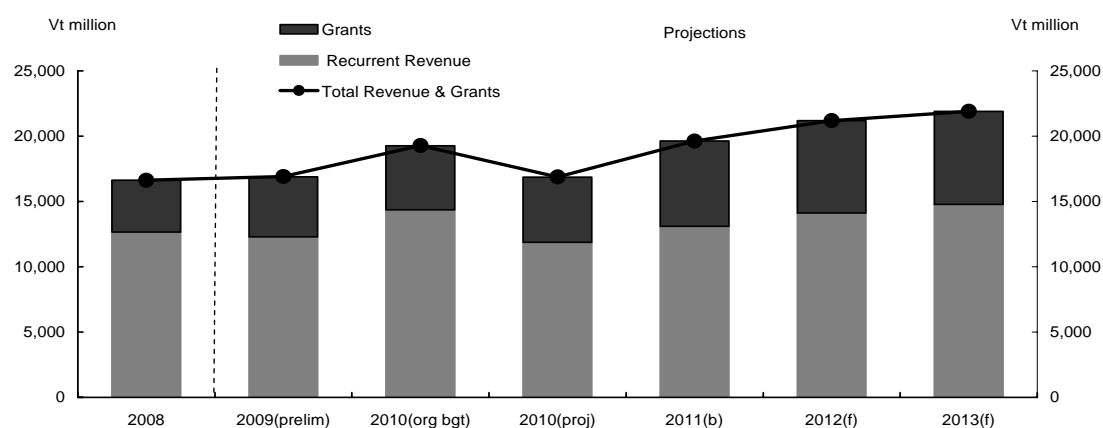
The 2010 recurrent revenue budget was projected at VT 14,579.3 million; this represents a growth of 18.6 per cent more from the VT 12,288.0 million collected in 2009. However, over the year actual collections have been significantly lower not even reaching the levels of 2008 and 2009.

The outlook since the release of the Budget Policy Statement (BPS) 2011 detected the lack of revenue performance, but with anticipation of recovery, given the level and strength of economic growth. However, the last few months have remained unchanged and with growth indicators reflecting upward trends, revenue inflows remain below par. It is expected that the current situation was also made more confusing in the eyes of the private sector following the recent changes in import duties and excise introduced in January 2010.

The Government's priority for revenue continues towards increasing coverage and to strengthen the administration of existing taxes; including in the more remote areas of the country. In addressing the tax base, the Government also aims to focus on an effective implementation and administration of new changes to excise taxes, exemptions and previous changes relating to taxes on land and other assets. These goals were to be attained by the recent allocation of additional funds to the Department of Customs and Inland Revenue for further recruitment and upgrading of the Revenue Management System (RMS).

It is now evident that with most of the year gone there will be a revenue shortfall in 2010 as compared to budget. Indeed, this has necessitated the need for more subdue revenue forecast for budget 2011. After careful analysis of individual revenue categories, it is now estimates that a projected VT 11,870.2 million of recurrent revenue will be paid into the Public Fund in 2010 (Figure 8). This is VT 2,500 million less than forecast. It is also VT 400 million lower than the recurrent revenue collected in 2009 and a further VT 800 million less than that receipted in 2008.

Figure 8: Recurrent Revenue and Grants



Source: Ministry of Finance and Economic Management

Value Added Tax (VAT) and import duty are the major components of tax revenue. Both components have been relatively weak over the last nine months of 2010. This has led to VAT target being reduced

from VT 4,803.7 million to VT 4,400.0 million and the import duty having a substantial reduction of VT 4,396.1 million to VT 2,505.6 million.

VAT (the leading source of tax receipts) contributed VT 3,185.1 million to recurrent revenue (equal to 36 per cent of total recurrent revenue). This is 2.0 per cent lower than that level receipted for the same period in 2009 (VT 3,191.7 million). One major challenge with VAT appears to be that companies that are 'voluntarily' submitting VAT returns (i.e. those with a turnover of less than VT 4 million) are actually costing the Government around VT 200 million per year. This means they claim back more than they pay. This has been happening consistently for several years.

Another major problem lies with import duties, the Government's second largest category of revenue. With only VT 1,877.2 million of Budget 2010 (VT 4,396.1 million - 42.7 per cent) registered at September month end. The shortfall in this category is projected to be almost VT 2,000 million at year-end, with the new projection being VT 2,505.6 million. The reductions are spread broadly evenly across the sub-categories of import duty (motor spirits, beer etc). In comparison to the same period in 2009, import duty has been underperforming this year by 31.1 per cent against a registered VT 2,724.8 million.

Despite the upgrade to the wharf having been completed import duties are not recovering to levels commensurate with their target. The Department of Customs and Inland Revenue has confirmed that there are still substantial problems with control at the wharf, with a key issue being a shortage of space within the wharf grounds to store containers. Other compliance related problems include poor management of bonded warehouses, the switching of containers at the wharf from red lane to green lane and a follow-up of legal action against people who refuse to pay their taxes.

On the upside, excise tax is performing to target after a slow start. With the changes to the excise tax and import duty regime on 1 January 2010, excise tax is now the third largest revenue handle and is expected to raise VT 1,750.0 million in 2010; this is up on budget 2010 of VT 1,547.4 million.

Remaining tax revenue categories indicate mixed signals of performance in collection. Property taxes, which were scheduled to raise VT 530.0 million in 2010, had by end September raised only VT 383.8 million (equal to 4.3 per cent of total recurrent revenue). The forecast for property taxes has consequently been revised downwards to VT 480.0 million. Business licences and turnover tax are within target collecting VT252.5 million (85.6 per cent of budget) and VT258.0 million (95.1 per cent of target) respectively. The marginal impact of business licences and turnover tax on total revenues is small, with each contributing around 3.0 per cent to total recurrent revenue. With three months of 2010 still to be accounted for, receipts from both business licences and turnover tax will have reached target.

In conjunction with receipts from taxes, non-tax revenues were projected to contribute VT 6,304.1 million to public receipts in 2010. At the end of September, total receipts from non-tax sources recorded VT4,791.6 million (76.0 per cent of budget). In relation to the same period last year, non-tax revenue recorded VT4,394.9 million exceeding its target by 51.0 per cent (VT2,904.0 million), resulting in an upward revision to non-tax revenue during that financial year. This has led economists to raise expected collection in 2010 by 53.9 per cent.

The largest class of non-tax revenue is the administrative fees and charges category, contributing VT 549.2 million to receipts at the end of September (80.0 per cent of forecast), slightly lower than September 2009 by 9.0 per cent. Within the administrative fees and charges, the leading components of revenue collection have been work permits (VT 100.2 million receipted), residency permits (VT 91.1 million), passport fees (VT 21.7 million) and firearm licenses (VT 14.9 million). Recently the target for administrative fees and charges has been revised upwards to VT 761.0 million.

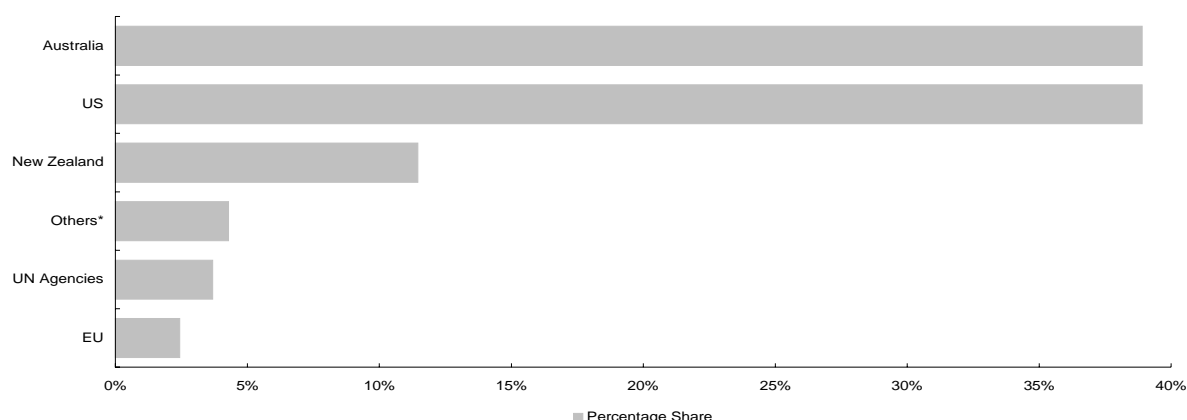
To the end of September, the total collected for entrepreneurial and property related income stood at low VT 222.6 million – equal to 31.0 per cent of the Budget 2010 target of VT 711.4 million. There are only two components that make this category; dividends and property income. Of the two; dividend constitute 70.0 per cent of the budget.

Dividends as at end of September 2010 recorded VT 55.0 million (11.0 per cent of budget) this comprises of only one provider being the Vanuatu Post. This is far lower than the VT 420.7 million for the same period one year previously. Unfortunately, the following State Own Enterprises (SOE) such as the RBV, NBV, and NISCOL that annually pay dividends have indicated that they will not contribute this year, for various reasons. The RBV cites the impact of the global economic crisis as the reason for non-payment. Meanwhile, NBV notes the high cost of severance legalised by the changes to the Employment Act together with the cost of meeting new banking regulations making it difficult to pay a dividend. Whilst a dividend of VT 12.0 million is expected from Ifira Wharf & Stevedoring, with the new projections expected at VT 67.0 million.

Additionally, land rent also contributed VT 142.5 million (77.0 per cent of budget) to the sub-category total but is expected to come below its 2010 target of VT 185.0 million. Such expectation has led to the land rents budget for 2010 to be revised downwards to VT 147.1 million.

Apart from the Government recurrent revenue, donor partner funds have a significant impact on the overall resources. With the emphasis on donor partners providing a stimulus to alleviate any adverse impacts of the global economic recession, grants from abroad registered a robust level of VT 3,993.7 million over the year to end September. With three months yet to be accounted for, the expectation is that donor support will exceed its budget 2010 of VT 4,898.5 million to a sizeable VT 4,996.9 million. The grants from abroad is made up of project grants (VT3,896.0 million) and budget support (VT 97.7 million). Of the project grants received, Australia contributes VT1,553.6 million as the leading contributor, followed by the Millennium Challenge Account (MCA) contribution of VT 1,541.6 million. The third highest contribution is New Zealand with VT 457.6 million. Meanwhile ‘Others’ agencies have accounted for about 12 percentage share of the total contribution (Figure 9).

Figure 9: Support provided by major aid partners to the Government of Vanuatu (2010)



Source: Ministry of Finance and Economic Management

*Includes South Pacific Commission, World Health Organization, ISP, Vanuatu Government, France, Japan and China

4.3. Revenue Estimates in Integrated National Budget 2011

Total recurrent revenue was originally forecasted at VT 13,199.3 million for 2011. With recent developments, the revenue forecast in 2011 has been raised to VT 13,343.7 million. Accommodating any changes to inflows would be strictly made in consultation with major revenue generating agencies. Respective variables have been revisited and recurrent revenue was revised down to VT 13,344.7 million. This 2011 revenue forecasts represent the limit of the level that is consistent with fiscal prudence. Full details of the updated Budget 2010 and 2011 revenue projections are shown as Table 5 and Table 6.

The Integrated National Budget is an ongoing initiative. The Integrated National Budget was previously termed the 'Development Budget' - a name that many parties deemed confusing and open to misinterpretation. The goal of the Integrated National Budget is to bring government and donor resources together under a unified budget. Though this will require time, the benefits are enormous as this will ensure that the Government can take complete charge of its policy preferences, whilst avoiding duplicating projects; it will also develop a full understanding of the implications of donors' involvement in capital projects; and more importantly it will represent a crucial step towards aligning the objectives of aid programs with government policy for better management of scarce resources.

Of the major revenue categories, VAT should continue to dominate the stream of tax receipts in 2011, being forecasted to contribute VT 4,773.1 million of recurrent revenue (equal to 36.4 per cent of the total recurrent revenue). This represents growth of 10.9 per cent and 8.4 per cent in the revised 2009 and 2010 accordingly; the growth is consistent with forecast of rising domestic economic activity. The next leading category is import duty, which is projected to register VT 2,699.5 million in 2011 – a slight increase of 7.7 per cent from the revised 2010 estimate. This increase takes into account the recommended reviews to the Import Duty Act as well as the VAT Act. Furthermore, with a positive outlook for business activity in 2011, contributions from business licenses and turnover tax are anticipated to register VT 272.3 million and VT 284.0 million respectively.

Non-tax receipts are forecast to repeat the solid revenue performance of 2009 over 2011; administrative fees and charges are scheduled to raise VT 857.1 million with entrepreneurial and property income contributions projected to register VT 445.3 million. The revised increase could be justified by the increase in administrative fees and charges as they currently indicate a strong growth for 2010 spilling over into 2011 once economic activity rebounded. On the other hand, the dividend budget 2011 forecast have been reduced substantially resulting from partial indicative contributions from the SOEs. The dividend outlook is very much subject to performances underpinned by continuous reforms.

It is expected that bilateral agreements with donor partners will increase significantly beginning in 2011. One illustration is the Government's policy of Universal Primary Education which will be jointly funded by the governments of Vanuatu (VT 226.6 million), Australia (VT 152.9 million) and New Zealand (VT 152.9 million). This represents a substantial, joint investment of VT 532.4 million in 2011. Notwithstanding other commitments by donor partners, grant from abroad is forecasted to reach a record VT 5,000 million in 2011.

4.4. Expenditure 2010

The recurrent budget of the Vanuatu Government has almost doubled in just over half a decade from VT 7,331 million in 2004 to an estimated VT14, 600 million in 2010. Every year new policies are added to the budget, with the aims of improving government service delivery.

There is a total of VT 560 million worth of supplementary budgets in 2010 with details as outlined in table 4.0.

Table 4: Total Supplementary Budget 2010

Supplementary Item	Amount (VUV)
Correctional Service - Officer Salaries	60,000,000
New Teachers - Salaries	100,000,000
Loan to Air Vanuatu	400,000,000
Total	560,000,000

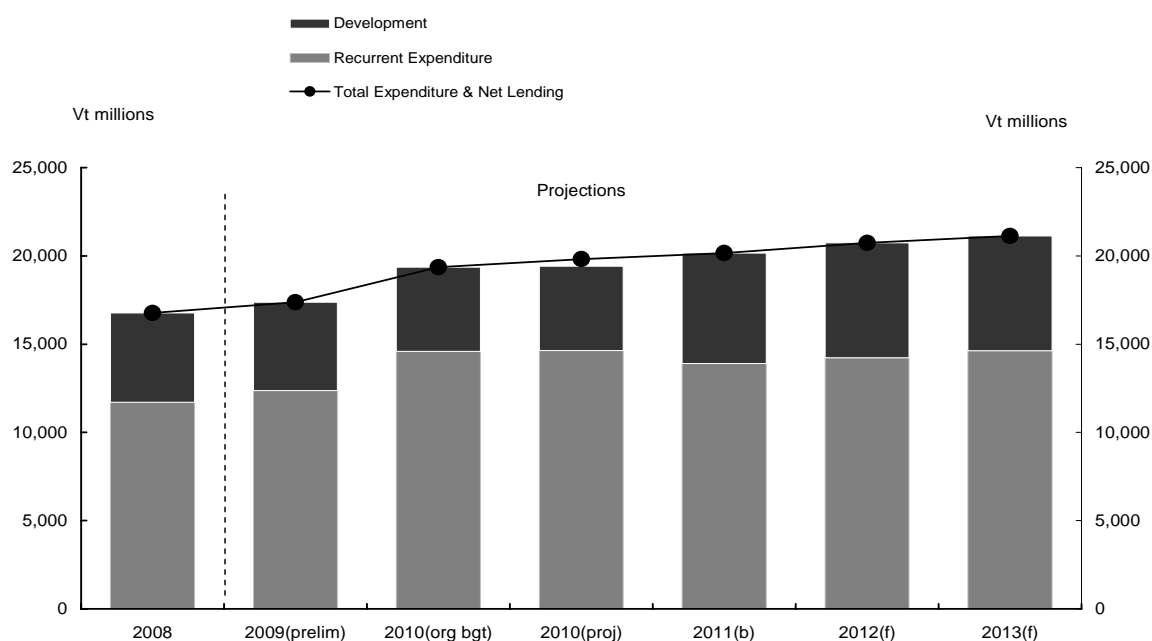
The leading category of recurrent expenditure is always personal emoluments with VT 5.3 billion expended to date –compare with VT 5.1 billion expended on year previously.

Subsidies and other transfers is within budget. Of the transfers, transfers abroad recorded VT 32.8 million (50.7 per cent of budget); transfers to Provinces and Municipalities stands at VT 168.2 million. The major component of transfer is the transfer to government bodies sitting at VT 807.9 million to date. Transfers abroad reflects Vanuatu's membership contribution to international organisations; student allowances and tuition payments to overseas' institutions.

4.5. Expenditure Estimates in 2011

The proposed recurrent expenditure for the Government in 2011 is VT 15.1 billion. This compares to VT 15.5 billion in 2010, excluding supplementaries. The ceiling is the utmost limit of what the Government can spend in 2011. Given the dependency of the domestic economy from external trades and foreign direct investments, it means that the investment climate overseas will continue to have an impact on the domestic economy.

Figure 10: Total Expenditure and Net Lending



Source: Ministry of Finance and Economic Management

Total recurrent expenditures in budget 2011 includes all New Policy Proposals (NPPs) which summed to VT 287.5 million. This year's amount of NPP are lower by 84.9 per cent in relation to the 2010 amount of VT 1.9 billion. This decrease reflects higher than anticipated one-off initiatives in 2010 and most importantly a reflection of the tight fiscal situation.

The strategy of NPPs approval for 2011 involves investing in infrastructure related projects such as the new National Archive building, the E-government project, roads and airstrips. The Government continues its commitment towards the Universal Primary Education initiative that constitute the leading policy of the Ministry of Education. Finally, in maintaining the institutions of governance the Government is committed to contribute on a phased basis towards funding the new court house and a contribution towards the new State Law building in 2011.

Table 5: Revenue

	Actual 2008	Prelim 2009	Original Budget 2010	Projection 2010	Budget 2011	Forecast 2012	Forecast 2013
Tax Revenue	11,456.9	10,825.0	12,964.4	10,818.9	11,761.3	12,504.6	13,094.2
A1 - Taxes on income and profits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
A4 - Taxes on property	684.8	463.3	530.0	480.0	502.8	528.3	553.3
A5 - Taxes on the use of goods	6,932.4	6,445.6	8,028.3	7,828.3	8,553.8	9,087.5	9,518.7
VAT	4,561.7	4,304.9	4,803.7	4,400.0	4,773.1	5,065.1	5,305.5
Business Licenses	243.1	280.9	294.9	260.0	272.3	286.1	299.7
Turnover Tax	237.9	262.3	271.1	271.1	284.0	298.4	312.5
Internet Casino	36.4	29.1	34.9	24.0	25.1	26.4	27.7
Debits Tax							
Service Taxes	105.9	74.5	90.1	78.2	81.9	86.1	90.1
Excise	631.6	606.9	1,547.4	1,750.0	2,022.8	2,175.3	2,278.5
Other	1,116.0	887.0	986.2	1,045.0	1,094.6	1,150.1	1,204.7
A6 - Taxes on international trade	3,839.6	3,916.1	4,406.1	2,510.6	2,704.7	2,888.8	3,022.2
Export duty	0.9	8.0	10.0	5.0	5.2	5.5	5.8
Import duty	3,838.8	3,908.0	4,396.1	2,505.6	2,699.5	2,883.3	3,016.4
<i>Import duty breakdown</i>							
<i>beer & wine</i>	256.0	260.8	844.4	168.5	176.5	210.4	220.4
<i>tobacco</i>	482.2	546.9	485.5	136.8	143.3	172.5	177.0
<i>vehicles</i>	270.5	258.6	456.0	200.0	209.5	220.1	230.6
<i>motor spirits</i>	607.3	758.1	852.0	280.3	293.6	308.5	323.1
<i>other</i>	2,222.7	2,083.7	1,758.2	1,720.0	1,876.6	1,971.8	2,065.3
Non-Tax Revenue (incl grants)	5,174.6	6,081.2	6,304.1	6,012.1	6,568.4	8,640.4	8,766.8
A8 - Entrepreneurial & Property Income	396.3	639.5	711.4	254.2	445.3	667.9	699.5
Dividends	233.8	440.7	501.2	67.0	190.2	349.8	366.4
Property Income	133.5	140.2	185.0	147.2	213.2	274.0	287.0
Other	29.1	58.6	25.2	40.0	41.9	44.0	46.1
A9 - Administrative fees and charges	770.4	793.0	690.0	761.0	857.1	900.6	943.3
Households	325.5	313.8	334.7	339.0	385.1	404.6	423.8
Other	444.8	479.2	355.3	422.0	472.0	496.0	519.5
A10 - Other non-tax revenue	35.4	32.4	4.1	36.2	37.9	39.8	41.7
Total Recurrent Revenue	12,659.0	12,289.9	14,370.0	11,870.3	13,101.7	14,112.8	14,778.8
as % of GDP	20.2%	17.9%	19.5%	16.1%	16.9%	16.9%	17.6%
A13 - Sales of fixed capital assets	13.3	6.3	12.8	6.2	6.5	6.8	7.1
Grants From Abroad	3,959.1	4,610.0	4,898.5	4,996.9	4,316.2	7,072.0	7,124.0
Project Grants	3,834.4	4,610.0	4,773.5	4,773.5	4,050.2	6,500.0	6,500.0
Budget Support	124.7	-	125.0	223.4	266.0	572.0	624.0
Total Revenue & Grants	16,631.5	16,906.2	19,281.3	16,873.4	17,424.3	21,191.7	21,909.9
as % of GDP	26.5%	25.9%	26.1%	22.8%	22.4%	25.3%	26.2%
Gross borrowing	2,551.9	1,729.4	799.5	1,599.5	1,471.4	701.8	1,200.0
Domestic	895.0	590.0	799.5	1,599.5	1,471.4	701.8	1,200.0
External	1,656.9	1,139.4	0.0	0.0	0.0	0.0	0.0
Sale of financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Principal receipts from lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL RECEIPTS	19,183.3	18,635.7	20,080.7	18,009.0	18,895.8	21,893.4	23,109.9
as % of GDP	30.6%	28.6%	27.2%	24.4%	24.3%	26.1%	27.6%

Table 6: Expenditure

	Actual 2008	Prelim 2009	Org Budget 2010	Projection 2010	Budget 2011	Forecast 2012	Forecast 2013
C1 - Goods and Services	9,654.8	9,942.3	11,647.8	11,591.8	11,070.6	11,402.7	11,744.8
Salary & Wages	7,044.6	7,186.6	7,780.4	7,934.0	7,783.8	8,017.3	8,257.9
Other Contributions	323.2	435.7	666.0	672.4	585.0	602.6	620.7
Other Goods and Services	2,179.0	2,212.1	3,093.5	2,985.5	2,701.7	2,782.8	2,866.3
C2 - Interest Payments	348.1	317.8	728.7	728.7	467.5	380.8	376.0
Domestic	226.5	189.0	588.8	588.8	363.5	245.0	245.0
External	121.5	128.8	139.9	139.9	104.0	135.8	131.0
C3 - Subsidies and other transfers	1,209.2	1,430.6	1,810.0	1,918.0	2,055.6	2,006.0	2,066.2
Subsidies	108.0	108.0	108.0	108.0	108.0	0.0	0.0
Transfers to Government Bodies	719.4	943.4	1,051.2	1,051.2	1,151.1	1,185.6	1,221.2
Transfers to Provinces & Municipalities	207.0	209.6	216.9	216.9	217.1	223.6	230.3
Transfers to Households	227.9	202.4	477.3	477.3	496.4	511.3	526.6
Transfers Abroad	54.9	75.4	64.7	64.7	82.9	85.4	88.0
C4 - Acquisition of fixed capital assets	504.1	676.2	403.8	403.8	310.9	445.0	445.0
Total Recurrent Expenditure	11,716.2	12,367.0	14,590.4	14,642.4	13,904.6	14,234.5	14,632.0
as % of GDP	18.7%	18.1%	19.8%	19.8%	17.9%	17.0%	17.5%
C8 - Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Recurrent Transfers to Government Bodies	1,000.4	0.0	0.0	400.0	0.0	0.0	0.0
Development	4,048.8	5,009.9	4,773.5	4,773.5	4,050.2	6,500.0	6,500.0
Salary & Wages	288.7	277.8	0.0	0.0	0.0	0.0	0.0
Other Goods and Services	563.0	1,030.8	0.0	0.0	0.0	0.0	0.0
Acquisition of Fixed Capital Assets	3,145.1	3,492.9	0.0	0.0	0.0	0.0	0.0
Other Expenditures	51.9	208.4	0.0	0.0	0.0	0.0	0.0
Total Expenditure & Net Lending	16,765.3	17,376.9	19,363.9	19,815.9	17,954.8	20,734.5	21,132.0
as % of GDP	26.7%	26.6%	26.2%	26.8%	23.1%	24.8%	25.2%
D - Amortisation	1,529.3	1,040.3	1,112.5	1,112.5	941.0	1,025.9	1,525.3
Domestic	1,295.0	688.0	799.5	799.5	600.0	701.8	1,200.0
External	234.4	352.3	313.1	313.1	341.0	324.1	325.3
E - Change In Balances	888.7	218.4	(395.7)	(2,455.5)	0.0	133.0	452.7
Currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operational	1,103.1	618.3	(395.7)	(2,919.4)	0.0	133.0	452.7
Development	(214.4)	(399.9)	0.0	463.9	0.0	0.0	0.0
TOTAL PAYMENTS	19,183.3	18,635.7	20,080.7	18,472.9	18,895.8	21,893.4	23,109.9
as % of GDP	30.6%	28.6%	27.2%	25.0%	24.3%	26.1%	27.6%

Table 7: Financing

	Actual 2008	Prelim 2009	Org Budget 2010	Projection 2010	Budget 2011	Forecast 2012	Forecast 2013
A. Total Revenue and Grants	16,631.5	16,906.2	19,281.3	16,873.4	17,424.3	21,191.7	21,909.9
B. Total Expenditure and Net Lending	16,765.3	17,376.9	19,363.9	19,815.9	17,954.8	20,734.5	21,132.0
Balance Budget	(133.8)	(470.7)	(82.6)	(2,942.5)	(530.4)	457.1	778.0
Per cent of GDP	(0.2)	(0.7)	(0.1)	(4.1)	(0.7)	0.5	0.9
D. External Financing	1,422.5	787.1	(313.1)	(313.1)	(341.0)	(324.1)	(325.3)
D1. Concessional Financing	1,422.5	787.1	(313.1)	(313.1)	(341.0)	(324.1)	(325.3)
New Borrowing	1,656.9	1,139.4	0.0	0.0	0.0	0.0	0.0
(Less Amortisation)	234.4	352.3	313.1	313.1	341.0	324.1	325.3
D2. Commercial Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
New Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(Less Amortisation)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
E. Domestic Financing	(1,288.7)	(316.4)	395.7	3,255.5	871.4	(133.0)	(452.7)
E1. Domestic Market Borrowing (NET)	(400.0)	(98)	0.0	800.1	871.4	0.0	0.0
New Domestic Market Borrowing	895.0	590.0	799.5	1,599.5	1,471.4	701.8	1,200.0
(Less Amortisation)	1,295.0	688.0	799.5	799.5	600.0	701.8	1,200.0
E2. Other Domestic Borrowing	(888.7)	(218.4)	395.7	2,455.5	0.0	(133.0)	(452.7)
New Domestic Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(Less Amortisation)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(Change In Balances)	888.7	218.4	(395.7)	(2,455.5)	0.0	133.0	452.7
TOTAL FINANCING	133.8	470.7	82.6	2,942.5	530.4	(457.1)	(778.0)
Gross Borrowing	2,551.9	1,729.4	799.5	1,599.5	1,471.4	701.8	1,200.0
Concessional	1,656.9	1,139.4	0.0	0.0	0.0	0.0	0.0
Commercial	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	895.0	590.0	799.5	1,599.5	1,471.4	701.8	1,200.0

Table 8: Government Finance Operation

	Actual 2008	Prelim 2009	Org Budget 2010	Projection 2010	Budget 2011	Forecast 2012	Forecast 2013
REVENUES							
Taxes on income and profits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on property	684.8	463.3	530.0	480.0	502.8	528.3	553.3
Taxes on the use of goods	6,932.4	6,445.6	8,028.3	7,828.3	8,553.8	9,087.5	9518.7
Taxes on international trade	3,839.6	3,916.1	4,406.1	2,510.6	2,704.7	2,888.8	3022.2
Total Tax Revenue	11,456.9	10,825.0	12,964.4	10,818.9	11,761.3	12,504.6	13,094.2
Entrepreneurial & Property Income	396.3	639.5	711.4	254.2	445.3	667.9	699.5
Administrative fees and charges	770.4	793.0	690.0	761.0	857.1	900.6	943.3
Other non-tax revenue	35.4	32.4	4.1	36.2	37.9	39.8	41.7
Sales of fixed capital assets	13.3	6.3	12.8	6.2	6.5	6.8	7.1
Grants From Abroad	3,959.1	4,610.0	4,898.5	4,996.9	4,316.2	7,072.0	7124.0
Total Non-Tax Revenue (incl grants)	5,174.6	6,081.2	6,316.9	6,054.5	5,663.0	8,687.1	8,815.7
TOTAL REVENUE AND GRANTS	16,631.5	16,906.2	19,281.3	16,873.4	17,424.3	21,191.7	21,909.9
EXPENSES							
Goods and Services	9,654.8	9,942.3	11,647.8	11,591.8	11,070.6	11,402.7	11744.8
Interest Payments	348.1	317.8	728.7	728.7	467.5	380.8	376.0
Subsidies and other transfers	1,209.2	1,430.6	1,810.0	1,918.0	2,055.6	2,006.0	2066.2
Acquisition of fixed capital assets	504.1	676.2	403.8	403.8	310.9	445.0	445.0
Total Expenditure Recurrent Budget	11,716.2	12,367.0	14,590.4	14,642.4	13,904.6	14,234.5	14,632.0
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Recurrent Transfers to Government Bodies	1,000.4	0.0	0.0	400.0	0.0	0.0	0.0
Total Expenditure Development Budget	4,048.8	5,009.9	4,773.5	4,773.5	4,050.2	6,500.0	6,500.0
TOTAL EXPENDITURE AND NET LENDING	16,765.3	17,376.9	19,363.9	19,815.9	17,954.8	20,734.5	21,132.0
FISCAL (DEFICIT) / SURPLUS	(133.8)	(470.7)	(82.6)	(2,942.5)	(530.4)	457.1	778.0
FINANCING							
Net External Financing	1,422.5	787.1	(313.1)	(313.1)	(341.0)	(324.1)	(325.3)
Net Domestic Financing	(1,288.7)	(316.4)	395.7	3,255.5	871.4	(133.0)	(452.7)
TOTAL FINANCING	133.8	470.7	82.6	2,942.5	530.4	(457.1)	(778.0)

Table 9: The Vanuatu Central Government Fiscal Operations

	Actual 2008	Prelim 2009	Org Budget 2010	Forecast 2010	Budget 2011	Forecast 2012	Forecast 2013
Total revenue and grants	16,631.5	16,906.2	19,281.3	16,873.4	17,424.3	21,191.7	21,909.9
Total revenue	12,672.3	12,296.2	14,382.8	11,876.5	13,108.1	14,119.7	14,785.9
Current revenue	12,659.0	12,289.9	14,370.0	11,870.3	13,101.7	14,112.8	14,778.8
Tax 1/	11,456.9	10,825.0	12,964.4	10,818.9	11,761.3	12,504.6	13,094.2
Taxes on property	684.8	463.3	530.0	480.0	502.8	528.3	553.3
Goods and services	6,932.4	6,445.6	8,028.3	7,828.3	8,553.8	9,087.5	9,518.7
VAT	4,561.7	4,304.9	4,803.7	4,400.0	4,773.1	5,065.1	5,305.5
Business licenses	243.1	280.9	294.9	260.0	272.3	286.1	299.7
Turnover tax	237.9	262.3	271.1	271.1	284.0	298.4	312.5
Internet/casino	36.4	29.1	34.9	24.0	25.1	26.4	27.7
Debits tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on tourism services	105.9	74.5	90.1	78.2	81.9	86.1	90.1
Excise and beer duty	631.6	606.9	1,547.4	1,750.0	2,022.8	2,175.3	2,278.5
Other	1,116.0	887.0	986.2	1,045.0	1,094.6	1,150.1	1,204.7
International trade	3,839.6	3,916.1	4,406.1	2,510.6	2,704.7	2,888.8	3,022.2
Export duties	0.9	8.0	10.0	5.0	5.2	5.5	5.8
Import duties	3,838.8	3,908.0	4,396.1	2,505.6	2,699.5	2,883.3	3,016.4
Beer, wine, and spirits	256.0	260.8	844.4	168.5	176.5	210.4	220.4
Tobacco and tobacco products	482.2	546.9	485.5	136.8	143.3	172.5	177.0
Vehicles	270.5	258.6	456.0	200.0	209.5	220.1	230.6
Motor oil	607.3	758.1	852.0	280.3	293.6	308.5	323.1
Other	2,222.7	2,083.7	1,758.2	1,720.0	1,876.6	1,971.8	2,065.3
Nontax	1,202.1	1,464.9	1,405.6	1,051.4	1,340.3	1,608.3	1,684.6
Public enterprises and property	396.3	639.5	711.4	254.2	445.3	667.9	699.5
Dividends	233.8	440.7	501.2	67.0	190.2	349.8	366.4
Property	133.5	140.2	185.0	147.2	213.2	274.0	287.0
Other (rent and interest)	29.1	58.6	25.2	40.0	41.9	44.0	46.1
Administrative fees and charges	770.4	793.0	690.0	761.0	857.1	900.6	943.3
Households	325.5	313.8	334.7	339.0	385.1	404.6	423.8
Other	444.8	479.2	355.3	422.0	472.0	496.0	519.5
Other	35.4	32.4	4.1	36.2	37.9	39.8	41.7
Capital revenue	13.3	6.3	12.8	6.2	6.5	6.8	7.1
Grants 2/	3,959.1	4,610.0	4,898.5	4,996.9	4,316.2	7,072.0	7,124.0
o/w: Project grants	3,834.4	4,610.0	4,773.5	4,773.5	4,050.2	6,500.0	6,500.0
o/w: Budget support	124.7	0.0	125.0	223.4	266.0	572.0	624.0
Total expenditure and net lending	16,765.3	17,376.9	19,363.9	19,815.9	17,954.8	20,734.5	21,132.0
Total expenditure	15,764.9	17,376.9	19,363.9	19,415.9	17,954.8	20,734.5	21,132.0
Current expenditure	11,212.1	11,690.7	14,186.5	14,238.5	13,593.7	13,789.5	14,187.0
Goods and services	9,546.8	9,834.3	11,539.8	11,591.8	11,070.6	11,402.7	11,744.8
Wages and salaries	7,044.6	7,186.6	7,780.4	7,934.0	7,783.8	8,017.3	8,257.9
Other contributions	323.2	435.7	666.0	672.4	585.0	602.6	620.7
Purchases of goods and services	2,179.0	2,212.1	3,093.5	2,985.5	2,701.7	2,782.8	2,866.3
Interest payments	348.1	317.8	728.7	728.7	467.5	380.8	376.0
Domestic	226.5	189.0	588.8	588.8	363.5	245.0	245.0
External	121.5	128.8	139.9	139.9	104.0	135.8	131.0
Transfers 3/	1,317.2	1,538.6	1,918.0	1,918.0	2,055.6	2,006.0	2,066.2
Subsidies	108.0	108.0	108.0	108.0	108.0	0.0	0.0
Transfers to government bodies	719.4	943.4	1,051.2	1,051.2	1,151.1	1,185.6	1,221.2
Transfers to provinces and municipalities	207.0	209.6	216.9	216.9	217.1	223.6	230.3
Transfers to households	227.9	202.4	477.3	477.3	496.4	511.3	526.6
Transfers to abroad	54.9	75.4	64.7	64.7	82.9	85.4	88.0
Capital expenditure	4,552.8	5,686.2	5,177.3	5,177.3	4,361.1	6,945.0	6,945.0
Acquisition of fixed capital assets	504.1	676.2	403.8	403.8	310.9	445.0	445.0
Government development budget	4,048.8	5,009.9	4,773.5	4,773.5	4,050.2	6,500.0	6,500.0
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Recurrent Transfers to Government Bodies	1,000.4	0.0	0.0	400.0	0.0	0.0	0.0
Current balance	1,446.9	599.2	183.5	(2,368.2)	(492.0)	323.3	591.8
Overall balance (excluding net lending)	(133.8)	(470.7)	(82.6)	(2,942.5)	(530.4)	457.1	778.0
(including net lending)	(133.8)	(470.7)	(82.6)	(2,942.5)	(530.4)	457.1	778.0
Financing	133.8	470.7	82.6	2,942.5	530.4	(457.1)	(778.0)
Foreign (net)	1,422.5	787.1	(313.1)	(313.1)	(341.0)	(324.1)	(325.3)
Concessional borrowing (net)	1,422.5	787.1	(313.1)	(313.1)	(341.0)	(324.1)	(325.3)
New borrowing	1,656.9	1,139.4	0.0	0.0	0.0	0.0	0.0
Amortization	234.4	352.3	313.1	313.1	341.0	324.1	325.3
Commercial financing (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	(1,288.7)	(316.4)	395.7	3,255.5	871.4	(133.0)	(452.7)
Domestic market borrowing (net)	(400.0)	(98.0)	0.0	800.1	871.4	0.0	0.0
New borrowing	895.0	590.0	799.5	1,599.5	1,471.4	701.8	1,200.0
Amortization	1,295.0	688.0	799.5	799.5	600.0	701.8	1,200.0
Other domestic borrowing (net)	(888.7)	(218.4)	395.7	2,455.5	0.0	(133.0)	(452.7)
New borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Increase in balances/ (Decrease in Balance)	888.7	218.4	(395.7)	(2,455.5)	0.0	133.0	452.7

Table 10: Statement of Government Borrowing

		2008 Prelim	2009 Projection	2010 Projection	2011 Projection	2012 Projection	2013 Projection
External Debt							
Bilateral							
	CFD	464.9	374.5	334.5	295.5	256.5	217.5
	China	1,656.9	2,577.3	2,577.3	2,577.3	2,577.3	2,577.3
Total Bilateral Debt		2,122	2,952	2,912	2,873	2,834	2,795
Multilateral							
	ADB	6,068.6	5,184.1	5,051.6	4,894.6	4,737.6	4,580.6
	EIB	484.7	312.8	252.59	139.18		
	IDA	1,440.6	1,211.5	1,170.48	1,156.07	1,141.66	1,127.2
Total Multilateral Debt		7,993.9	6,708.3	6,474.6	6,189.8	5,879.2	5,707.8
Total External Debt		10,115.7	9,660.2	9,386.5	9,062.6	8,713.1	8,502.6
Total Domestic debt		2,582.7	2,484.7	3,284.7	3,284.7	3,284.7	3,284.7
Total stock of debt		12,698.4	12,144.9	12,671.2	12,347.3	11,997.7	11,787.3
(In percent of GDP)		20%	18%	17%	16%	14%	14%

Figures are end of year balances

5. The Government's Fiscal Strategy

The Government's leading priority, as set in the 2011 Budget Policy Statement, is to manage its budget in a way that enhances economic growth and the distribution of that growth to all sectors of Vanuatu communities. The Government will continue to implement policies that encourage private sector growth and ensure that state-owned enterprises are productive in the long run.

The Government is committed to achieving this through sound management of public finances and by following fiscally responsible policies as outlined in the Public Finance and Economic Management Act of 1998 (PFEM Act).

The PFEM Act requires that the Government pursues policies which:

- Ensure that the Government's borrowing is kept at manageable levels;
- Maintain the Government's assets in good condition;
- Manage fiscal risks;
- Maintain stable and predictable tax rates.

These are defined in the PFEM Act to be the *Principles of Responsible Fiscal Management*.

5.1. Integrated National Budget 2011 and Long-Term Fiscal Objectives

A key requirement of responsible fiscal management is the publication of a Budget Policy Statement that outlines the Government's long-term fiscal objectives and intentions for the annual budget. The Government is then obliged to compare the intentions (or targets) outlined in the Budget Policy Statement with the actual Integrated National Budget 2011.

Long-term objectives for fiscal policy, as stated in the 2011 Budget Policy Statement, cover the budget balance, revenue, expenditure, debt, economic growth and inflation. These are set out in Table 11.

The analysis that follows considers whether Budget 2011 and the medium-term outlook are compliant with the PFEM Act.

Table 11: Integrated National Budget 2011 and the 2011 Budget Policy Statement

Budget Targets for 2011	Long term fiscal objectives
Budget balance Balance Budget	Recurrent balance is positive over the medium-term
Revenue Recurrent revenue is forecast to be at least 19.0 per cent of GDP	There is a broad revenue base with sufficient revenue to meet the Budget Balance objective
Expenditure Recurrent expenditure is forecast to be 19.0 per cent of GDP	Expenditures are consistent with the Budget Balance objective
Debt Public debt remains at manageable level	Debt maintained at prudent levels so its share in GDP remains below 40.0 per cent
Economic Growth Growth forecast at 3.7 per cent	Annual economic growth rate averages at least more than population growth rate (2.6 per cent)
Inflation Inflation forecast at 3.0 – 4.0 per cent	Annual inflation rate remains below 4.0 per cent

Budget 2011 is consistent with the Budget Policy Statement and long-term fiscal objectives. Fiscal risks have been considered and a strategy to manage these is being prepared.

Financial requirements are expected to be manageable over the medium-term and the outlook over the period 2011-2013 is consistent with the *Principles of Responsible Fiscal Management*.

6. Budget Policy Statement 2011

1. Statement of Responsibility

The following Budget Policy Statement is made with reference to and in accordance with sections 9 and 10 of the Public Finance and Economic Management (PFEM) Act number 6 of 1998.

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:
 - Consistent with the Principles of Responsible Fiscal Management laid down in section 22 of the PFEM Act; and
 - Consistent with the previous year's Budget Policy Statement – that is, policies have remained consistent over time or, otherwise, justifications have been made for their departure.

Pursuant to section 10, the Government confirms that the fiscal policy objectives, strategic priorities and intentions are consistent with the Principles of Responsible Fiscal Management specified in section 22 of the PFEM Act of 1998 and that there is broad consistency with the 2010 Budget Policy Statement.

2. Economic and Financial Policies

The PFEM Act of 1998 specifies the principles of responsible fiscal management. These require that the Government pursues budget policies that:

- Ensure that the Government's borrowing is kept at manageable levels;
- Maintain public assets in good condition;
- Manage fiscal risks prudently;
- Maintain stable and predictable tax rates.

The Government's highest priority for Budget 2011 is to maintain Vanuatu's economic growth and the well-being of all ni-Vanuatu, in a way that is financially sustainable and does not jeopardize future economic growth.

The Government will achieve this by sound management of public finances and by following fiscally responsible policies. Section 22 of the PFEM Act requires that the Government adheres to a set of defined principles of responsible fiscal management. These are set out in the box opposite.

Principles of Responsible Fiscal Management

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

3. Budget Policies

Government's Budget Policies come from the application of the "Principles of Responsible Fiscal Management" section 22 of the PFEM Act of 1998. The Budget Policies consist of:

1. Budget Priorities for 2011;
2. Economic and Fiscal Targets for 2011; and
3. Long Term Fiscal Objectives

(a) Budget Priorities for 2011

As a matter of careful consideration, the Government has selected for the four year duration, priority areas set forth in the Planning Long and Acting Short (PLAS) matrix. In 2011, the Government will continue to pursue its existing policies which are set out as follows:

- Better access to primary education and strengthening of youth development;
- Strengthening accountability and transparency in public offices and institutions;
- Ensuring equitable and sustainable development of land;
- Providing reliable and accessible infrastructure services;

- Supporting the productive sectors;
- Offering quality health care;
- Decentralisation and institutional strengthening;
- Political stability; and
- Strengthening security and the rule of law.

The Government will continue to implement policies that improve the business environment, with particular emphasis on issues constraining growth prospects. As part of this program, the Government will resort to continue its reform of state-owned enterprises and utilities.

(b) Fiscal Policies

The Government's high priority for 2011 is to manage its budget in a way that promotes economic growth and the distribution of that growth to all the communities of Vanuatu. The Government will continue to implement policies that encourage private sector led growth and will ensure that state-owned enterprises are as productive as possible in the long-run.

(c) Fiscal Position in 2011

According to the last International Monetary Fund (IMF) world economic update, the economic recovery in most advanced economies has got off to a stronger start than earlier anticipated but is occurring at differing rates across the globe. In most emerging and developing economies activity is expected to be vigorous, driven by buoyant internal demand. More importantly, Vanuatu's Major Trading Partners have weathered the global economic crisis relatively well and are forecasted to maintain positive growth over the medium term.

Vanuatu's economy continued to recover but at a much slower pace than initially forecasted according to recent partial indicators. Private sector credit has slowed recently, tourist arrivals have weakened and the data on construction and consumption suggest a softening. All of these factors would lead to lower than anticipated inflows in government receipts. In line with these developments, economic growth projections were recently downgraded - to 4.1 per cent in 2010 and by 3.7 per cent in 2011. Nonetheless growth is expected to remain above trend.

(d) Budget Management

Budget 2011 will be consistent with the principles of fiscal responsibility as defined by section 22 of the PFEM Act. The Government will continue to commit itself towards achieving a balanced budget in 2011.

(e) Government Debt and Borrowing

The Government will continue to ensure that public debt remains at a manageable level during 2011 and successive years and will restrict any new borrowings, unless for productive purposes to reflect current policy directions. The Government will ensure that external and domestic borrowings are limited to the financing of capital investment projects which generate future capacity to repay the loans bequeathed upon future generations.

(f) Revenue and Taxes

The Government's priority for revenue is to increase coverage and strengthen the administration of existing taxes; this includes the more remote areas of the country. There will also be focus on the effective implementation of new changes to excise duties, exemptions and previous changes relating to taxes on land and other assets. To meet these goals, the Government has recently allocated additional funds to the Department of Customs and Inland Revenue for further

recruitment and purchasing of Asycuda software to reinforce the administration of government receipts. The ongoing initiative of the Government opening up offices of customs, finance and statistics in the provinces will also help improve administration.

(g) Expenditure Programme Policies

The Government's priorities for expenditure programmes are to continue to enhance funding for the provision of essential services and to ensure that expenditure remains within the budgeted amount. The Government will also be directing greater attention to expenditure productivity to ensure maximum value of public funds. To this end identifying efficiency gains, eliminating unproductive expenditures, and enforcing strict fiscal discipline and punitive measures are all part of the Government efforts to achieve greater quality, efficiency and accountability of service.

i. New Policy Proposals

Each year the Government sets aside funds for New Policy Proposals that are consistent with the Government's policy priorities.

New Policy Proposals that fall within the policy areas identified at 3 (a) will only be considered for funding in 2011 if they are:

- Well researched and fully developed 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
- Sustainable within future recurrent funding.

Budget 2011 will include donor funded New Policy Proposals that have been developed to implement government policy priorities such as access to primary education. This will ensure that donor funding is channelled through the Government of Vanuatu Budget Management System (VBMS) and is in line with Government funding. Merging the two funding streams will result in a significant efficiency gain. Further, the integration of the budget process will enable the Government to better manage the recurrent cost implications and hence improve the financial sustainability of capital investment in essential public services.

ii. Economic and Fiscal Targets for 2011

In preparation for unforeseen shocks to the domestic economy, the Government will continue to pursue policies towards achieving a balanced budget in 2011. The economic growth rate for 2011 is forecasted to be 3.7 per cent in real terms, while the inflation rate is projected to be within the range of 3.0 - 4.0 per cent.

Budget Targets for 2011	Long term fiscal objectives
Budget balance Balance Budget	Recurrent balance is positive over the medium-term
Revenue Recurrent revenue is forecast to be at least 19.0 per cent of GDP	There is a broad revenue base with sufficient revenue to meet the Budget Balance objective
Expenditure Recurrent expenditure is forecast to be 19.0 per cent of GDP	Expenditures are consistent with the Budget Balance objective
Debt Public debt remains at manageable level	Debt maintained at prudent levels so its share in GDP remains below 40.0 per cent
Economic Growth Growth forecast at 3.7 per cent	Annual economic growth rate averages at least more than population growth rate (2.6 per cent)
Inflation Inflation forecast at 3.0 – 4.0 per cent	Annual inflation rate remains below 4.0 per cent

iii. Conclusion

Preparation for the Budget 2011 will be based on existing government policies and priorities. The budget will be prepared in line with the “Principles of Responsible Fiscal Management” and the long term fiscal objectives of the Government.

There remains uncertainty as to the performance of domestic consumption and private investment. This presents a challenge to revenue forecasts and expenditure policies in Budget 2011. The balance of risks to the near term outlook is on the downside. The Government will continue to be guided by fiscal prudence and will ensure that spending pressures in 2011 are controlled.