

# Budget Policy Statement 2012

## 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:

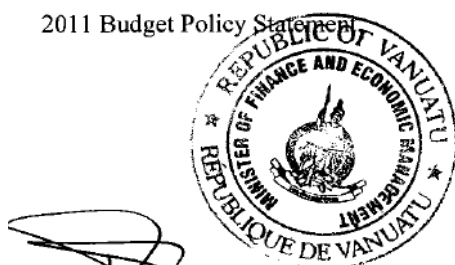
- specify its economic and financial policies, including those relating to key economic and fiscal variables; and
- state the discipline it will adhere to in its economic and financial dealings.

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

2011 Budget Policy Statement



**Honourable Bakoa Kaltonga**  
Minister of Finance &  
Economic Management



**Georges Manu**  
Director General  
Ministry of Finance &  
Economic Management

**Honourable Moana Kalosil Carcasses**  
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 2012 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 2012;
2. Economic and Fiscal Targets for 2012; and
3. Long Term Fiscal Objectives

***a) Budget Priorities for 2012***

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 2012, the Government will remain prudent in achieving its existing policies, which are set out as follows:

- better access to primary education and development of youth programmes and employment opportunities;
- enhance good governance via strengthening accountability, strengthening rule of law, reduce corruption and maintain transparency in public offices and institutions;
- ensuring equitable and sustainable development of land and natural resources;
- providing reliable and accessible infrastructure services;
- enhance an enabling environment to supporting the productive sectors;
- enabling a conducive business environment;
- offering quality health care;
- decentralisation and institutional strengthening;
- enhance democratic processes towards political stability; and
- Strengthening security and the rule of law

The Government will continue to implement policies that will improve the economy, with particular emphasis on issues constraining growth prospects. As part of this program, the Government will resort to continue to monitor and conduct reforms of State-Owned Enterprises and utilities where necessary. It is also paramount that the Government facilitates the smooth operation of the general election in 2012.

***(b) Fiscal Policies***

The Government's high priority for 2012 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 policies that encourage private sector led growth and will ensure that long-term growth for the State-Owned Enterprises remain productive.

***(c) Economic Update in 2012***

In its January 2011 World Economic Outlook (WEO), the IMF has revised its global economic growth forecast upward by a ¼ percentage point from its prediction made last

October to 4½ per cent for 2011. It is expected that world growth are to be more pronounced in the emerging markets. Looking ahead, it is expected that world output growth is projected to grow by another 4½ per cent in 2012.

However, there are concerns surrounding global growth over the dramatic increase in the size and volatility of capital flows to emerging economies. Similarly, global inflation risks remain to the upside in 2011. This is due to robust demand and a sluggish supply response to tightening market conditions. On the other hand unemployment in advanced economies still remains high. The non-oil commodity prices are expected to increase in 2011 due to weather related conditions. This will in turn strain the budgets of low-income households and beginning to feed into overall price inflation of economies.

Real economic growth in the domestic economy is expected to pick up moderately to 3.0 per cent and 4.0 per cent in 2011 and 2012 respectively, driven by the services, industry and the agriculture sectors. However, given imbalances in global growth there are downside risks to the GDP forecast. With unemployment remaining high in advanced economies; combining with political turmoil in oil exporting countries, the misalignment of exchanges rates in developing countries and the economy been subject to natural disasters, poses further uncertainties about the recovery of the domestic economy.

The domestic Consumer Price Index (CPI) rose in 2010 by 2.8 per cent on average, to level at 135.8 with annual inflation rate reaching 3.4 per cent relative to 2009. The rise in price level was in response to external forces and improved economic conditions abroad driving Vanuatu's import prices higher. Accordingly, it is also a reflection of the monetization of the budget deficit in 2010. It is expected that the annual inflation growth may exceed the RBV's annual target of around 3.0-4.0 per cent in 2011 with pressures escalating from both the fiscal sector and abroad.

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

The Government will commit to achieving a balanced budget in 2012, in line with the 2012 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 2012.

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

The Government will continue to make sure that public debt remains at a sustainable level in 2012 and beyond. This will provide a buffer to help absorb any future adverse shocks to the Government's fiscal position. The Government will ensure that all new external and domestic borrowing is limited to the financing of capital investment projects which will

generate additional capacity and high financial returns to repay the debts bequeathed upon future generations.

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

The Government's priority for revenue is to maximise collections through increasing coverage to the islands and strengthening the compliance and administration of existing taxes. This will be supported by improved compliance in regard to Import Duties, Excise, VAT and Business Licences legislation. The Government will continue to minimise exemptions and continue to put great emphasis on the collection of taxation debts, using disciplinary measures against non-payers if necessary. The Government will continue to focus on improving efficiency and effectiveness of revenue collection through out the year.

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

The Government's priorities for expenditure programmes are to continue to give sufficient funding for the provision of essential services and ensure that expenditure levels remain within the budgeted amounts. The Government will also be looking to make substantial savings where necessary, across all Ministries, Departments and Constitutional Bodies in 2012 relative to the previous budget year. Productivity maximization remains the core target of approved programs and activities, adding value to the use of already limited public funds. The findings of regulation 2.2 report have critically identified areas that require re-allocation, reduction, and realistic budgeting. Hence, the Government will be focusing on improving efficiency, eliminating unproductive expenditures and enforcing strict fiscal discipline as well as imposing punitive measures if necessary. These efforts should ensure that the public finances remain sustainable and are all part of the Government's aims 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 only be considered for funding in 2012 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 2012 budget 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 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 2012***

In preparation for unforeseen shocks to the domestic economy, the Government will continue to pursue policies towards achieving a balanced budget in 2012. The economic growth rate for 2012 is forecasted to be 4.0 per cent in real terms, while the inflation rate is projected to be within the range of 3.0 to 4.0 per cent.

<b>Budget Targets for 2012</b>	<b>Long term fiscal objectives</b>
<b>Budget balance</b> Balanced Budget	Recurrent balance is positive over the medium-term
<b>Revenue</b> Recurrent revenue is forecast to be at least 19.0 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% of GDP.
<b>Expenditure</b> Recurrent expenditure is forecast to be 19.0 per cent of GDP	Expenditures are consistent with the budget balance objective
<b>Debt</b> Public debt remains at manageable level	Debt maintained at prudent levels so its share in GDP remains below 40.0 per cent
<b>Economic Growth</b> Growth forecast at 4.0 per cent	Annual economic growth rate averages at least more than population growth rate (2.3 per cent)
<b>Inflation</b> Inflation forecast at 3.0 – 4.0 per cent	Annual inflation rate remains below 4.0 per cent

## ***6. Conclusion***

Preparation for the Budget 2012 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, regardless of 2012 being the year of election; it will focus on being critically accountable and fiscally responsible towards achieving a sound, manageable and balanced budget 2012.