

Budget Policy Statement 2014

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 2013 budget policy.

Honourable Maki Stanley SIMELUM
Minister of Finance &
Economic Management

George 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 2014 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 2014;
2. Economic and Fiscal Targets for 2014; and
3. Long Term Fiscal Objectives

a) Budget Priorities for 2014

The development of 2014 policy priorities captured the essence of the national broad policy framework in the national planning documents (PAA and PLAS) and also acknowledged the 100 Days Priority List in 2013 issued by the Prime Minister.

The strategic policy priorities are set out as follows:

- Broaden economic capacity to grow revenue base (reassess the current tax base and other measures to strengthen revenue collection), maintain quality expenditure, (revenue greater than expenses) boost government savings and trigger public investment;
- Strengthen relationship between Trade and Investments in order to build confidence for private sector participation, increase employment, and grow exports;
- Enabling continuous political reform, decentralization, human and institutional strengthening to improve service delivery;
- Enhance protection and conservation of Vanuatu's natural resources and biodiversity, taking climate change issues into consideration;
- Improve quality of educational outcomes, more equitable access to education and skills development at all levels with continued emphasis on overall strengthening of sectoral management;
- Improve management and access to quality youth services and programmes at all levels throughout Vanuatu with more focus to the 2017 Pacific Mini Games;
- Continue allocate resources to improve health services as well as to implement Vanuatu National Population Policy;
- To provide sustainable, resilient, appropriate infrastructure and services for equitable, social and economic development; and,
- Ensure that appropriate measures are in place to address tension between informal and formal system, backlog of cases, support to victim of the crime and gender mainstreaming initiative.

(b) Fiscal Policies

The Government's top priority for 2014 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 the State-Owned Enterprises remain productive over the long term. The Government aims to provide audited financial statements in a timely manner, and will continue to maintain stringent financial discipline.

(c) Economic Update in 2013

World Economic Outlook (WEO)

Global growth has been revised upwards by the International Monetary Fund (IMF) in its January WEO from 3.5 per cent in October 2012 to 3.8 per cent for 2013. The revision was necessary following improved management of the global uncertainties stemming from the Euro debt crisis in the euro area, an unexpected pickup in economic activity in the US whilst the possibility of Japan sliding into recession was prevented thanks to timely policy intervention through stimulus to boost growth. Despite mixed growth experiences in the advanced economies, growth in the emerging economies held up comparatively well with 5.5 per cent expected in 2013 and a further 5.9 per cent forecasted for 2014.

Vanuatu Economic Outlook (VEO)

Following unfolding uncertainties in the global economic environment, economic activity in Vanuatu is expected to be driven by the expected scaling up of public investment and buoyant activity of the services sector particularly tourism while developments in the agriculture remain broadly modest. The spillover effects of increasing tourism arrivals together with construction is expected to benefit retail trade, transport, manufacturing, professional, scientific, research and administrative services, accommodation and food services. While developments in the agriculture sector is dependent on external demand and supply conditions of closely traded commodities such as copra, beef, fish and coconut oil. Against these backdrops, the macroeconomic committee believes the economy will grow by 4.5 per cent and 4.6 per cent in 2013 and 2014 while more expansion is expected in 2015 before normalization kicks-in from 2016.

Inflation, which is closely related to economic activity, is expected to gather momentum as use of resources become scarce while at the same time pressure from domestic demand starts to accumulate. The average inflation, measured by the consumer price index, is expected to grow by 1.5 per cent in 2014 on the back of an expected increase in construction activity combined with rising demand emanating from consumption and investment activities from the services sector.

Monetary conditions remain comparatively weak to date although monetary policy has been very accommodative. Private sector credit remains sluggish growing by 5.9 per cent in 2012 after reaching its growth peak in 2008 at 36.6 per cent. The sluggish growth in private sector credit reflected the high level of uncertainties in the economy together with ongoing supply constraints affecting private sector incentives for investment despite the high level of liquidity in the banking system. With the banking sector's net foreign assets contracting for the third straight consecutive year in 2012 by 6.2 per cent, Vanuatu's competitiveness (measured through pricing of its currency – exchange rate) needs further consideration so does its effect on the value of export and service earnings.

Expectations about increased public investments and tourism activities over the medium term will impact on the country's balance of payments with the current account expected to remain strong supported by developments in the services sector. While the capital account is anticipated to rise following anticipated inflows from donor funded projects however, developments in the financial accounts are forecasted to remain subdued. The overall balance of payments is forecast to remain sufficient with stock of foreign reserves anticipated to rise over the medium term, pushing the projected months of import cover comfortably higher than its threshold level of 4 months.

(d) Budget Management

Budget 2014 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 2014.

(e) Government Debt and Borrowing

The Government will continue to make sure that public debt remains at a sustainable level in 2014 and years thereafter. From 2014, the Government will restrict new borrowing unless for productive purposes to reflect current policy implementations. Definitely, the Government will make sure that new external and domestic borrowings are limited to the financing of capital investment projects which will generate future capacity to repay the loans bestowed upon future generations.

(f) Revenue and Taxes

The Government's priority for revenue is to improve and strengthen the administration of compliance with existing taxes, including in the remote areas of the country. There will also be emphasis on the effective implementation of an amendment to the Import Duties Act on exemptions and Gaming Licences Act and likewise, there will also be the execution of new revenue initiatives such as fees and charges by revenue generating Departments across the Government following the 2013 Revenue Initiative Forum. In addition, the Government has tightened the compliance unit under the Department of Customs and Inland Revenue to reinforce the administration of swift and timely collection of taxation debts. It will focus on the level of compliance and the continuity of revenue collections throughout the year.

(g) Expenditure Programme Policies

The Government will continue to ensure that procedures of requesting and accessing funds for expenditure programmes are in line with the Public Finance and Economic Management Act. In 2014, the Government's priority is to provide adequate and sufficient funding for expenditure programmes that are linked to 2014 strategic policies priorities. This includes expenditure programmes and policies that will cover a wide range of different activities and services that will enhance service delivery and at the same time promote efficient and effective use of resources to improve economic growth.

On this note, the Government will ensure that expenditure programmes remain broadly in line with budget target and there is efficient and effective use of funding provided by the Government and the Donors to achieve higher quality and improved accountability of services. Hence, the Government will continue to enforce strict fiscal discipline as well as imposing prudent and punitive measures if necessary to control expenditure programmes in line with Budget targets and the Principles of Responsible Fiscal Management.

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 in 3 (a) will be strictly considered for funding in 2014 if they are:

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

The 2014 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's priorities. Merging the two funding streams will result in efficiency gains. 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 2014

In preparation for unforeseen shocks to the domestic economy, the Government will continue to pursue policies towards achieving a balanced budget in 2014. The economic growth rate for 2014 is forecasted to be 4.6 per cent in real terms, while the inflation rate is projected to be around 1.5 per cent.

Budget Targets for 2014	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 4.6 per cent	Annual economic growth rate averages at least more than population growth rate (2.3 per cent)
Inflation Inflation forecast at 1.5 per cent	Annual inflation rate remains between 0 and 4.0 per cent

6. Conclusion

Preparation for the Budget 2014 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 2014.