



Vanuatu

Economic activity in Vanuatu during 1995 continued at the subdued pace established in 1994. Improved export receipts and some recovery in tourism helped to keep economic growth at about the same level as in 1994. On a brighter note, the balance-of-payments current account deficit contracted and an improved revenue performance helped to keep the fiscal deficit at a low level. Inflation also declined over the year despite the imposition of a new turnover tax at the beginning of 1995. Other reforms of the taxation system are being considered. The need for more wide-ranging reforms of the public sector to improve the efficiency of decision making and to enlarge substantially the scope for private sector activity remains a priority.

Recent Trends and Prospects

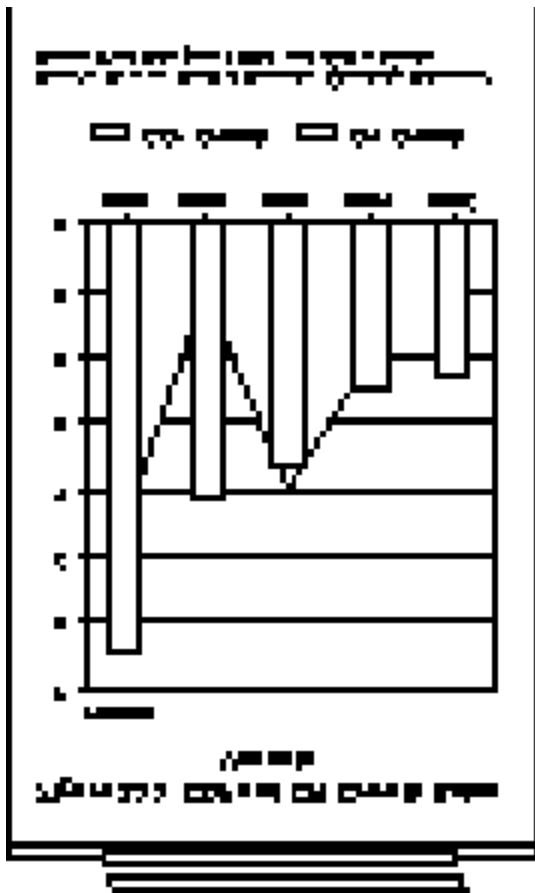
Growth of the Vanuatu economy in 1995 is estimated at 2 percent, the same as in 1994. Although sectoral details are not available, indications are that most of that growth originated in the export-oriented agriculture sector and in service activities related to tourism. Increased income from copra was the main feature in agriculture in 1995; however, that increase came largely from higher world prices rather than from a higher volume of copra production. In the case of tourism, much of the growth occurred in tourist ship arrivals; hotel room occupancy rates declined.

In its fiscal operations, the Government has endeavored to avoid deficits in the recurrent budget, leaving development expenditure to be financed from external grants and concessional loans. In 1995, it was again successful

in doing so. A recurrent surplus estimated at 3.7 percent of GDP was achieved, following a surplus of 2.2 percent in 1994. Current revenue rose by nearly 13 percent and current expenditure by about 7 percent. The increase in revenue largely resulted from the imposition in January 1995 of a turnover tax of 4 percent on wholesale and retail trade. To lessen the burden on disadvantaged sections of the community, a number of essential consumer items were exempted from import duties. Steps were also taken to rationalize the import tariff system, which contributes nearly 65 percent of tax revenue, by eliminating various other duty exemptions. Development expenditure in 1995 was estimated at about 11 percent of GDP compared with about 9 percent in 1994. External grants for development projects, other than technical assistance, amounted on average to an estimated 6.6 percent of GDP in 1994 and in 1995. The overall budget deficit after allowing for grants was an estimated 0.9 percent of GDP in 1995 compared with 0.5 percent in 1994 and 2.7 percent in 1993.

Money supply (M3) showed little growth during 1995, increasing by less than 3 percent compared with a more substantial rise in 1994. The rate of inflation declined. There was a sharp increase in prices in the early part of the year following the imposition of the turnover tax; subsequently, prices remained fairly stable so that, for the year as a whole, the average increase in the CPI was 2.3 percent (Figure 2.33).

The external position of Vanuatu showed modest improvement in 1995. Export earnings were up by some 6 percent, mainly because of improved prices for some commodities



such as copra, although there were also increases in exports of several minor cash crops. However, export earnings remained sufficient to cover only 31 percent of imports and the trade deficit declined only slightly to 26.9 percent of GDP. Net services receipts, especially from tourism, together with increased official transfers were 18 percent higher, so that the current deficit at 2.4 percent was less than half of what it was in 1994. Capital movements were sufficient to generate an overall surplus and to enable the external reserves to remain at the equivalent of nearly eight months of imports. External debt remains low at about 22.5 percent of GDP. Most loans have been concessional so that the debt-service ratio is also very low at about 2.5 percent in 1995.

The immediate outlook for the economy is for a continuation in 1996 of the lackluster economic conditions experienced in 1994 and 1995, with growth at 2 percent or less. The main stimulus is likely again to come from tourism. Government fiscal operations should continue to display a prudent stance and there could be some further progress in

implementing reforms of the taxation structure as recommended following a review in 1994. Some limited measures toward the privatization of certain commercial activities of the Government are also a possibility. The external accounts are also unlikely to show much change in 1996, with the trade deficit remaining at around 27 percent of GDP and the current account deficit largely covered by external assistance and concessional finance.

Policy and Development Issues

Vanuatu has been fairly successful in maintaining macroeconomic stability in recent years. Inflation has been modest, and the balance-of-payments and fiscal deficits have been kept under control with the aid of external assistance. However, economic growth has declined and has been insufficient to enable any increase in per capita income over the past three years. If the economy is to reach a higher and sustainable growth path, reforms in a number of areas are needed. A major reform would be to reduce the size of the civil service and increase its efficiency in the design of policy and in the management and delivery of essential services such as education, health, and public infrastructure. Privatization of commercial activities should be pursued more vigorously, although the creation of private monopolies needs to be guarded against if economic efficiency is to be served. Private sector involvement in the development process needs to be encouraged; this calls for a much more transparent and coherent policy framework and procedures governing foreign investment and business licensing so that investor confidence can be restored.

Tax reform is an urgent requirement, especially to reduce reliance on import tariffs which impede the development of a more internationally competitive private sector in tradeable goods and services. The lack of skilled workers is also a serious impediment to economic development generally as well as to the maintenance of physical infrastructure. Adult literacy rates are low and only about 9 percent of primary school children advance to secondary school. Real public expenditure on education has declined by 20 percent over the last decade. Reversal of this trend should be a central objective in reforms of the civil service and public expenditure structure.