

Budget Policy Statement 2013

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

Pursuant to section 10, 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 2012 budget policy.


Honourable Moana Kalosil
Minister of Finance & Economic Management




Georges Maniuri
Director General
Ministry of Finance & Economic Management



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 2013 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 2013;
2. Economic and Fiscal Targets for 2013; and
3. Long Term Fiscal Objectives

a) Budget Priorities for 2013

Development of the 2013 policy priorities captured the essence of the national broad policy framework in the national planning documents PAA and PLAS and the PM Policy Retreat in early this year 2012. In 2013, the Government will remain prudent in achieving its existing policies, which are set out as follows:

- Decentralization and strengthening Government Machinery and institutions to improve service delivery
- Enhance economic capacity through increase participation in the productive sector and also to facilitate economic activities and participation in rural areas
- Grow the Revenue Base
- Enabling a business friendly environment
- Enhancing access and improving quality of education at all levels, focusing on skills development to address national human resource requirements
- Improve health status of the population through access to quality of health services and effective and efficient application of resources
- Provide reliable, accessible and continuous improvement in the infrastructure Services
- Strengthening democratic processes focussing on political stability
- Continue Strengthening of security enabling prevalence of law and order and accessible equitable Justice

(b) Fiscal Policies

The Government's high priority for 2013 is to effectively 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 sound policies that encourage private sector led growth and ensure that long-term growth for the State-Owned Enterprises remain productive. The Government aims to provide audited financial statements in a timely manner, and will continue to maintain its financial discipline in a more stringent way.

(c) Economic Update in 2013

The International Monetary Fund (IMF) has downgraded its global economic growth forecast by $\frac{3}{4}$ percentage point¹ to $3\frac{1}{4}$ per cent for 2012. The IMF estimated that the global economy grew by 3.8 per cent in 2011. The downward revision for 2012 reflects the expectation that growth in the Euro zone will be very weak throughout this year as many of its member countries continue to implement austerity measures; at the same time improving private and public sector debt repayments. The weakening external environment is also anticipated to drag on for sometimes across many emerging and developing economies in 2012. Global

¹IMF January 2012 World Economic Outlook

inflation is expected to ease through 2012 as consumer demand softens and non-oil commodity prices decline. In contrast, risks to oil prices remain on the upside given the possibility of further geopolitical tension in the Middle East especially in major oil exporting countries.

Real economic growth in the domestic economy is expected to pick up from an estimated 2.5 per cent in 2011 to a projected 3.0 per cent in 2012 and a forecasted 4.5 per cent in 2013. Growth over this period is expected to be supported by expansions across all sectors of the economy. However, growth in 2012 is projected to be weaker than originally anticipated at the time of Budget 2012 preparation given the weakening global economic environment and further delays to the implementation of major donor-funded construction projects. Looking further ahead, restoring public confidence in the advanced economies should boost external demand and encourage capital mobility across international borders. This will in turn create jobs, increase employment and consumption, which should eventually increase domestic demand and economic growth.

Inflation measured by the Consumer Price Index (CPI) decelerated from 2.8 per cent in 2010 to only 0.9 per cent in 2011. The slowdown in inflation is being largely driven by a softening in external economic conditions (feeding through to weaker external prices) and the Reserve Bank of Vanuatu (RBV's) action to raise its SRD in 2010 and again in 2011 as a result, weakened growth in private sector credit feeding through to lower household and investor spending. It is expected that annual inflation growth will remain within the RBV's annual target range of 0 to 4 per cent in 2012.

(d) Budget Management

The Government will commit to achieving a balanced budget in 2013, in line with the 2013 Budget policies and priorities. The principles of responsible fiscal management that are set out in section 22 of the PFEM Act will help and guide the Government to manage its revenue and expenditure at prudent levels to achieve a balanced budget in 2013.

(e) Government Debt and Borrowing

The Government will continue to make sure that public debt remains at a sustainable level in 2013 and beyond. This will provide a buffer to help absorb any future adverse shocks to the Government's fiscal position. From 2013, the Government is planning to undertake significant new external borrowing to finance new capital investment projects which will generate additional capacity and high financial returns to repay the debts bequeathed upon future generations. Indeed, the Government will ensure that both new external and domestic borrowing is limited to financing investment projects (and not consumption) with a positive net financial return.

(f) Revenue and Taxes

The Government's priority for revenue is to boost collections throughout increasing coverage to the islands and to toughen the administration through compliance with the existing taxes. There are also few minor changes to the excise duties and casino taxes prior to the changes made in 2011. In addition, with the amendment of the Import duties Act an exemption committee has set up to manage and tighten the exemptions. To achieve the targets, the Government will continue to emphasize on the prompt and timely collection of taxation debts, and focus on the effective implementation of previously sated changes. Moreover, the Government will remain focused on the level of compliance and the continuity of revenue collections throughout the year.

(g) Expenditure Programme Policies

The Government's priorities for expenditure programmes are to continue to give sufficient funding for policies that provide essential services and enhance economic growth. On this note, the Government will be focusing on improving efficiency and effectiveness of expenditure programmes and ensures that that expenditure programmes remain broadly in line with budget targets.

The findings of the regulation 2.2 report have critically identified areas of expenditure that require reduction, re-allocation, and realistic budgeting. Hence, the Government will be focusing on re-allocation of funding, eliminating of unproductive expenditures and enforcing strict fiscal discipline as well as imposing prudent and punitive measures if necessary. In addition, the Government will continue to ensure that the public finances remain sustainable and all expenditure programmes are in line with Government policies to achieve a higher quality, greater efficiency and improved accountability of service.

4. 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 be strictly considered for funding in 2013 if they are:

- able to be accommodated within the overall aggregate fiscal envelope;
- well researched and proper detailed proposals to reinforce the Government's key policies and programs;
- within the capacity of the Ministry to implement over the suggested time frame;

- able to expand and develop the economic capacity and growth rate of the country; and
- must be financially sustainable if it is to become a recurrent activity.

The 2013 budget will include donor funded New Policy Proposals, new and ongoing, that have been developed to implement government policy priorities. This will ensure that donor funding is channelled through the Vanuatu Budget Management System (VBMS) and is in line with Government priority. Merging the two funding streams will result in efficiency gain. The integration of donor resources with Government recurrent resources will enable the Government to better manage the recurrent cost implications and hence improve the financial sustainability of capital investment in essential public services.

5. Economic and Fiscal Targets for 2013

In preparation for unforeseen shocks to the domestic economy, the Government will continue to pursue policies towards achieving a balanced budget in 2013. The economic growth rate for 2013 is forecasted to be 4.5 per cent in real terms, while the inflation rate is projected to be around 3.4 per cent.

Budget Targets for 2013	Long term fiscal objectives
Budget balance Balanced Budget	Recurrent balance is positive over the medium-term
Revenue Recurrent revenue is forecast to be at least 18.0 per cent of GDP	There is a broad revenue base with sufficient revenue to meet the budget balance objective. Recurrent revenue to reach at least 22 per cent of GDP.
Expenditure Recurrent expenditure is forecast to be 17.0 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 of GDP remains below 40.0 per cent
Economic Growth Growth forecast at 4.5 per cent	Annual economic growth rate averages at least more than population growth rate (2.3 per cent)
Inflation Inflation forecast at 3.4 per cent	Annual inflation rate remains between 0 and 4.0 per cent

6. Conclusion

Preparation for the Budget 2013 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.

The Government will remain cautious in every decision making, and it will mainly focus on being critically accountable and fiscally responsible towards achieving a sound, manageable and balanced budget 2013.