

Development Constraints

The development of Vanuatu's agriculture and fisheries faces many constraints, some natural, many man-made. These constraints have been documented in previous reviews. However, the focus has often been on symptoms rather than on underlying causes. As a result, efficient responses based on the individual motivations of growers, their knowledge and beliefs about the future, available prices, and resources at hand are judged as constraints rather than symptoms. The design of effective policy to improve the functioning of the market must focus on the causes of the failure for markets to develop.

Returns to agricultural production, be it food gardening or commercial farming, are depressed and distorted at all stages in the supply process from garden or farm to the market. Much agricultural activity in Vanuatu is subsistence or self-sufficiency farming with some surplus exchanged or traded for cash to pay for things such as school fees, travel expenses, consumer goods and services. Families provide for their welfare largely through their own efforts, and there is relatively little specialization. Viable commercial agricultural activity in Vanuatu has emerged from the food garden to a more important degree than concepts and projects imported from abroad by governments, donors, or expatriates.³⁰

Fishing is subject to the same constraints as agriculture. However, there are specific constraints and a number of policy issues requiring urgent attention. Fishing differs from agriculture in that the community owns the resource, which the Government manages. Regulation to allocate access, to compensate the community, and to ensure sustainable practices is more critical to fishing than agriculture. Moreover, Vanuatu fishers share resources with foreign fishers, in Vanuatu's EEZ and on the high seas. A major impediment to development is the lack of suitable regulations and management plans to ensure sustainable fishing in Vanuatu's waters and compliance with international fishing and marine environmental agreements.

Physical Constraints

Vanuatu has agronomic and climatic conditions suitable to the raising of a wide range of crops and livestock. Resources of fertile land per person, except in some areas, are relatively high by international standards. Custom ownership and the traditional sharing of produce

³⁰ Food gardens have created value whereas larger-scale specialized projects sponsored by governments and donors have, with almost no exception, lost money and therefore reduced living standards.

are an important strategy for providing security by managing risk.³¹ However, lack of ownership and inalienable title to land can undermine efforts to combine land parcels and take advantage of economies of scale, specialization, and market exchange. Inability to transfer ownership of land is also a constraint on borrowing and the introduction of new ideas and capital where banks follow tradition in their demands for collateral.³²

The Review Team often heard conflicting views on the difficulty of obtaining access to land and the terms of that access. Some regarded this as a serious constraint while others pointed to successful farming projects established under long (up to 75-year) leases. However, the process of obtaining access could be considered unnecessarily complex and capable of being simplified.

Credit Constraints

In free markets, competition among lenders produces innovative solutions to specific impediments. Subsistence farmers themselves have developed forms of savings and lending that involve the exchange of goods or labor to be repaid later in kind, and to a much lesser extent such exchange by means of accumulated cash surpluses. These arrangements, given their context, should not be regarded as primitive or inefficient.³³

Credit markets require both demand and supply. The demand for credit is restricted by its high cost, the attitude of smallholders to the

³¹ Most of Vanuatu's land ownership is not formally recorded. Land cannot be sold or alienated, making it difficult to lease land for commercial and development purposes, to transfer land, or to use it as security for loans. This applies to Ni-Vanuatu wishing to develop their land, and foreigners applying for leasehold. About 80 percent of land in Vanuatu is under *kastom* usage in rural areas, with the remaining 20 percent under lease or owned by the Government. Developing *kastom* land is difficult because of the lack of a formal title, disputes over ownership, and difficulties in delimiting boundaries verified only by oral history. Only registered *kastom* land can be leased. The lack of legal title prevents the land from being leased or used as collateral for loans. To gain leasehold, an intending lessee must first obtain a certificate from the Department of Lands, negotiate with *kastom* owners, and ensure all outstanding disputes are resolved. The *kastom* owners can renegotiate the lease terms at any time.

³² Banks in Vanuatu, both foreign and local, seek security either in the form of equity in land or savings equivalent to the value of the loan. But interest payments on savings are very low compared with the interest payments demanded by the banks. It therefore makes no sense to take out a loan on such conditions.

³³ Theodore Schultz won a Nobel Prize for his pioneering work in modern development economics. He was applauded for his observations that subsistence farming and their methods of "market" organization had evolved out of necessity to become efficient and relatively sophisticated. This was not to deny that farmers could become more productive with access to improved knowledge and capital. However, it does cast doubt on extension services designed to inform farmers about things in which they are expert and inappropriate schemes to provide rural credit to farmers, often when they have no immediate uses for such credit.

considerable risks that they face (often made worse by state interventions), and returns to investment that are depressed by high input costs (implements, intermediate goods, labor costs, etc.) and uncertain access to markets. Returns to investment are often judged not to be worth taking the risks.³⁴

The CRP does not address financial market reform other than merging the balance sheets of failing state banks. There is limited competition in financial markets and this reduces incentives to reduce the costs of lending. The result is that credit is unavailable except at high rates. The private banking sector in Vanuatu needs to be exposed to competitive pressures by the removal of any barriers to entry for financial intermediaries, both large and small. It is likely that there is a significant element of natural monopoly in banking, given the small size of the Vanuatu market and the limited savings of its citizens. That is, the market can support only a few banks. If this is the case, competition among banks may be limited and the Government may need to consider regulatory oversight to encourage competition.

Local credit initiatives, formal or informal, should be allowed to develop with minimum prudential regulation. In terms of credit provision, locally based “microfinance” may have certain competitive advantages over the banks based in Port Vila and Santo. Advantages include lower overhead and transaction costs; lower costs of obtaining specific information about persons, place, and project, and greater ability to collect based on proximity and the use of customary or social mechanisms. The absence of a vigorous microcredit market has meant that any savings have flowed to the banks in Port Vila, never to return to be invested locally where risks are judged by the banks to be unmanageable.

Natural Risks

Markets cannot prevent cyclones but they can mitigate their effects. Smallholder farmers already adopt apparently efficient strategies to

³⁴To illustrate, consider a donor/Government-sponsored coconut improvement project in the 1980s. Smallholders were encouraged (and subsidized) to replace productive trees with improved hybrids. On the whole, they showed a disappointing, though rational, lack of enthusiasm. Department of Agriculture (1995) concluded:

The concentration of adoption of higher yielding coconuts amongst the larger (richer) farmers can be appreciated. This group is more likely to take the risk of speculative investment than smaller, more risk averse farmers for whom the investment may mean a significant deferment of consumption, with no guarantee of a realised return. For the risk averse group of non-adopters, higher yields are not necessarily an important attribute of a coconut. The higher potential production improved coconuts offer, but at a cost, can also be obtained, should it be wanted, by planting traditional material over a larger area, at no cost (or at lower cost). In Vanuatu, land availability in the majority of cases is not a constraint.

deal with the risk of cyclones. Food gardens are planted inland surrounded by bush. Large-scale and capital-intensive plantings of crops with long payback periods are deterred. These strategies may be efficient in reducing the cost of cyclones, but they are not cost-free. The costs are in terms of shortened outlook, and low commitment to capital and larger, more efficient-size plantings. A vibrant market provides some mechanisms to reduce the costs of cyclones that may reduce the costs of current strategies. By improving returns to effort, wealth is created to provide for future contingencies and to adopt ideas to reduce cyclone damage.

Cultural Constraints

Vanuatu custom places great value on giving. Prestige is measured partly in willingness and ability to share the fruits of effort. Many consider this to be inconsistent with the profit motive and the drive to accumulate surpluses for investment. These altruistic motives are present to varying degrees in all advanced economies. There is nothing wrong or inefficient with sharing as this has evolved as an efficient mechanism to reduce risk and earn prestige in communities with few other outlets, and in response to the limited need to save (or accumulate) to even out living standards throughout the year. Greater profits also provide a means to win prestige. Individuals can make rational choices to keep back that part of the surplus cash or product necessary for reinvestment in working capital or planting material. It is not so much that the Ni-Vanuatu confound the laws of economics while, like the rest of us, obeying the laws of physics, but they, like everyone else, make the best of their circumstances.

Wages and Productivity

Labor is said to constrain agricultural development in these respects: its relatively high cost and low productivity compared with labor in competing nations and its relative scarcity and unreliability of supply. The high cost of rural labor naturally reflects the value of time spent in subsistence production and valued social and recreational activities. The subsistence wage in Vanuatu is relatively high, reflecting the relatively high standard of living that subsistence provides.³⁵

³⁵The Review Team learned of a number of cases where experienced and competent staff laid off following the civil service strike in 1993 could not be reemployed even into relatively senior and highly paid positions. The view was that the subsistence lifestyle was far too pleasant to induce them back to the rigors and high cost of Port Vila.

This is a positive attribute of a high subsistence wage. The other side to the coin is that to induce smallholders into employment, wages commensurate with the high cost of living must be paid.³⁶ High prices for consumer goods contribute to high wages.

Low productivity reflects lack of capital and implements and limited adoption of productivity-enhancing technology. These factors in turn reflect, as discussed earlier, poor returns to investment in capital, effort, and knowledge. This must be because risks are excessively high, costs of inputs are high, and transport and marketing costs are high. Despite high prices at market, therefore, returns to growers (or grower prices) are low. High costs in themselves undermine incentives to become more productive.

Given the cost structure of the Vanuatu economy, it therefore cannot be said that the source of low labor productivity and high wages is the fault of the smallholder or rural laborer. Given the circumstances and apart from some regulations concerning employment and severance conditions, labor markets are competitive and efficient. The problems of underdevelopment lie elsewhere.

Purchased Inputs

Farming in much of the smallholder sector is labor-intensive with minimal use made of implements, almost no use of machinery, and little use of intermediate inputs. The agricultural systems adopted reflect the high cost of capital, even working capital, and the lack of cash surpluses with which to finance the purchase of implements and machines. High import duties and very high transport costs have inflated the costs of intermediate inputs and capital goods.³⁷ High risks, from cyclones and market vagaries, and relatively low returns to farming would also deter investment in capital.

The lack of use of chemicals, such as fertilizers and pesticides, in part reflects the natural fertility of the soil and the fact that most pests and diseases are more manageable in an intensive food garden. However, there is still a significant potential for reducing crop losses

³⁶Wage rates in Vanuatu are generally set in competitive markets, with the exception of the relatively high wages paid to politicians and civil servants. The minimum wage of Vt16,000 a month (or a little over Vt500 a day) is low compared with the returns to labor from most crops in Vanuatu. Most workers receive well in excess of this amount or they would remain in subsistence, provided they have access to land. It is therefore unlikely to present a disincentive to work.

³⁷According to ADB (1997) there was a 37 percent duty on barbed wire, a 150 percent duty on imported diesel fuel, a 7 percent import duty on fertilizer and cartons. Import duties on these imported inputs have been significantly reduced under the CRP.

to disease and pests. The organic farming of Vanuatu suggests opportunities to supply growing markets for organically grown food. While this may well be the case, it does not suggest that organic necessarily means micro scale, with its very high unit costs.

Infrastructure

Lack of roads and the poor standard of existing roads contribute to the high cash costs of paid road transport and the high costs (in terms of effort and time) in carrying products to beach points for collection by visiting vessels. Inadequate and poorly maintained roads add to the cost of transport because of the greater time involved, greater wear and tear on vehicles, and damage to produce.

The direct and indirect benefits to investment in main roads, feeder roads, and jetties can be high, but only when the investment generates net social and economic benefits. In Vanuatu there are many examples of infrastructure projects that have not provided benefits to rural communities commensurate with Vanuatu's contribution to the costs, in some cases any benefit at all. In other cases, benefits have been short-term as roads and jetties have deteriorated for want of resources for maintenance.

Lack of storage facilities, and in the case of fishing, lack of ice-making machines, has been identified as a constraint on marketing produce. The response of governments and donors in the past was to build such facilities rather than to understand why it was not economically rational for the private sector, which stood to capture any benefits, to build even the rudimentary facilities appropriate to many commodities. The interventionist approach resulted in rusting, disused ice-making machines. Where economics has dictated that storage facilities be built, these have more often been appropriate and generated returns in excess of their costs. The reasons why storage facilities, even those well within the means of farmers to build, have not been built is more likely to be related to poor returns on investment due to impediments elsewhere in the economy. Improved market efficiency will improve the potential returns from investment in storage and ice making to growers and fishers, and those who source their supplies from them.

The MAQFF has no role in the provision of infrastructure such as roads and jetties. Infrastructure provision is the responsibility of other ministries. However, the MAQFF can facilitate private development in agriculture by advising these ministries and donor agencies about the infrastructure needs of farmers and projects likely to maximize development benefits.

Energy and Utility Costs

The costs of primary energy (fuel) and secondary energy (electricity and motor spirit) are very high in Vanuatu compared with costs in the region in which it is located and in the rest of the world to which it seeks to sell its products. Energy costs would be naturally high in a competitive market, but there are a number of artificial factors that raise costs even further. All fuel is imported and subject to extremely high duties. This raises transport costs, farming costs (depending on the amount of diesel fuel used), and the costs of processing agricultural and fishing products, and seriously erodes the viability of fishing.³⁸ Import duties, such as those on fuel, impose other direct and indirect costs on agriculture and fisheries and these are discussed below.

Another issue concerns the high landed cost of diesel fuel. Various reasons have been given for this, including limited storage facilities for imported refined petroleum products. The proposition is that this prevents Vanuatu from taking advantage of price discounts associated with large lot purchases and the economies of using larger ships. The view of the Review Team is that such economies of scale in purchasing and transportation are relatively small in comparison to the value of the fuel. In seeking a culprit for high landed fuel costs a more fruitful ground to be explored may be the competitiveness of the marketing arrangements of the oil companies and distributors.³⁹

For diesel-generated electricity, prices in Vanuatu are extremely high by international standards. High fuel costs and the small domestic market explain some of the cost disadvantage and it is acknowledged that reliability of services is better than in many other countries. That said, lack of competition and effective oversight of the monopoly supplier UNELCO certainly does not provide incentives to lower profit margins and to seek innovative cost reductions. High electricity prices add to the overall cost structure in Vanuatu

³⁸While fishermen qualify for some relief through duty exemptions, this amounts to only a small percentage of the amount of duty. The commercial price of diesel in Vanuatu is around Vt93.8 per liter. The Government price is Vt81.5 while the duty-free price to fishermen is Vt60.13 per liter for category A and Vt64.6 per liter for category B fishermen. The cheapest fuel, at Vt60 per liter, is 35 percent more expensive than the regional average and, combined with high electricity charges that would be imposed on shore facilities, is the major impediment to the development of the domestic tuna industry.

³⁹International markets for refined crude products are highly competitive. Domestic markets will reflect that degree of competitiveness only when there are no barriers to competition arising from import restrictions (such as import licenses and tariffs) and no barriers inhibiting competing suppliers from entering the market and distributing their products.

and therefore reduce the competitiveness of the agriculture and fishing sector. Directly, high electricity prices are a leading disincentive to further process and add value to agricultural and fishing produce in Vanuatu.

Urban water is also monopoly-supplied by UNELCO under contract with the Government. The high cost of water adds to the general cost level and specifically discriminates against processing activities that require large volumes of competitively priced water.

The world has experienced a revolution in communications, part of which was facilitated by the opening of telephone lines to competition. Telecom operates a communications monopoly in Vanuatu, being responsible for the provision of telephone, mobile telephone, and Internet services. Telephone charges are very high and a mobile phone network effectively does not exist. Internet access is satisfactory, to those few who can afford the very high rates.

Low-cost communications would dramatically increase the supply of knowledge (market and technical) to farmers in rural areas and reduce the costs of providing it. This would contribute to a major improvement in the linking of production decisions with market demand, reduce waste and shipping costs through a more efficient land-sea (or land-air) interface, expose producers to new ways of thinking and new ideas, and allow them to take advantage of niche market opportunities.

In a small country such as Vanuatu, electricity, water, and communications services are likely to have a strong natural element of monopoly.⁴⁰ Even if there is a case for monopoly supply, sensible utility regulation and price oversight provides a means of retaining the efficiency of single, private firm supply while at the same time avoiding monopoly pricing. Under the CRP, the Government is committed to reviewing the contractual arrangements with UNELCO and Telecom and to creating a regulatory body to regulate utility activities and pricing policies. This initiative would encourage more competitively priced services and provide an important stimulus to the development of agriculture and fisheries, particularly in the form of further processing. However, the Review Team must note that nothing concrete has been achieved in this area at the time of writing and prices have certainly not fallen (in fact, electricity prices have risen).

⁴⁰ Although it should be observed that competition provides powerful incentives to innovate around natural monopolies to capture monopoly rents for a time (for example, mobile phones and efficient small-scale electricity-generating technology).

As in other areas that are the responsibility of other ministries, the MAQFF can play a useful facilitating role in ensuring that the Government places an appropriate priority on a major constraint on the development of agriculture and fishing. To communicate this priority effectively the MAQFF needs to arm its clients with sound evidence of the magnitude of the benefits of reform to agricultural development and the value of these benefits to Vanuatu.

Shipping and Airfreight

High cost, unreliable and infrequent shipping, and poor quality of service have been major constraints on growth in interisland and international trade in rural produce. Large distances, small populations, poor communications, and small volumes are natural constraints. These will always contribute to relatively high cost and limited services to most islands, but particularly to the outer islands. These constraints, however, were made worse by inappropriate Government interventions.

Two CRP initiatives promise to result in increased competition and with that reduced freight rates and better service. These are the repeal of legislation limiting entry into coastal shipping to vessels owned by Ni-Vanuatu and the abolition of route licenses that constrained competition on a number of routes. The effect of these restrictions was collusion in price setting and limited incentives to invest in new vessels and to provide more efficient services.

International airline services to Vanuatu are dominated by the state-owned airline Air Vanuatu. CRP has not focused on this issue and previous reviews such as ADB (1997) advocated the introduction of an “open skies” policy to enhance competition and to ensure that supplies of cargo space are sufficient to meet Vanuatu’s needs. The situation in relation to entry into the private airfreight business is unclear in Vanuatu. At present Air Vanuatu operates a limited schedule of services in terms of frequency and destination. There are no direct flights to many of Vanuatu’s major existing and potential export markets. While this has not to date constrained agricultural exports that require airfreight, there would be benefits in opening up the air to greater competition.

In the previous section of this review, it was argued that there is some potential for Vanuatu to supply fresh fruit, flowers, vegetables, and seafood, taking advantage of off-season market opportunities. For this to develop there is a need to ensure that airfreight capacity is available at competitive rates. Currently, Air Vanuatu’s capacity would not allow any significant development of fresh-food exports.

Export Marketing

Through the VCMB, the Government controlled a large part of Vanuatu's commodity exports—copra, cocoa, and for a time kava were prescribed commodities whose export was a VCMB monopoly. The actions of the VCMB undermined the development of export-oriented agriculture in Vanuatu. Prices were set and, for extended periods, subsidized under Government influence. As such, prices did not transmit valuable information to growers upon which they could base sensible production decisions.

Margins charged by the VCMB were necessarily high to recoup the high costs of its inefficient operations. Even with its monopoly, the VCMB lost large amounts of money and therefore did not have the resources, much less the incentive, to maintain service standards. Poor handling and storage resulted in lost quality, further reducing returns to growers.

The dismantling of the VCMB monopoly will increase competition among buyers for produce and should result in higher returns to growers as marketing margins fall.⁴¹ Even where there are few buyers, attempts to collude on prices would be undermined by the potential entry of other buyers and the option of growers, acting individually or collectively, to bypass traders and sell direct.

Export marketing is now predominantly in private hands. However, there are threats to this desirable situation. Politicians and civil servants in Vanuatu have inherited a tendency to seek to control or plan development and market activity. This manifests itself in phrases such as “orderly marketing,” the “formalization of marketing systems,” “maintaining export quality,” and identifying “niche market” opportunities.

Market participants know how to market and if unfettered by government regulations will develop efficient marketing systems. They have nothing to learn in this regard from civil servants. Buyers and sellers are continuously seeking each other out, searching for profitable investment opportunities and mutually beneficial exchange. If there are niche market opportunities, the private sector will find them, sift through them and invest only where profits can be made. If prospects change, funds and resources are rapidly withdrawn and channeled elsewhere. It would be a mistake for the Government to “tame” or make export marketing more orderly.

⁴¹The VCMB is to be corporatized and must then compete on its own merits without budget assistance.

Local Marketing

The marketing of kava and food crops in Vanuatu is largely unregulated. While there are constraints on marketing, private marketing systems, though rudimentary, could be judged to be relatively efficient. Other than in providing infrastructure, developing market information (extension), and regulating to protect public health and safety and to protect buyers and sellers from unfair trading practices, government has no role to play in the marketing of produce.

Under the CRP, the Government is committed to introducing a body of trade practices law. The MAQFF could play a useful role in assisting in the development of competition in food markets in Vanuatu. Thus it could represent the interests of its clients by bringing cases of unfair or monopoly practices to the attention of the trade practices regulator. It could also play a useful role in providing research and advice to aggrieved parties.

Relative to the size of Vanuatu, Port Vila is an important and fast-growing outlet for produce grown on Efate and other islands. There is scope for substantially increased sales to residents, restaurants, hotels, and tourists. However, demand for locally grown produce will increase only if prices are competitive with imported foodstuffs. Despite the high import duties on food, imported foods account for a large proportion of local consumption and are a major item in Vanuatu's import bill. With tariffs falling (under the CRP and if Vanuatu is to gain entry into the World Trade Organization) and the removal of several monopoly import licenses for a range of staples, competition from imports will intensify. As the constraints on development identified in this review are eased, costs of landing produce in Port Vila and Luganville will fall. It is important that the benefits of these cost savings are passed through to consumers in the form of lower prices and to growers in the form of higher returns. Colluding retailers must not be allowed to capture the benefits. Barriers to entry at the retail level must be identified and removed to allow greater competition in retailing. The MAQFF should assist the future trade practices regulator in this important work.

A curiosity of Port Vila is the market practices adopted by vendors in the public market.⁴² Across scores of vendors, prices are identical and produce is sold in lots or bundles rather than by weight and quality. In some cases bundles of produce have poorer speci-

⁴²Vendors mainly sell food crops grown by themselves or others in their village. There are a few "retailers" who purchase food from Efate and other islands for resale at the markets. Some residents sell produce sent to Port Vila from other islands by their relatives.

mens in the middle, although repeat buying could limit this practice. For some items vendors maintain that prices have not changed for decades. Price does not vary through the day or through the week, although the size of lots is increased toward the end of the vendors' trading period. Vendors appear to be unwilling to reduce prices on nonperishable or semiperishable items such as yams, plantain, or pumpkin, and would rather take these home. For perishables such as island cabbage there is a greater willingness to offload wilting produce through lower prices.

The village ladies have not developed a radical approach to marketing but their actions are dictated by municipal regulations. Who first called for such regulations, civil servant or vendor, is unclear, although many vendors with access to the market claim to benefit from the regulations.⁴³

The essence of the municipal regulation is this. Time at the Port Vila market is allocated to different villages in Efate. Similar regulations apply in the Luganville market. On many days, all the vendors are from the same village.⁴⁴ A dim view is taken of anyone trying to increase his or her sales by competing on price. There is a strong *tabu* against competition. There are two outcomes: high prices and discontinuities in the supply of certain products during the week reflecting the specializations of each village. Except for those who can time their purchases according to the schedule of vendors, there is likely to be significant unsatisfied demand. The need to make multiple trips to the market to obtain the desired range of produce, in some cases leaving Mother Hubbard's cupboard bare, adds to the cost of buying from the market.⁴⁵

In other parts of Port Vila and in rural areas these practices are less prevalent. In the suburbs of Vila informal markets, roadside stalls, and door-to-door sales have increased, providing competition to the Port Vila market. Although prices are still high, this is because of the high costs of obtaining produce rather than the result of anticompetitive practices. This informal market sector appears to be

⁴³ Before the establishment of the Port Vila market, vendors used to set up stalls along Port Vila's streets. Entry was free to anyone wishing to set up a stall. At the Port Vila market, only those allotted access and who have paid a Vt400 fee per stall can trade.

⁴⁴ In Port Vila, the first three days are reserved for farmers from around Port Vila and the final two days (Friday and Saturday) are allocated to all comers. In Luganville there are three market days per week. One day each fortnight is allocated to each of six groups of villages and this regulation is strongly enforced.

⁴⁵ On one day in Luganville a pickup laden with peanuts was turned away because it had come on the wrong day. Yet there were no peanuts available at the market on that day.

unregulated and appropriately so. These sellers increase the opportunities for buyers to shop around and to punish poor quality and excessive prices by taking their custom elsewhere. The introduction of quality standards for food crops is inappropriate and could see further increases in prices and hardship for families unable to afford that quality standard. The market will sort itself along the quality spectrum in a way that satisfies both preferences and budgets.

An important “trade” involves the shipping of food baskets from other islands to support relatives living in Port Vila. As Port Vila’s population has become increasingly diverse with migration from other islands, the importance of this trade has grown. It provides an important form of food security for locals originally from other islands that do not have access to land and whose tight budgets are challenged by Port Vila’s high prices. This trade is mostly nonmonetarized, although Port Vila residents are obliged to reciprocate by sending cash back home. Presumably if food continues to flow, both sides are happy with the terms of the exchange.⁴⁶

The market regulations in Port Vila constitute a barrier to competition and therefore a significant constraint on the development of food markets. The MAQFF should encourage the municipal government to dismantle these restrictive regulations.

Trade and Exchange Rate Policy

Both trade taxes and the exchange rate policy have discriminated against the development of the agricultural and fishing industries in Vanuatu. It is probably incorrect to say that Vanuatu has pursued a trade policy. Taxes have been levied on trade for convenience rather than to encourage import substitution and greater processing of raw material exports. In any case, trade policy has not had these effects as little has grown up behind the relatively high tariff walls.

Tariffs are a tax on exports, a fact well recognized throughout the world, and most countries are rapidly dismantling barriers to trade. In Vanuatu the agricultural sector was hit twice: first by tariffs which raised its input costs and caused the exchange rate to appreciate, and thereby reduced the country’s ability to compete on export markets. What exports crawled over this hurdle were hit by relatively high taxes levied on the value of exports.

Some agricultural producers, particularly those producing import substitutes have probably benefited from the protection afforded by

⁴⁶It would be of interest to compare the “shadow prices” of this free trade with market prices in Port Vila. It is likely that these prices are significantly lower.

high tariffs on imported foods. For example, imported fish products attract a 72 percent import duty, cheese 52 percent, and vegetables 47 percent, to name a few. Despite this protection at the cost of consumers, Vanuatu has a far from viable dairy and fishing industry.

Under the CRP, an export tax of 4 percent of value has been abolished and this alone will greatly encourage export-oriented projects. However, while tariffs have been reduced somewhat and there is commitment to further reforms, tariffs remain high and continue to impose a burden on the sector.⁴⁷ There are concerns that the pace of tariff reform has been too slow. The proposed entry of Vanuatu into the World Trade Organization (WTO) will see trade barriers fall significantly and this will be of considerable benefit to agriculture and fisheries.

Vatu exchange rates are determined by comparison with a basket of currencies, and movements in exchange rates seem to be based more on maintaining foreign exchange reserves than the fundamentals of the Vanuatu economy. It is unclear what the market value of the vatu would be if it were freely floated. Pressures to devalue in the past have been relatively isolated, although the flow of donor aid has undoubtedly contributed to the balance of payments (aid flows have averaged around 20 percent of GDP over the past decade). If aid flows dried up, it is likely that the value of the vatu would fall significantly. Provided local prices did not rise to the same extent, this would result in a considerable improvement in the ability of Vanuatu farmers to compete in overseas markets.

Political Constraints

Past Vanuatu governments have followed strongly interventionist policies and, with the assistance of a number of donor agencies, were directly involved in agricultural production and marketing. Normally these projects first involved Government as an equity holder with management provided by foreigners. *Bel Mol*, *Metenesel*, *South Pacific Tuna*, the *Vanuatu Livestock Development Corporation*, and *Tanna Coffee* were projects of this nature that all shared the same fate. When the projects failed, the foreigners withdrew, leaving the projects under state control.

Interventionist policies are particularly prone to failure when administered by corrupt government and public officials. These projects

⁴⁷In 1998 the average level of tariffs was lowered from 29 percent to 22 percent. Further reductions are to take place each year up to 2004, by which date the average level of tariffs will have been reduced by one third.

made very large losses because of poor project design, unfavorable market trends, and inept and in some cases corrupt management. Political connections rather than ability have too often determined the composition of state enterprise boards and management in Vanuatu.

The 1980s for Vanuatu were a period of relative political stability, if not one of economic policy reform. Through the 1990s, there was increasing political instability culminating in the three governments of 1996. Since board membership was normally a political reward, the operations and oversight of state enterprises were adversely affected.

The major initial focus of the CRP was institutional reform, strengthening the civil service and making it less prone to political instability and discretion. While much progress was made under the previous government, the political situation remains volatile and there is growing populist resistance to the continuation of the CRP. More recently, the Government has sought greater control over the appointment of the directors general of ministries.

An important principle of the CRP that is accepted by the current Government is the need for the private sector to take the lead in economic development. The role of government is now seen as “facilitating” private-sector development. This has seen the privatization of some Government enterprises involved in agricultural production and recommendations to corporatize and then privatize the remainder. The MAQFF has a reduced role to play in production and must now focus on its core activities of extension, research, and private-sector facilitation.

However, the capacity of the MAQFF to begin this task is severely limited in two major respects. First, its ranks were severely depleted by the 1993 civil service strike and by CRP “rightsizing.” Second, many civil servants do not understand business and are unsure of what to do to help business to flourish. Many are uncomfortable with leaving such an important task as agricultural development to the private sector. This is a legacy of the past when the work of civil servants was focused on developing and overseeing agricultural projects. It cannot be left to businessmen to tell them how to facilitate private-sector development, as businessmen too often tend to place their interests first and seek positive assistance, if not subsidies, rather than the removal of the impediments to their businesses.

Even if there was a strong civil service administering sound policies and laws conducive to economic development, development will not take place unless there is both political stability and reduced

political interference in the work of the public service. The Review Team concurs with the conclusions of the 1997 ADB review that unless Vanuatu is able to provide a more stable form of government, the environment for private sector investment will remain unsound.

Foreign Investment

The constraints discussed thus far apply in varying degrees to all agricultural endeavors, from smallholder gardens to plantations owned by Ni-Vanuatu, expatriates, or foreign investors. Foreign investment in agriculture and fisheries has the potential to greatly increase the stock of physical and human capital and technology available to add value to Vanuatu's natural resources. However, the constraints discussed above are a major deterrent to increased, good-quality foreign investment in the sector.

Vanuatu's shortcomings and advantages to foreign investors have been well documented in previous reports and in the 1997 ADB review. The Review Team does not reiterate them here. An objective of the CRP is to facilitate greater foreign investment by streamlining approval processes and providing a "one-stop-shop" in the form of the Foreign Investment Board (FIB). A law, the Foreign Investment Act No 15, was introduced in 1998. While a major shortcoming of the law was a list of activities exclusive to Ni-Vanuatu, this only indirectly affects investments in agriculture, though it has a more important impact on inshore fishing activity (see below).⁴⁸

The first annual report of the FIB released in April 2000 provided an indication of the progress made in relation to foreign investment and the impediments that still have to be removed. The FIB announced that it had failed to achieve its investment targets. In the period September 1998 to December 1999, there was foreign investment spending of Vt2.1 billion (about US\$16.1 million). Approved investments for the period totaled Vt13.1 billion. Two major contributors to investment spending were a tourist resort on Port Vila and the Santo Oil Mill (Coconut Oil Production Vanuatu). Tourism and manufacturing accounted for 70 percent of foreign investment in that period, indicating that foreign investment in agriculture and fishing was minimal.

The projects approved to date require a number of years for full implementation and therefore naturally expenditure last year will be less than the approved total projects' expenditures. However, the

⁴⁸To address concerns of investors and donor agencies, the Act was reviewed in 1999 and a bill removing some restrictive provisions was enacted by Parliament on 11 June 1999.

FIB expressed concern with the slow rate of implementation, ascribing its causes to inaccessibility of land and refusal to grant duty exemptions. Howard Aru, Acting Chief Executive Officer of the FIB, had this to say:⁴⁹

The major difficulties, it seems, are related largely to administrative barriers. More specifically, these are related to procedures and qualification criteria for certain incentives and investment permits/licenses processing time, old and outdated policies to facilitate investments, and the relaxed attitudes of so many civil servants involved one way or another in the whole investment process.

The Review Team discerned some ambivalence among politicians and civil servants toward foreign investment. Many pay lip service to it, but are concerned with losing control of their country. Vanuatu has a small commercial sector and this is already well subscribed by expatriates and foreigners. There is anecdotal evidence of growing resentment of the large and widening disparities in incomes and living standards between Ni-Vanuatu and the foreign-born.

Summary of Constraints and Policy Implications

The major constraints facing the development of agriculture and fisheries in Vanuatu are summarized in Table 2. Also included in the table is the Review Team's assessment of the major underlying causes of these constraints, the steps being taken to address those causes, and further actions that need to be taken either by the MAQFF or another ministry. The major constraints identified in this review include:

- Continuing high levels of import tariffs that effectively tax export industries such as agriculture
- High cost and unreliability of interisland shipping because of anticompetitive practices, poor communications and high fuel and other input costs
- Electricity, communications, and water costs that are very high by international standards
- Complexities in obtaining access to agricultural land
- Lack of competition in retail markets for agricultural products
- Poorly developed and maintained roads, storage, and other infrastructure

Many of the constraints are not the result of natural causes. They are either the result of, or made worse by, inappropriate policies or regulations. For agriculture and fisheries to develop, these impedi-

⁴⁹*The Trading Post Vanuatu*, 8 April 2000, page 2.

ments need to be removed. The CRP is addressing some of these impediments, but not all. Where it is addressing some of the impediments, the actions being taken in many cases do not go far enough. The MAQFF has an important role to play in working with the private sector to identify impediments to development, to remove any impediments within its responsibility, and to encourage the Government to address other impediments.

Many of the constraints facing agriculture and fisheries are outside of the role of the MAQFF. Most of the policy impediments and their removal or amendment are the responsibility of other parts of Government. This does not mean that the MAQFF has no role to play. The MAQFF should take the lead in identifying these constraints or impediments to development, undertaking the research necessary to support the case for reform (including quantifying the benefits of reform), and working with the private sector in lobbying Government to undertake the necessary actions.

The fisheries sector in Vanuatu faces many constraints on development, and shares many of these constraints with the agricultural sector. The potential for development of commercial fishing is limited by the relatively sparse resource in Vanuatu's waters. It is also constrained by the high costs of fishing arising from import duties on imported inputs, particularly fuel, the lack of capital, and the high costs of shipping or freighting fish to markets in Vanuatu or overseas. In the case of processing, additional constraints include the high costs of electricity and other utilities.

In addition, the development of sustainable commercial fishing activity in Vanuatu is constrained by the lack of knowledge about Vanuatu's fisheries resources and about sustainable catches and the absence of adequate fisheries legislation, regulations, and management plans. Without appropriate regulations there is a considerable threat to Vanuatu's fisheries resources from increased fishing activity, particularly from modern, high-impact fishing operations from overseas.

Table 2: Constraints on Agriculture and Fisheries Development

Constraint	Causes and/or Confounding Factors	Actions Being Taken	Further Actions Required	Role of the MAQFF
Land Complexities in obtaining leases over land for agricultural development	Complex regulations concerning negotiations with traditional landowners	Review of relevant legislation to register land titles and to simplify lease negotiation	Consideration should be given to withdrawal of Lands Department in favor of allowing private real estate agents to facilitate land negotiations and access	MAQFF should adopt an advisory role in this process
Credit Lack of access to credit in rural areas due to difficulties of assessing risks and land titles not being accepted as suitable collateral	Need to register ownership titles Review restrictions on entry to banking and finance and other regulations that may contribute to high lending margins and conservative borrowing strategies	State-owned banks have been restructured and regulations governing their activities amended Some initiatives to encourage development of rural credit unions and microfinance	Need to address issue of land titles and collateral Need to review barriers to entry and competition in banking and finance	MAQFF has a role to play in advising the relevant ministries of obstacles to entry and providing finance to farmers
Purchased inputs and capital equipment High costs of purchase and high costs of credit	Import duties on agricultural inputs and implements Uncompetitive financial sector and difficulty of obtaining working and investment capital	CRP has reduced tariffs to some extent but they remain high Financial market reforms have been limited	Further reductions in tariffs ultimately to low or even zero levels. More generally, need to eliminate taxes on business inputs Measures to reduce high transport costs Removal of obstacles to competition in financial markets	MAQFF has an important role to play in quantifying the costs of import protection to the agricultural sector and how these constrain the adoption of productivity-enhancing purchased inputs, implements, and capital
Interisland shipping and airfreight High costs, poor and infrequent service	Low traffic volumes Barriers to new entry due to restriction to Ni-Vanuatu ownership	Several restrictions have been abolished and standards for licensing of vessels have improved. Several new ports of entry have been opened allowing foreign vessels to service outer islands	Need to monitor developments and to address anticompetitive practices and monopoly pricing on routes subject to limited competition. Need to consider providing subsidized minimum level of service to outer islands (community service obligation)	MAQFF has no direct role to play in providing shipping services. However, it has an advisory role to play in relation to a future trade practices body that will address monopoly practices

Table 2: Constraints on Agriculture and Fisheries Development (Cont'd)

Constraint	Causes and/or Confounding Factors	Actions Being Taken	Further Actions Required	Role of the MAQFF
<p>Infrastructure Lack of feeder roads in producing areas and poor quality of roads and jetties, raising land transport costs</p>	<p>Early stage of economic development and lack of public funds to finance infrastructure development Deterioration of infrastructure due to "right-sizing" and budget cuts under CRP Inappropriate donor-funded infrastructure projects that have been beyond the capacity of local authorities to maintain</p>	<p>Infrastructure needs are being assessed</p>		<p>MAQFF has no role in the provision of infrastructure such as roads and jetties. Infrastructure provision is the responsibility of other ministries. However, MAQFF can facilitate private development in agriculture by advising these ministries and donor agencies about the infrastructure needs of farmers and projects likely to produce the maximum development benefits</p>
<p>Electricity, communications, and water costs High costs adding to general cost structure and reducing the competitiveness of Vanuatu in further processing</p>	<p>High underlying costs made worse by provision by largely unregulated monopoly suppliers</p>	<p>CRP has indicated that it would review contractual arrangements and establish an independent regulator to monitor charges and rates of return</p>	<p>An independent regulator should be established</p>	<p>MAQFF has a role to play in representing the interests of the sector before an independent regulator</p>
<p>Export marketing High costs of marketing, poor quality and loss of quality in the marketing chain, lack of innovation and effort in seeking new markets</p>	<p>VCMB had a monopoly over a large part of Vanuatu's agricultural exports. It subsidized copra growers, incurred large losses, charged high margins, and provided poor services</p>	<p>The monopoly powers of VCMB have been removed and competition has been introduced into marketing</p>	<p>Private-sector marketing should be allowed to operate freely with minimum Government intervention in marketing, including resisting calls for minimum export quality standards to be introduced</p>	<p>MAQFF has a role to play in providing broad market information to growers and acting as a liaison point for initial contacts between overseas buyers and growers. Extension services could be redirected away from farm-level advice toward greater emphasis on market advice through publications and media material</p>

<p>Local marketing</p> <p>Lack of competition, high prices, and poor quality reduce the ability of growers to compete with imported foodstuffs and constrain growth in markets for foods</p>	<p>Municipal regulations that create barriers to competition and entry in Vila and Luganville</p> <p>Restrictions on entry of foreigners into retailing and wholesaling</p> <p>Possible collusion among retailers of food in Vila and Luganville</p>	<p>Monopoly import licenses for certain products have been eliminated</p> <p>Turnover tax, a major impediment to investment in retailing, has been abolished</p>	<p>Need to abolish municipal regulations that restrict competition and to review barriers to entry into food marketing</p>	<p>MAQFF can play a role in analyzing wholesale and retail markets to identify barriers to entry and competition</p>
<p>Tariffs and exchange rate policy</p> <p>Tariffs are a major tax on exports and distort allocation of resources within the agriculture sector</p> <p>The exchange rate bears no relation to economic developments in Vanuatu and can play no role in adjusting to enhance the competitiveness of exporters</p>	<p>High proportion of revenue collected through import duties (and in the past export taxes) rather than through income taxes</p> <p>Method of setting the exchange rate against a fixed-weight basket of currencies</p> <p>Import taxes and the large capital inflows associated with foreign aid have contributed to an overvalued exchange rate</p>	<p>Minor reductions in tariffs have been made</p> <p>Export taxes have been abolished</p> <p>There is no exchange rate reform under CRP</p>	<p>Further reductions in tariffs will provide a major stimulus to the profitability of agriculture and fishing. Tariffs will need to be reduced for Vanuatu to enter the WTO</p> <p>Consideration needs to be given to providing greater flexibility or even ultimately floating the exchange rate so that it can adjust to reflect the competitiveness of Vanuatu's economy. A market-determined exchange rate could enhance the attractiveness of exporting agricultural products</p>	<p>MAQFF has a role to play in quantifying the benefits to the sector, and the economy more generally, of removing import duties and floating the vatu</p>
<p>Foreign investment</p> <p>Laws and approval processes were unattractive to foreign investors because of excessive risks and high costs of dealing with Government</p>	<p>Inappropriate laws and restrictions on foreign investors and unnecessarily complex approval processes and complex and distortive taxes</p>	<p>A new foreign investment law has been implemented, a one-stop FIB has been established, the tax system has been simplified</p>	<p>There are a range of further initiatives of CRP</p>	<p>MAQFF has a role to play in facilitating private investment in agriculture and identifying specific impediments to foreign agriculture development projects.</p>