

ASIAN DEVELOPMENT BANK

RRP: VAN 31485

**REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
BOARD OF DIRECTORS
ON A
PROPOSED LOAN
AND
TECHNICAL ASSISTANCE GRANT
TO THE
REPUBLIC OF VANUATU
FOR THE
COMPREHENSIVE REFORM PROGRAM**

June 1998

CURRENCY EQUIVALENTS

(As of 31 May 1998)

Currency Unit	-	Vatu (Vt)
US\$1.00	=	Vt 127.25
Vt100	=	US\$0.78

ABBREVIATIONS

AusAID	-	Australian Agency for International Development
CG	-	Consultative Group
CoM	-	Council of Ministers
CRP	-	Comprehensive Reform Program
DBV	-	Development Bank of Vanuatu
DG	-	Director-General
DSM	-	Department of Strategic Management
GDP	-	Gross Domestic Product
HR	-	Human Resource
HRD	-	Human Resource Development
MFEM	-	Ministry of Finance and Economic Management
NBV	-	National Bank of Vanuatu
NGO	-	Nongovernment Organization
NZODA	-	New Zealand Overseas Development Assistance
OFC	-	Offshore Financial Centre
PDMC	-	Pacific Developing Member Country
PS	-	Public Service
PSC	-	Public Service Commission
RBV	-	Reserve Bank of Vanuatu
TA	-	Technical Assistance
UNDP	-	United Nations Development Programme
VAT	-	Value-Added Tax
VFSC	-	Vanuatu Financial Services Commission
VNPF	-	Vanuatu National Provident Fund

NOTES

- (i) The fiscal year (FY) of the Government ends on 31 December.
- (ii) The term "ni-Vanuatu" refers to the people of Vanuatu.

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LOAN AND PROGRAM SUMMARY

Borrower	:	Republic of Vanuatu
The Proposal	:	<p>(i) A loan to support implementation of Vanuatu's Comprehensive Reform Program (CRP)</p> <p>(ii) Technical assistance (TA) for institutional support to the central agencies for the CRP</p> <p>(iii) The coordination of the support from other funding agencies for the implementation of the CRP</p>
The Program Rationale	:	<p>The Vanuatu economy is characterized by structural weaknesses, low private investment, and an economic growth rate that barely keeps pace with the population growth rate. Standards of living have not improved, and the quality of services, particularly education and health, have been steadily deteriorating. In recent years, increasing political instability including the politicization of the public service, resulted in an erosion of confidence, both generally and in the key institutions of governance in particular. The CRP seeks to renew and strengthen key institutions for good governance with a view to restoring stability and confidence. Central to the reform strategy is the refocusing of the future role of Government, to one that is catalytic and supportive of private sector-led sustainable growth.</p>
Objectives and Scope	:	<p>The overall objectives of the CRP are to (i) carry out structural adjustments in the economy, through policy and institutional changes, with a view to promoting private sector-led sustainable growth; and (ii) strengthen institutions relating to good governance and public sector reform, including restructuring of the civil service. These aims reflect, in broad terms, the Government's vision to empower ni-Vanuatu (the people of Vanuatu) and the private sector generally, to lead the development process in Vanuatu, and for the Government to play a supportive and enabling role. An important consideration is to ensure that the reforms lead to greater openness to the global economy and also to the more equitable distribution of the benefits.</p>

Program Impact	:	The reforms under the CRP are designed to address good governance issues and the root problems contributing to the poor performance of the economy in Vanuatu. In particular, they are expected to result in sound institutions of governance leading to greater political stability; more certainty, transparency, and consistency in the regulatory regime and other economic policies, leading to greater business confidence; a smaller, more efficient and more effective public sector; a broader tax base with a lower and more uniform tariff structure; greater expenditure on social programs, especially health and education; a more dynamic private sector; a more open economy that attracts direct foreign investment; and a reformed financial sector. These improvements in the political and business environment, if implemented resolutely, are expected to restore stability and confidence, stimulate increased private investment, and provide the impetus for higher levels of sustainable economic growth to be achieved over the longer term.
Classification	:	Economic Growth
Environmental Assessment	:	Category C Environmental implications of the proposed policy and institutional reforms were reviewed, and environmental interventions were incorporated, as required.
The Bank Loan		
Loan Amount and Terms	:	A loan equivalent to US\$20 million from the Bank's Special Funds resources. The loan will have a maturity of 40 years, including a grace period of 10 years, and will carry a service charge of 1 percent per annum.
Program Period and Tranching	:	January 1998-December 2000. The proposed loan will be released in two tranches. The first tranche will be made available in two parts, the first part upon loan effectiveness, and the second part upon the satisfaction of a number of incentive subtranche conditions. The second tranche is expected to be released by the end of October 1999.
Executive Agency	:	Department of Strategic Management
Procurement	:	The proceeds of the loan are expected to be disbursed by October 1999 against a broad range of imports, subject to a negative list. Expenses for eligible items incurred up to 180 days prior to loan effectiveness may be reimbursed from the proceeds of the loan.

- Counterpart Funds :** The counterpart funds to be generated from the proceeds of the loan will be used by the Government (i) to provide financial and human resource development support to employees retrenched under the rightsizing of the public service and to support the public service restructuring program; (ii) to restructure and rehabilitate selected public financial institutions; and (iii) to support fiscal stabilization.
- Technical Assistance :** A TA grant of US\$1.2 million equivalent from the TASF will be provided for Institutional Support to Central Agencies for the Implementation of the CRP.
- Risks and Safeguards :** The principal risks are that (i) the political will and commitment to the CRP weakens in the face of growing pressures from groups directly affected by some of the reform measures, such as political advisers, retrenched civil servants, and those opposed to the introduction of tax reforms; (ii) capacity and institutional constraints are not overcome over the medium-term to ensure the sustainability of the reform process; and (iii) despite the enactment of various pieces of legislation aimed at good governance, there is a long lag in attaining the required significant changes in the standards of behavior, especially of the political leaders. The CRP will lose credibility if a business-as-usual environment is perceived to persist. To mitigate these risks, the Program includes measures such as strengthening the various mechanisms for the ongoing active participation of wider society in the CRP process; ensuring regular and timely communication of CRP information to the public, through the media and other mechanisms such as task forces; and institutional strengthening and capacity building.



I. THE PROPOSAL

1. I submit for your approval the following Report and Recommendation on (i) a proposed loan to the Republic of Vanuatu for the Comprehensive Reform Program (CRP); and (ii) proposed technical assistance (TA) for Institutional Support to Central Agencies for the CRP.

II. INTRODUCTION

2. Vanuatu is a small island economy with a land area of 7,565 square kilometers and population of about 178,000, on 68 islands spread across more than 1,000 kilometers. Over the last decade, Vanuatu's overall economic performance has been poor, with the annual economic growth rate remaining stagnant at around 3 percent, barely keeping pace with the population growth rate of 2.4 percent. The majority of Vanuatu's people are now little better off than they were ten years ago. Moreover, investment in human capital has been inadequate, thereby constraining the supply of skills and the country's ability to access technology. Private sector investment rates remain low while the financial performance and operational efficiency of almost all State-owned enterprises are poor. Vanuatu's cost structures are high, making it internationally uncompetitive. Also, the continued dual structure of the economy provides weak and inadequate rural and urban linkages. The public sector, constrained by capacity and institutional weaknesses, is generally ineffective and has, in some areas, grown to a level that is now unaffordable. Also, in recent years, Government intervention in the economy increased, particularly in the day-to-day management of public enterprises. During 1996, fiscal imbalance emerged as a problem and the situation has deteriorated rapidly. The size of the fiscal deficit in 1998 and the concomitant pressure on the currency seriously threaten macroeconomic stability. There has been growing disenchantment in the country with the continuing economic stagnation, poor social services, and, in particular, the inefficient public administration and political instability.

3. In February 1997, the Government signed a Memorandum of Understanding with the Bank indicating the nature and scope of the reforms that it was willing to pursue and seeking assistance from the Bank and other funding agencies for the formulation and implementation of the CRP. The Government also requested the Bank to play a lead role in coordinating aid support.

4. To formulate the CRP, an extensive, national-level consultative and participatory approach was adopted by the Government. A National Task Force was set up, chaired by the Prime Minister and including senior Government ministers, to oversee the reform formulation process. In addition, two task teams were also set up, one covering the area of financial and economic reforms and the other covering governance and public sector reforms. Both task teams were chaired by senior ministers and included representatives from the Council of Chiefs, youth and women's organizations, church groups, nongovernment organizations (NGOs), trade unions, as well as the business sector. A small Technical Secretariat was established in the Prime Minister's Office, and a ni-Vanuatu¹ appointed as full-time CRP coordinator. The Bank coordinated the provision of externally funded technical advisers.² In formulating the CRP, particular attention was paid to developing a greater ownership of the reform program, by ensuring that leaders representing a broad cross-section of ni-Vanuatu society were actively involved, by encouraging debate and discussion in the wider Vanuatu community, and by regularly disseminating information on the CRP through the media. The whole process culminated

¹ A person from Vanuatu.

² In addition to the Bank, assistance was readily provided by Australia, France, New Zealand, and the Pacific Operations Centre of the Economic and Social Commission for Asia and the Pacific.

implementation. The Summit was attended by more than 200 participants representing the community, business, and the Government sectors.

5. On 31 July 1997, the Bank convened a Consultative Group (CG) Meeting, the first such meeting for Vanuatu, in Noumea, New Caledonia. Funding agencies at the CG Meeting expressed strong support for the CRP, welcoming the extensive consultative and participatory approach adopted in formulating it. The Bank was requested to assist the Government translate the CRP into a time-bound action program, with monitorable performance milestones. Funders felt that the CRP should be implemented in a well-coordinated way, and without loss of momentum. They also recognized that the Government needed substantial financial and TA to implement the reforms. At the Noumea CG Meeting, the Government specifically requested the Bank for such assistance.

6. Soon after the CG Meeting, a Bank Mission visited Port Vila to assist the Government in translating the CRP into a Program Matrix, and to undertake fact-finding for a proposed Bank loan and TA. The program described in this Report is based on the Mission's findings, and the subsequent Appraisal and Post appraisal missions.¹

III. RECENT PERFORMANCE OF THE COUNTRY

A. Growth, Fiscal Developments, and Social Indicators

1. Growth Performance

7. Vanuatu attained its political independence in 1980, and the decade of the 1980s was a period of hope for the country. Economic growth was maintained at over 3 percent per annum, keeping pace with population growth. While this did not allow for any major improvements in the standard of living of the people, it was a period of adjustment for the young Government as it strove to establish the foundations of its democracy and economy. During this period, positive real growth was achieved and the Government avoided budget deficits, managed a stable foreign exchange regime with comfortable foreign exchange reserves, and maintained a monetary policy stance that provided reasonable price stability. Public debt was negligible, and, with the establishment of the Vanuatu National Provident Fund (VNPF) in 1987, the savings rate began to increase. The level of investment also rose with a gradual diversification of the economy.

8. Vanuatu's economy is dominated by two main sectors: agriculture and tourism. About 80 percent of the country's total population live in rural areas and depend entirely upon agriculture, fisheries, and forestry for subsistence and supplementary cash incomes. Coconuts continue to dominate the rural economy although production and prices have fluctuated markedly. Cocoa has become an important export commodity, followed by beef and squash. The contribution of the latter two commodities has grown recently with the entry of large private investors as well as the Government. Although timber production also appears significant, a reliable assessment of its contribution is difficult because of the problems with the statistics. The relative contribution of all these commodities to the gross domestic product (GDP) depends very much upon the level of commodity prices at any particular time. Prices tend to fluctuate considerably.

¹

The Appraisal Mission, from 17 November - 3 December, 1997, comprised J. Samy, (Mission Leader); C. Saldanha, Manager 2, Pacific Operations Division; Virgilio Velasco, Senior Financial Sector Specialist; and G. Atay, Counsel, Office of the General Counsel. A Post appraisal mission, from 20 April - 1 May, 1998, was led by J. Samy. The missions were assisted in the field by the external advisers in the CRP Secretariat: N. Vurobaravu, (CRP Coordination Adviser); M. Moriarty, (Macroeconomist); E. Attridge, (Public Sector Reform Adviser); and D. Trimoulla, Financial Adviser.

9. Tourism is Vanuatu's most important source of foreign exchange, followed by exports of copra, beef, timber, and cocoa. Tourism development has been affected by changes in airline policy, cyclones, and political disturbances. In the years immediately following independence, the annual number of visitors to Vanuatu reached 30,000. However, in 1985 the sector entered a prolonged recession due to several factors. Airline services to Vanuatu contracted following the termination of an air services agreement between Ansett Airlines and Air Vanuatu, and in early 1987, a major cyclone destroyed a substantial part of the tourist infrastructure. Also, the riots in Port Vila in 1988 and subsequent political events impacted adversely on visitor arrivals. From the latter half of 1989, the number of visitors began to rise again when (i) a new air services agreement was concluded between Air Vanuatu and Australian Airlines, (ii) Air Vanuatu purchased a new Boeing 727; and (iii) a new airport and hotel facilities opened in the early 1990s. Visitor arrivals reached 42,000 by 1992. However, in more recent years, the tourist industry has barely grown in real terms. While tourist arrivals increased by 1.5 percent per annum since 1992, prices declined by a roughly equivalent amount. Tourism earnings in 1995 represented about 37 percent of exports of goods and services, and 26 percent of current account receipts. On an added-value basis, tourism-related activities constitute about 9 percent of GDP, generate about 1,500 jobs, and represent about 13 percent of total Government revenues.

10. Since 1989, economic performance has deteriorated. Several factors have contributed to the decline: (i) the price of copra, which represented about 66 percent of exports before independence, fell to approximately half its previous level; (ii) the overall rate of investment in the economy declined from the high levels reached during the late 1980s; and (iii) many of the investments made by the Government in agricultural enterprises have failed. Moreover, increased political instability, with a series of fragile coalition governments, severely eroded both public and business confidence.

11. Gross domestic investment in Vanuatu has averaged around 30 percent of GDP, although much of this has been public sector investment. With a domestic savings rate of about 23 percent, the investment-savings gap is met by external financing in the form of foreign investment flows, including reinvestment of profits by foreign-owned enterprises, and external public sector borrowing. However, the economic growth rate is not commensurate with the high domestic investment rate. This indicates a low economic yield on investments, which is generally attributed to the poor performance of Government-owned and managed enterprises. Private sector investment has fallen to a low level mainly because of the uncertainties created by the volatile political environment, and the lack of clear policy toward investment, including direct foreign investment. Investment by ni-Vanuatu businesses is limited by a shortage of capital as well as by cultural obstacles to entrepreneurial behavior. Progress needs to be made in addressing the problems in both these areas before any significant improvement in private sector investment can be expected.

2. Fiscal and Monetary Developments

12. The Government's financial situation has deteriorated steadily since 1989 and, in 1998 has become precarious. The Government has run persistent fiscal deficits since 1989, as large as Vt1.8 billion in 1990 and fluctuating around Vt0.5 billion in more recent years. The deficit in 1997 was Vt0.5 billion. Public debt has grown to about 25 percent of GDP over the last eight years. The fiscal deficits in the early 1990s mainly reflected Development Fund overspending. Until 1996, fiscal discipline was much tighter on the recurrent side of the budget. Because successive governments tried to maintain a balanced recurrent budget, growth of recurrent expenditure was tied to growth in revenue. Revenue performance, however, has been weak, which explains why recurrent expenditure levels have declined as a share of GDP, with serious consequences for the provision of essential Government services. The quality of public services

also declined as skilled and experienced staff were replaced, for political reasons, by less skilled staff.

13. There were civil disturbances in Port Vila in January 1998 following the publication of a report by the ombudsman, highlighting certain poor investment decisions of the VNPF. Many VNPF contributors, fearing that their savings were lost, started protests. The disturbances rapidly escalated, and there were riots that the Government was unable to control. Order was only restored when the Government instructed the VNPF to repay the contributions of any VNPF member requesting a withdrawal. The withdrawal requests that followed this decision totaled Vt3.5 billion, equivalent to about 12 percent of GDP, and about 91 percent of members' total savings in the Fund. However, to meet these payments, the VNPF was only able to mobilize about Vt1 billion from its own cash resources and by breaking the deposits it held with the commercial banks. As the guarantor of members' deposits with the VNPF, the Government undertook to make up the shortfall. This commitment dramatically increased the Government's fiscal deficit for 1998. With other proposed expenditures for 1998, the prospective deficit amounted to about Vt3.7 billion, equivalent to about 12.7 percent of GDP.¹ Since a deficit of this size could not be financed, the Government reviewed its 1998 expenditure programs and reduced the projected deficit by about Vt1 billion. This still left a significant domestic financing requirement of about Vt2.7 billion.

14. A domestic deficit of this size threatened to create major problems for monetary policy. The injection into the economy of a total of about Vt3 billion would have almost doubled the monetary base, with very serious implications for inflation and the balance of payments. Indeed, as the perception developed that fiscal and monetary policies were not consistent with the current parity of the vatu, a run on the vatu commenced by early March 1998. The official foreign exchange reserves began to fall. Compared with about five months import cover at the end of 1997, the reserves were down to about three months cover by the end of March 1998. The Government acted quickly to restore equilibrium by changing the monetary policy regime.² Despite the monetary measures introduced, the ongoing borrowing by the Government, and the need to maintain the liquidity of the banking system to allow the commercial banks sufficient liquidity to take up the Government paper made it very difficult to tighten monetary conditions to the extent required. It became increasingly difficult to convince the market that the monetary authorities were reacting with sufficient determination to defend the existing parity of the vatu. As the decline in the official reserves accelerated, the need for tighter monetary conditions became more acute.³

15. The new Government, which assumed office on 30 March, 1998 and inherited these problems, has been actively exploring alternatives to further domestic borrowing. The alternatives include (i) the feasibility of liquidating a greater proportion of VNPF assets so that the VNPF can self-finance a larger share of the payouts; (ii) further reductions in Government

¹ These figures exclude major CRP-related expenditures, such as for the public sector restructuring, and the cost of rehabilitating and restructuring the Government-owned financial institutions.

² The commercial banks were allowed to hold their liquidity and statutory reserve deposit (SRD) requirements in the form of "prescribed assets" such as Treasury bills, Government bonds and Reserve Bank Notes instead of simply depositing cash with the Reserve Bank of Vanuatu (RBV) which largely earned no interest. To the extent that they held Treasury bills and/or Government bonds, they were also helping to finance the domestic deficit. The combined liquidity and SRD ratio was also increased from 10 percent to 16 percent of vatu deposits, and a further rise to 22 percent was foreshadowed to take effect from about the end of April 1998. A weekly tendering system was put in place for the sale of these securities.

³ On 27 March, 1998, on the last day of his term of office, the outgoing governor of RBV publicly announced a 20 percent devaluation of the vatu. Although the minister of finance reversed this decision on the same day, these developments only reinforced the speculative attack on the currency. It became an imperative to bring the Government's domestic borrowing to an end in order to tighten the monetary conditions.

expenditure, including allocations for education, health, and other critical development programs; and (iii) introducing the value-added tax (VAT) at a higher rate than originally proposed, although this would be regressive with an adverse impact on the poorest and most disadvantaged sections of the community. A further option, with the fewest drawbacks, would be to obtain additional external financing to substitute for any further domestic financing.

16. There are no controls on foreign exchange transactions in Vanuatu and the country has traditionally maintained a high level of foreign reserves, held by both the Reserve Bank and the commercial banks. The current account of the balance of payments, which was generally running a small surplus in the 1980s, has been in persistent deficit during the 1990s, averaging about 8 percent of GDP. In 1997, the trade balance improved significantly because of the stronger export performance and slow growth in imports. However, it is expected to deteriorate substantially in 1998, as export receipts weaken and, more importantly, as imports increase. Imports are expected to rise by as much as 30 percent in 1998, with a surge in consumption (mainly on imported goods) following the VNPF members' contributions payout and the consequential loosening of monetary conditions in the first quarter of 1998. As a result, the current account deficit in 1998 is expected to deteriorate sharply, from Vt2 billion in 1997 to Vt4.7 billion in 1998. Until the VNPF-related developments, it was possible to finance large deficits. The ongoing decline in official foreign exchange reserves, however, has focused attention on the structure of the market for foreign exchange for there appears to be a systemic problem. In times of monetary and exchange rate crisis, the Reserve Bank of Vanuatu (RBV) tends to become the only provider of foreign exchange, with its commitment limited only by the size of the country's bill for imported goods and services. But RBV has access to less than half of the foreign exchange earned by traders based in Vanuatu, i.e., only the foreign exchange earned by the Vanuatu Commodities Marketing Board and the commercial banks are not obliged to sell foreign exchange to RBV. This is not a sustainable situation. Changes are needed to arrangements for the sale and purchase of foreign exchange involving the commercial banks.

3. Social Indicators

17. Vanuatu ranks as the third lowest (ahead of Solomon Islands and Papua New Guinea) in the Human Development Index of the eleven Pacific developing member countries (PDMCs). In the last decade, multiple social problems have emerged as economic growth has barely kept pace with the high population growth rate. Pressure on land and natural resources has been increasing and public services remain both poor and inadequate. Education and health services, for instance, have limited coverage and are deficient in quality. Provision of places at both the secondary and tertiary levels fall far short of demand. It is estimated that for every 120 children who are six years old, only 100 are able to obtain access to the first year of primary schooling. Eighty percent of these leave school before reaching the sixth form; and of those who complete secondary schooling less than one fourth progress to tertiary level education. For the 95 percent who drop out of the school system, facilities for training and acquiring vocational or technical skills are grossly inadequate. They remain without practical skills or qualifications for most jobs. Female enrollment progressively lags behind that of males at higher levels of post primary schooling. Women generally have limited access to resources and entitlements, despite their heavy workloads in household management and agricultural production. Obviously, the deficiencies of the education system, unless remedied, will have a long-term impact upon Vanuatu's growth and development potential.

18. Growing disparities between rural and urban areas are reinforced by the problems of providing services to the nearly 178,000 people scattered on the 68 islands, speaking more than 100 languages. While Vanuatu does not have an official definition of poverty or poverty line, vulnerable groups are emerging. They include people with limited access to traditional safety nets

and to cash income and basic services. Peri-urban squatter settlements are developing, reflecting growing urbanization, up from 18 percent of the total population in 1989 to 25 percent in 1997. The two urban centers, Port Vila and Luganville, have been growing at more than twice the national population growth rate. Rural migrants often pay rents for uncertain tenure in informal settlements with virtually no provision of basic water, sanitation, and electricity. They have limited access to small, leased agricultural plots. Since jobs are scarce, there is a rising incidence of crime and social problems, especially among younger people.

B. The Causes of Poor Performance

19. Beside the external factors beyond the country's control, such as volatile commodity prices, and inclement weather conditions, four key and interrelated factors have contributed to economic stagnation and poor social performance in Vanuatu. These are (i) the quality of governance and public sector management, (ii) the Government's financial and economic management, (iii) an overly large presence of Government in the commercial sector, and (iv) inadequate private sector investment.

1. Governance and Public Sector Management

20. At independence in 1980, the governmental structure, systems and processes that were then established reflected the country's colonial "condominium" experience, which drew on the Westminster traditions as well as the French administrative experience. Government is undertaken through a number of institutions: a president who plays a largely formal role as head of State; a 52-member Parliament that performs the legislative role; the judiciary which is intended to enforce the rule of law; and the Council of Ministers (CoM), led by the Prime Minister, which is responsible for directing the activities of the Executive Government. In recent years, ministers have been supported by a significant complement of political advisers and other personal staff. The Public Service (PS), which totals about 4,520 persons, supports the Executive in administering the country with the Public Service Commission (PSC) being responsible for the employment of members of the PS. The Office of the Ombudsman investigates complaints involving poor administration; and the auditor-general audits Government accounts. The experience since independence has been that most of these institutions of Government have faced difficulties in effectively fulfilling the roles required under the country's Constitution.

21. The effectiveness of Parliament is an issue of priority. The Parliament meets irregularly and has been unable to fully secure its own independent status, in accordance with the separation of powers intended by the Constitution, or in holding the Executive accountable to the Parliament for its performance. Weaknesses in the functioning of Parliament are in large measure due to inadequate provisions for the reporting of the Executive to the legislature, inadequate parliamentary skills of some members, and a general lack of mechanisms to ensure accountability to the public.

22. In recent years, the Executive Government has been substantially influenced by continuing shifts in alliances between the various political parties. Consequently, CoM has tended to be more preoccupied with political issues including how to survive as a government, rather than administrative or financial and economic management concerns. CoM has, therefore, been unable to give the required emphasis to key government functions such as budget management, economic policy making, and the provision of leadership in setting long-term strategic directions for Vanuatu.

23. The system of political advisers and support staff for ministers has tended to marginalize the role of the PS. Until the recent general elections in March 1998, each minister

had, on average, between 10 and 14 political advisers and other support staff. These political advisers have tended to assume the functions of administration, executive decision making, and supervision, thereby getting involved in the day-to-day management of the PS. However, because many of the political advisers were generally unskilled in public policy and administration, the Government's effectiveness in the areas of both policy and administration became increasingly constrained.

24. Vanuatu's PS is not large in size compared with most other Pacific countries, averaging just over three civil servants per 100 members of the population. It is, however, large by other measures. Salaries and allowances represent over 60 percent of the recurrent budget. Capital expenditures are almost entirely from external aid sources. Funding for supplies, equipment, and maintenance is already below minimum acceptable levels such that public health and safety are endangered, and progress toward meeting fundamental development objectives has come to a halt in many areas. The PS has also been encumbered by an unwieldy administrative structure that comprised over 50 departments and other organizations, some large and complex, some having overlapping functions with other agencies; and some lacking effective working relationships with agencies with like functions. Moreover, the central agencies, such as PSC, often failed to offer effective coordination and leadership or support. This has impeded effective coordination or interaction. Institutional and capacity weaknesses are endemic at almost all levels and across the whole of the PS.

25. The need for reform of the PS is, therefore, urgent. Political interference has undermined its professionalism, capacity, performance, and independence. The PS is poorly organized to perform its important functions and lacks effective leadership. Unless it is properly renewed through legislative action and capacity building, it will not be possible to move on to effectively implement the economic and social reforms that Vanuatu needs. To modernize the PS, there is a need for a series of financial and management improvement reforms that will enhance its capacity to serve the Government and the community.

2. Financial and Economic Management

a. Policies

26. Major weaknesses in the economic and financial policies of the Government have contributed to the country's poor performance. One of the most critical problems is the weakness of the Government's revenue base. Since about 1986, recurrent revenues have been declining as a proportion of GDP, falling from 26.8 percent during 1986-1989, to 22.5 percent in the period 1992-1995. During FY1997, Government expenditure exceeded revenues by Vt0.5 billion. In 1998, Government expenditure is running at an annual rate of Vt11.3 billion, while its revenues are about Vt7.0 billion. While the sharp rise in the fiscal deficit is attributable to the VNPF-related developments, the deterioration of the Government's fiscal situation is also partly explained by weak revenue mobilization including compliance and enforcement problems.

27. Vanuatu does not have an income tax. The main taxes are import duties, a turnover tax on retail trade, and business licenses. There are also export taxes, set at low rates, levied on a range of commodities, but these do not yield significant revenues. The overall elasticity of the tax system, therefore, is low. Since about 1986, the main tax bases have not been growing even commensurately with the low growth of the economy. Two thirds of tax revenues are derived from taxes on imports, but imports have been declining as a proportion of GDP (from over 50 percent in the 1980s to less than 40 percent now). As a result, the Government has only been able to balance the recurrent budget by increasing some taxes each year, e.g., the extension of turnover taxes to service industries in the late 1980s, and to businesses generally in

diesel fuel. The Government faces a major structural problem. Considered as a whole, the current tax structure is not capable of producing the revenue required to meet the demands of the public for a greater volume and quality of public services, except by significantly increasing some tax rates year after year. The constant uncertainty about the future incidence of taxation has added to general business risk and has been one of the factors deterring investment.

28. The disproportionately large reliance by Government upon import duties to finance its activities has resulted in very high tariffs, a major factor, although not the only one, contributing to a high cost structure in Vanuatu. The cost of credit has also been relatively high, with an interest rate spread that has generally exceeded 10 percentage points throughout the 1990s. This is attributed to the high country risk premium required of equity investments by the foreign-owned banks with establishments in Vanuatu, the high wage costs of both international and domestic staff, the implicit tax levied on the non-interest-bearing statutory reserve requirements (set at 10 percent of vatu deposits), and the relative lack of alternative income-earning opportunities for bank assets during times of excess liquidity (because there is no money market in Vanuatu). Wage costs generally are considered to be high, relative to wage rates in neighboring countries and to the productivity of the workforce. Finally, the smallness of the domestic market and the high transport costs associated with the country's physical configuration also combine to increase the cost of doing business in Vanuatu.

29. Price movements in Vanuatu are largely determined by changes in the price of imports. In the 1990s, however, domestic inflation was running at a rate somewhat higher than imported inflation, with the consumer price index recording a 20 percent increase between 1990 and 1995, compared with a 13 percent increase in imported prices over the same period. This implied a gradual loss of international competitiveness and raised a question about the appropriateness of the exchange rate regime. However, between 1988 and 1996, the vatu depreciated by about 12 percent against the currencies of Vanuatu's major trading partners. The fall in reserves in 1996-1997, which accelerated in early 1998, and the increased pressure on the exchange rate in 1998, occurred on account of capital outflows and do not reflect loss of competitiveness. The increased speculative pressures have been due more to the perception that macroeconomic policies are inconsistent, the loss of confidence in the vatu, and in particular to the entrenched expectation of a devaluation. In mid-May 1998, the Reserve Bank announced a 5 percent increase in its lending rate to commercial banks and the Government; a move aimed at defending the currency parity of the vatu and at increasing the attractiveness of holding it.

b. Financial Institutions

30. The domestic financial sector in Vanuatu comprises RBV; three private commercial banks: Australia and New Zealand Bank, Westpac, Banque de Hawaii; three Government-owned financial institutions, i.e., the National Bank of Vanuatu (NBV), which is a Government-owned commercial bank, the Development Bank of Vanuatu (DBV), and VNPF; AGC Finance (Vanuatu) Limited, specializing in leasing equipment and vehicles; and some institutions providing nonbanking services, like insurance. In addition, in the informal sector, there are about 60 unregulated credit unions, of which around 40 are active. The private commercial banks are governed by the Banking Act and fall under the supervision of RBV, while NBV, DBV, and VNPF are statutory corporations established under their respective legislative acts and controlled by the Ministry of Finance and Economic Management (MFEM). However, having established a bank supervision unit a year ago, RBV seeks to place all domestic financial institutions under its supervision through legislation and has sought assistance of the International Monetary Fund to build a surveillance and inspection capacity. Under a proposed bill, the governor of RBV will be the registrar of credit unions.

31. The private commercial banks lend mainly for construction, housing, and personal needs, and to wholesale and retail trade. They operate at high interest margins (currently about 8 percent). The high cost of operations is attributed to the excess liquidity of the banks, large expenses for communication, rental, and international salaries, small size of loans, bad debt provisions, and a risky environment. The banks can maintain high profit margins because of low competition. The high interest margin has reduced capital growth and impeded productive investment.

32. NBV was established by the Government to provide credit access and banking services to ni-Vanuatu, including those in the rural areas and outer islands, to draw them into the cash economy and provide a stimulus to local entrepreneurship and production. NBV commenced operations in December 1991 when it took over the assets of the Vanuatu Savings Bank Ltd. (VSBL) which, at that time, had 20 branches. Initially, the Government injected Vt128 million to set up NBV. The combination of establishment costs together with the takeover of doubtful loans from the Vanuatu Savings Bank, quickly eroded this initial capital. The Government injected a further Vt72 million of capital in 1994, raising its total equity contribution in NBV to Vt200 million. NBV, compared with the other three commercial banks, is small with a market share of 7.6 percent on deposits, 15.2 percent on lending, and 7.1 percent on assets. Most of NBV's loans are small, short-term, and concentrated in the urban areas. Its network of 17 branches is used to generate deposits, facilitate payment of salaries of Government employees, and lend for personal needs. NBV has serious operational weaknesses in its management, credit approval, monitoring, and recovery practices. Its arrears are high, amounting to Vt312 million, or 26.7 percent of its Vt1,167 million loan portfolio. Of the outstanding accounts, 87 percent are over nine months, indicating a long-term problem in collection. NBV is technically insolvent with a negative equity of Vt260 million, as at the end of 1997, as a result of successive losses since it commenced operations in 1991.

33. DBV was created as a statutory corporation under the Development Bank Act in May 1983 to provide long-term development finance to facilitate and promote the economic development of Vanuatu's natural resources, especially agriculture, forestry, fisheries, manufacturing, and tourism, through the provision and guarantee of finance; equity participation; provision of technical, managerial, and financial consultancy; and assistance in the identification and promotion of viable projects. DBV has experienced difficulties in achieving commercial viability as a result of weak lending practices compounded by an underskilled workforce, weak management, and significant political interference. Since the late 1980s, DBV has persistently recorded operating losses. In the 1980s, France's Caisse Centrale and the European Investment Bank provided financial assistance, while in the early 1990s, the Bank provided both financial and technical assistance. Despite this, and even though Caisse Centrale forgave all future repayments on a loan of Vt91.6 million, DBV's shareholders' equity fell from Vt419 million in 1991 to Vt37 million by the end of 1997, due to mounting operating losses. This is also despite the injection of additional capital totaling Vt85 million in 1995 by the Government. DBV's loan portfolio is Vt825 million, evenly distributed among (i) agriculture and fishery projects; (ii) rural transport; (iii) tourism services, industry, and commerce; and (iv) housing and personal loans. The average size of its loans is Vt1.5 million and the average maturity is 3.5 years. At the end of December 1997, bad and doubtful loans totaled Vt484 million or 58 percent of DBV's loan portfolio; and provisioning for these loans was Vt274 million. DBV was technically insolvent, being unable to meet the repayment of principal and interest totaling Vt57 million.

34. Both NBV and DBV have suffered from common deficiencies, the most notable of which are (i) political interference, (ii) unqualified and inexperienced Board members, (iii) weak top management and ineffective middle management, (iv) severe lack of banking expertise, and (v) erosion of capital. Intervention from politicians, Government officials, and persons with political

connections have interfered with the decision making and operation of both institutions. This has led to appointments of unqualified directors with no knowledge and experience in financial matters, approval of loans to favored borrowers in breach of policies and operating guidelines, and various conflicts of interest. Most of the staff in these two institutions have little banking-related education and training. DBV and NBV have tended to be treated like Government departments.

35. The VNPF, established in 1986, is an accumulation fund, based on a defined contribution of 3 percent from both employers and employees. Since its establishment, and by the end of December 1997, the VNPF accumulated Vt3.855 billion, made up of members' funds of Vt3.81 billion, and a special death benefit fund of Vt45 million. As a social security scheme, the Fund promotes forced savings and assists in financing the country's economic and social development. Members can borrow, within limits, from the Fund. Until recently, it had a housing loan scheme for members with an interest rate lower than other financing institutions. The Government has been using VNPF funds to meet much of its financing requirements in State-owned enterprises, including NBV and DBV. The performance of VNPF has been poor in relation to return on members' contributions, indicating serious weaknesses in investment management. Moreover, the decision taken by the Government in January 1998, allowing members to withdraw a part or all of their contributions threatens the viability of the Fund.

36. Of the other financial institutions, AGC Finance is a source of medium-term lease finance for the transport sector. Its outstanding loans at the end of 1996 amount to Vt281 million, of which 60 percent was for motor vehicles. Credit unions, most of which are rural based, also mobilize savings and provide credit facilities to members. The Vanuatu Credit Union League, an apex body for credit unions operating as an NGO to promote the credit union movement in Vanuatu, provides training and support, such as marketing and auditing.

37. Vanuatu's Offshore Financial Centre (OFC), established in 1971, gives tax free status to financial organizations registered with and supervised by the Vanuatu Financial Services Commission (VFSC). Over 50 offshore banks are registered in Vanuatu. OFC contributes to the domestic economy primarily through the fees paid to VFSC, local expenditures of the offshore banks and their international personnel, and the externalities arising from the wide range of expertise available in Vanuatu to support offshore banking operations. However, the impact of OFC on the economy is relatively small, judging from the VFSC contribution of only about 5 percent to the Government's recurrent budget. The OFC contribution to GDP is about 2.5 percent. In recent years, OFC has experienced stagnation due to its declining competitiveness in the face of aggressive marketing and innovations of competing tax havens, and also because of perceptions of the country's political instability.

3. Presence of the Government in the Commercial Sector

38. The Government is involved in conducting a large range of commercial operations, both through statutory corporations and company structures, and within core functions of its departments. However, the experience flowing from the creation of companies and corporations has been largely unsatisfactory. With a few exceptions, most of the commercial activities of Government has delivered both inferior products and services. The activities of some of these enterprises have been controlled by ministers and political advisers; and they have had difficulty in operating on sound business lines, being constrained also by the lack of business acumen, and managerial and entrepreneurial skills. The two largest enterprises, the utilities UNELCO and Telecom Vanuatu Limited, are already managed as if they were part of the private sector, but the management regime is not sufficiently transparent for utilities that operate in an unregulated environment. Some of the Government's agricultural investments continue to lose money and

pose considerable financial risks. There is a recognition in Government that many of the operations should be privatized or wound up. There are also commercial functions within core Government departments that should be corporatized such as the postal services or civil aviation; or that should be contracted outside the public sector, in the case of skills required but not available in the public service.

39. There is no satisfactory framework in Vanuatu for managing Government enterprises. They lack clearly established objectives and performance standards. Financial rigor is also not enforced. The enterprises also lack, at times, the management autonomy needed to be able to work toward achieving those standards. Appointment as a member of a board of a Government corporation has been a means of dispensing political patronage rather than a means of bringing professional skills and experience to the enterprise. The ombudsman has identified some cases involving abuse of the privileges conferred by being a board member. The Government intends to develop a policy to establish appropriate standards to deal with these issues.

40. The poor management of many of the commercial functions undertaken by the Government has led to enormous financial losses. It is estimated that between 1980 and 1995, the losses of Government public enterprises have approximately equaled the total flow of external assistance provided to Vanuatu over the same period. In many cases, the pricing policies of public enterprises have crowded out alternative private sector suppliers, or deterred potential new entrants. The management of these enterprises must be put on a sounder footing. There should be clear accountability agreements between Government and the boards that it appoints, a move to more professional management at all levels, an active monitoring regime, and the elimination of politically motivated interventions in the daily operations of these enterprises. The Government should reexamine its role in the provision of goods and services that can be equally well supplied by the private sector, and privatize, or otherwise divest itself of, the enterprises that do not need to be owned and operated by the Government.

4. Lack of Private Sector Investment

41. Private sector investment has been low in recent years for a number of reasons. The administrative requirements facing potential investors, both foreign and domestic, are complex and excessively bureaucratic. There is a low level of participation in business by ni-Vanuatu, reflecting cultural barriers to capital accumulation and entrepreneurship. Many aspects of the economic environment militate against successful investment; the trade and tariff regime is inward looking, with selective high rates of duty encouraging the production of import substitutes and discouraging exports. Elements of the tax system, such as the business license regime, increase the establishment costs of business and can increase business risks, particularly for new, developing industries; export taxes discourage investment in export industries. Vanuatu has a high cost structure created by high tariffs, wage costs that are high relative to productivity, the high cost of credit and utility tariffs, the small size of the domestic market, and the high transport costs associated with the country's geography. The general shortage of skilled labor is a further major constraint influencing the decisions of potential investors. Political uncertainties and the unpredictability of economic decision making have eroded business confidence and added significantly to general business risk, especially for foreign investors. Finally, the Government's attitude toward foreign investors has tended to be ambivalent.

42. In the tourism sector, the availability of accommodation does not appear to be a major constraint at present. The stock of accommodation has increased by about 40 percent since 1984, although most of this is concentrated in Port Vila and Luganville. Average occupancy, however, has declined from 61 percent in 1984 to 48 percent in 1996. The problems appear to lie

more in the absence of a coherent set of tourism policies, limited air services linking Vanuatu to the outside world, poor road infrastructure, a shortage of adequately skilled service personnel in most sections of the industry, and marketing problems. There is scope for increased participation by ni-Vanuatu in tourism, especially through establishing a network of island bungalows and ancillary, tourism-related activities that could encourage tourists to travel more widely within Vanuatu. This would require significant organizational and administrative skills, as well as improvement to internal transport arrangements and infrastructure.

43. Agriculture also presents scope for additional investment by ni-Vanuatu. Vanuatu enjoys many advantages in agricultural production. These include ample land, good soils, and relative freedom from pests; a favorable climate; a strong research base; and an agricultural population skilled in traditional horticultural production. Private sector investors in this sector can follow one of two major investment strategies: adding value to coconut production or diversifying into noncoconut crops. Coconuts dominate agricultural production with an estimated 70 percent of households owning coconuts. The simplest way to increase the efficiency of the coconut industry and to add value is to invest in hybrid planting material. This is beginning to happen with sufficient replanting taking place in recent years to offset the loss of production from senile palms and to replace the national stock of coconuts in 33 years. Additional investment opportunities are available in value-added coconut processing, which include premium quality coconut cream, activated carbon, timber, specialty oil products (including organic cold-pressed oil), and high quality soap.

44. Agricultural diversification is already under way with a successful beef industry and work establishing the viability of smallholder production of cocoa and coffee. A broad range of other crops have the potential to be profitable. These include spices (vanilla and pepper); squash; kava; root crops (yams, sweet potato, taro, ginger); tropical nuts; fresh fruit; and cut flowers. Agricultural producers in Vanuatu face the usual problems of smallness: it is difficult to obtain economies of scale and investment in infrastructure is relatively expensive. The other difficulties include natural disasters, a complex land tenure system, and the relative scarcity of labor. Shipping is infrequent and unreliable. Guaranteeing regular supply is a major problem.

45. A strategy aimed at increasing investment in agriculture will first need to address the Government policies that have maintained a high cost structure in the economy generally, and in other ways disadvantaged exporters (including a review of the scope of the powers of the Vanuatu Commodities Marketing Board). It should safeguard and commercially exploit Vanuatu's favorable quarantine status and work to improve export market access. It must focus on improving the quality of agricultural production and the regularity of supply. This in turn underlines the need for adequate infrastructure to support agricultural expansion, credit facilities for agricultural smallholders, and appropriate agricultural extension and training services, particularly to support industry organizations.

IV. THE COMPREHENSIVE REFORM PROGRAM

A. Objective

46. The CRP is an initiative that began in early 1997. It seeks to address good governance issues and the root problems contributing to the poor performance of the economy. Its overall objective is to enhance economic growth and raise the socioeconomic standards of all ni-Vanuatu. These aims reflect, in broad terms, the Government's vision to empower ni-Vanuatu, through the private sector, to lead the development process in Vanuatu, with the Government playing a supportive and an enabling role. An important consideration is to ensure that the

reforms lead to greater openness to the global economy and also to a more equitable distribution of the benefits.

B. Key Elements of Reform

47. The CRP focuses on two major, interlinked areas: (i) public sector reforms, and (ii) financial and economic reforms. In the area of public sector reforms, broader governance issues are to be addressed, with a view to reviewing and revitalizing the key institutions of Government; restructuring the public service; and ensuring greater transparency and accountability, both to improve public sector performance effectiveness and to restore confidence in the Government. The key elements of the public sector reforms are (i) determining the core functions of the Government and the public sector, and rationalizing this vis-a-vis the role of the private sector in the economy, (ii) rightsizing and restructuring the public sector, (iii) improving civil service management and efficiency, (iv) improving the decision-making processes within Government and rationalizing the role of political advisers, (v) restoring the authority of Parliament, (vi) minimizing political interference in the management of statutory and State-owned institutions, and (vii) ensuring greater accountability and transparency in the management of the PS and public finances.

48. In the area of financial and economic reforms, the CRP seeks to restructure the economy toward private sector-led growth, with a view to ensuring that output expands at a sustainable rate that is faster than population growth, and also ensuring that the costs and benefits of growth are more equitably spread among all sectors of the community and across the country. The key elements of the financial and economic reforms are (i) improving financial and economic management, in particular by ensuring the structural stability of public finances and by putting in place policies that are transparent, mutually reinforcing, and that remain consistent over time; (ii) restructuring and rehabilitating public financial institutions; (iii) promoting increased private investment through a more conducive policy and regulatory environment, including measures to ensure competitive conditions; (iv) addressing human resource development issues and ensuring that the benefits of reform are shared equitably across the population; and (v) creating conditions for increased ni-Vanuatu participation in business.

C. A Phased Approach and Priorities

1. Phasing of Implementation

49. The CRP is extensive in its coverage and the implementation measures contained in it are correspondingly numerous and dense. The Government itself views the CRP as deliberately ambitious and reflecting the scale and urgency of the task. The CRP, including an Action Plan for its implementation, was conveyed to a broad cross-section of community leaders and representative groups at a National Summit in June 1997. The National Summit, which expressed strong support for the CRP, will now be a key mechanism to monitor implementation. Failure of individual agencies to perform will be readily apparent especially since the media, the business community, and the wider society are expected to keep a close watch, and to draw attention to unjustifiable slippages. Moreover, the CRP is now viewed as a benchmark against which the country at large will assess Government policies and actions. Discrepancies will provoke public criticism, as has already been evident in recent months since the adoption of the CRP.

50. Implementation of the CRP is being undertaken in three phases:

- (i) Phase I: the immediate-to-short term, covering the period from July 1997 to the end of December 1998;
- (ii) Phase II: the medium term, covering the period to the end of the year 2000; and
- (iii) Phase III: the longer term, covering the period beyond 2000.

51. The effective implementation of the CRP measures, and also ensuring that these take hold and have the desired impacts will essentially be a long-term process. The Government recognizes this, and also that there will inevitably be slippages in some areas. In view of the strong momentum that developed during the CRP formulation phase, including the broad-based community and bipartisan political support and commitment for it, the Government has adopted an implementation strategy that involves a heavy front-loading of major actions. Such actions need to be implemented vigorously and within a tight time frame, especially because other actions and the necessary results are contingent on these. Priority is being given to these major items. However, in assigning priorities, attention will also be paid to ensuring that the integrity of the whole CRP, especially the interdependencies between many of its elements, is kept intact. A balance has to be struck during the implementation phase between moving forward simultaneously on both the public sector reform and the financial and economic reform components of the CRP. The latter, which concentrates on the economic development aspects, could become intractable if the measures to remove structural and policy weaknesses in the economy are not effected expeditiously, and in a predictable and well-coordinated way. At the same time, a number of reform measures identified to achieve faster and sustainable economic growth will not be effective if the system of governance in Vanuatu remains constrained by political instability; and capacity problems, waste, and inefficiency in the public service. Improved governance, therefore, is a critical prerequisite and central to restoring confidence and stability, and for increased private investment and economic expansion.

2. Public Service Rightsizing and Restructuring

52. During the Phase I period, the main emphasis is on improving governance by reforming the legislative framework, structures, institutions, and the systems and processes of the public sector. To achieve this, the three key areas of reform are

- (i) restoring the separation of powers, and the checks and balances intended by the Constitution;
- (ii) removing inappropriate political influence from the PS; and
- (iii) restructuring and rightsizing the PS.

53. Also during the Phase I period, parallel action is being taken to reduce the fiscal deficit and to restore the structural stability of Government finances, through a combination of both expenditure reduction and revenue mobilization measures, and through the strengthening of institutions and mechanisms for effective financial management. To achieve this, the three key areas of reform are

- (i) at least a 10 percent reduction in the establishment size of the PS and the implementation of other cost-cutting measures;

- (ii) introduction of program budgeting and also systems and processes to ensure greater transparency and accountability in the management of public finances; and
- (iii) rationalization of the tax system such as through the introduction of a VAT, and tariff reforms.

54. To underpin these reforms during Phase I, several key pieces of legislation have been enacted:

- (i) a new Government Act that redefines and reinforces the boundaries between the political leadership and the PS, by codifying the fundamental roles and responsibilities of ministers, political advisers, and civil servants;
- (ii) a new Leadership Code Act that establishes standards of ethical behavior of politicians and public servants;
- (iii) a new Public Service Act that strengthens the autonomy and independence of the PSC;
- (iv) a new Public Finance and Economic Management Act that supports reform of the budgetary process including greater accountability and transparency in fiscal management; and
- (v) a new Expenditure Review and Audit Act that will strengthen fiscal oversight, reporting, and performance accountability.

55. The need for the new legislation was recognized early during the CRP formulation stage, and TA was provided to commence urgent drafting of all of these. These pieces of legislation were enacted by Parliament in its sitting in May-June 1998. In addition, the main focus of CRP implementation during the Phase I period is on establishing and operationalizing other related institutional mechanisms to drive the reforms. These include the appointment of a minister of CRP and the establishment of a Department of Strategic Management (DSM) charged with the specific responsibility of coordinating and monitoring CRP implementation. Other measures include (i) consolidating and restructuring ministerial portfolios and reducing the number of ministries from 12 to 9; (ii) establishing new positions of director-general (DG) to head the individual ministries and ensuring that appointments to these positions are through a competitive, panel selection process; (iii) appointing a new chairperson of the PSC and transfer of staff from the PS Department to the PSC; (iv) establishing a ministerial committee on the budget; (v) revising the role of political advisers and constraining the number appointed; and (vi) allocating adequate staff and resources to improve the Government's public information and communication efforts.

56. In April 1998, the DGs to the nine ministries were appointed, and will now be responsible for the effective ongoing management of the reform process. The DGs, who occupy a position similar to that of permanent secretary in the British public service system, will play an essential role in establishing and restructuring the new ministries. The PS restructuring and rightsizing process will focus upon: (i) reducing the total staff establishment size of the PS by at least 10 percent, (ii) streamlining organizational structures and critical work processes with the aim of achieving efficiency gains through the consolidation and/or elimination of unnecessary units and tasks, and (iii) implementing a series of management improvement and structural reforms designed to enhance public sector performance and accountability.

57. To implement the PS rightsizing and restructuring, three institutions that will be critical in the effort will be strengthened. The first is the new DSM, which reports directly to the CRP minister and the Prime Minister and which will be responsible for overseeing and coordinating the reform process. The second is the PSC, which has the major responsibility for managing the human resource (HR) function under the new nine-ministry Government structure. With the support of the Bank and also an institutional strengthening project funded by the Australian Agency for International Development (AusAID), professional HR management expertise will be utilized to enable PSC to establish transparent guidelines for personnel recruitment, selection, appointment, transfer, and promotion; and to provide training in HR management to local counterpart staff. The third is the creation of a temporary transition unit, that will assist in helping redundant public servants to make the transition to the private sector. The unit will facilitate access to a number of services, including counseling, advice, training, and retraining.

3. Improving Financial and Economic Management

58. In the area of financial and economic management, the new legislation will clarify the respective roles of Parliament, CoM, and the minister of Finance and Economic Management in decisions about the raising of taxes, authorization of expenditures, borrowing, and the granting of guarantees. The new Public Finance and Economic Management Act will identify transparent principles of responsible fiscal management, to guide the Government's conduct of fiscal policy. This will provide a set of transparent standards, for example, on the prudent level of public debt, against which the Government's performance can be judged. To ensure that the public will be able to monitor compliance with the principles of fiscal responsibility, the Government will also publish an annual budget policy statement that will provide fiscal forecasts; basic macroeconomic information about the state of the economy; an indication of the Government's long-term objectives for fiscal policy; and a formal affirmation that the objectives, priorities, and intentions outlined in the budget policy statement are consistent with the principles of responsible fiscal management. These new arrangements should encourage a more careful and cautious approach to financial management and discourage irresponsible financial decisions. In addition, the introduction of a value-added tax from 1 August 1998 and the associated tariff reform is significant for two reasons. First, it will help strengthen the government's financial position both now and over the longer term. The value-added tax will broaden the tax base and increase the elasticity of the tax structure. As a result, tax revenue will increase commencing in 1998, and thereafter, can be expected to grow at a rate that will closely match the rate of growth of nominal GDP. (It will still be a little short of fully matching GDP unless the government at regular intervals increases specific rates – mainly excises on tobacco and alcohol.) Second, a large part of the increased revenue from the value-added tax will be used to fund a lowering of import tariffs. These will be reduced by approximately one third on average from 1 August 1998, with further reductions in protective tariffs phased in over the following five years. By 2004, the average tariff level will be approximately 50 percent lower than its present level. This will contribute to a major reduction in the economy's cost structure. Tariff reductions will focus, in particular, on consumption items of significance to lower income people (such as rice, flour, canned fish, and kerosene).

59. Over the medium to longer term, i.e., Phases II and III, the main focus of CRP implementation will be on ensuring that the new systems and the streamlined processes, introduced during Phase I, are consolidated and made to work effectively so as to ensure the sustainability of reforms. This is to be achieved through improvements in skills and the enhancement of institutional capacities, and a continuous review and improvement of policies to ensure that the policy and regulatory environment is conducive for private sector-led growth.

60. The functioning of the executive arm of the Government will be enhanced by strengthening central mechanisms for policy formulation, coordination, and implementation. This will apply particularly to central agencies such as PSC, MFEM, DSM, and also the Secretariat to CoM. The Attorney-General's Chambers and the Office of the Public Prosecutor will also be strengthened. A program to enhance the management and technical skills across the whole PS will be implemented. The lack of skilled staff across the PS is a critical problem. It contributes to low productivity and the failure to meet key development objectives. The CRP will address this problem by developing and implementing a broad HR development (HRD) strategy for the public sector, with specific provisions for management training and capacity building for senior officials, as well as the development of a management improvement plan, that will include items such as upgrading current systems for personnel monitoring and performance evaluation. In support of these efforts to upgrade the quality of HRD and its management, some of the initiatives will include an audit of employee skill levels; a survey of pay and employment in comparison with the private sector for certain key skilled positions (such as accountants, doctors, computer technicians, etc.) and a review of benefit packages. The information generated by these activities will be useful both for the rightsizing exercise and, more importantly, for long-term efforts to upgrade the quality of public sector staff and their management and development.

4. Promoting Private Sector Development

61. The CRP aims to promote sustainable private sector-led growth over the medium to longer term (Phases II and III) through a redefinition and the progressive rationalization of the role of the public sector vis-a-vis the private sector. The intervention and involvement of the Government in commercial activities will be progressively reduced and the role of the private sector enhanced by (i) strengthening the policy and the regulatory framework for a stable, competitive business environment; (ii) restructuring, rehabilitating, and strengthening the public financial institutions; (iii) implementing a program of corporatization, commercialization, and privatization of State-owned enterprises; (iv) promoting private investment, particularly for small enterprises in the rural areas, and removing obstacles to, and creating conditions for, increased ni-Vanuatu participation in business; and (v) enhancing the international competitiveness of the country as a place for investment, and for its products and services in the global economy by reducing the costs of doing business, introducing a business-friendly tax regime, improving public infrastructure and utilities, and introducing tariff reforms. A Foreign Investment Act was enacted that simplifies and makes transparent the regulations governing private sector operations. Also, a foreign investment board will be created to attract more direct foreign investments. Exports will be promoted by phasing out export taxes and supporting the development of products and services with export potential. Also, during Phases II and III, sectoral strategies and investment programs will be formulated to guide and assist the development of the country's productive sectors, in particular tourism and the resource-based industries (agriculture, forestry, fishery, livestock, and minerals). Policy and legislative initiatives and sector-specific measures will be introduced to provide better institutional and infrastructure support to stimulate private investment. To make Vanuatu more competitive internationally in the export of financial services, its attractiveness as a tax haven will be enhanced through new products and services, and amendment of the Offshore Finance Center Act.

5. Reform of Financial Institutions

62. Political, financial, and macroeconomic stability are a prerequisite for private sector-led growth. RBV has a central role in ensuring financial stability, as it is tasked with managing the country's monetary and financial system. During the Phase II period, the powers of RBV will be increased to enable it to better control liquidity in the economy, achieve price stability,

and strengthen its supervision over banks and nonbank financial institutions, including in particular NBV, DBV, and VNPF.

63. NBV and DBV are technically insolvent while the survival and future viability of the VNPF is now severely threatened following the decision to allow its members to withdraw their contributions. Commencing in Phase I and during the Phase II period, NBV will be restructured and the VNPF will be rehabilitated. Comprehensive strategic business plans have been formulated, with Bank TA, and formally adopted by CoM for the restructuring and rehabilitation of these two financial institutions.

64. The strategic business plan for the restructuring of NBV embraces legislative, corporate governance, management, and operational reform measures, including the following:

- (i) amendments to the NBV Act to facilitate restructuring;
- (ii) appointment of independent professionally qualified board of directors,
- (iii) injection of additional equity of Vt400 million,
- (iv) amalgamation of the good loans portfolio of DBV into NBV to create a single stronger Bank offering personal and commercial banking services;
- (v) establishment, through legislation, of a separate asset management unit to manage and liquidate the combined bad and doubtful loan portfolios of both NBV and DBV;
- (vi) implementation of a revised organization, reporting and accountability structure including establishment of best practice benchmarks for all of NBV's operation; and
- (vii) external recruitment of a core team of at least four qualified and experienced banking professionals, including a new general manager, to manage the restructuring of NBV.

65. The strategic business plan for the rehabilitation of the VNPF is essentially aimed at restoring the members' confidence in the Fund. The reform measures, which embrace legislative amendments, address corporate governance issues especially to remove political interference, and seek to rationalize the Fund's investment operations, include the following:

- (i) amendment of the VNPF Act to facilitate rehabilitation, in particular, to (a) mandate professional, arm's-length funds management; (b) allow offshore investments; (c) mandate good employer principles for all staffing; and (d) restrict ministerial involvement to matters of policy and performance review;
- (ii) appointment of an independent professionally qualified board of directors;
- (iii) transfer of effective control of all direct nonperforming investments to the Asset Management Unit;
- (iv) implement a smaller, flatter VNPF organization structure that is focused only on contribution and benefit management; and
- (v) review of the contribution rates and member interest credit rates.

66. Growth of the small business sector, especially ni-Vanuatu businesses in the rural areas, is given strong emphasis in the CRP. This is to be achieved through mechanisms to improve their access to credit, develop business and technical skills, and provide measures to overcome obstacles to their competitiveness. The feasibility of establishing a credit guarantee scheme will be investigated for commercial banks to underwrite debt financing of worthy but undercapitalized projects that fail to meet normal credit criteria due to insufficient collateral. Business advisory assistance, skills and training, and other support services will be extended to ni-Vanuatu small business. Credit unions and NGOs will be mobilized to channel savings, and advisory and training resources will be provided for small business development.

D. Social Equity and Sustainability

67. The overriding cross-cutting issues under the CRP are how to protect and support groups at risk, distribute the benefits of reform more equitably, and enhance prospects for the sustainability of reforms. Public servants and others displaced from their jobs constitute the most immediate group at risk. Their loss of livelihood and, potentially, of assets, will be mitigated through the establishment of a transition service program that will implement a range of measures to reduce hardship and facilitate reentry to the labor market. The program will develop a package of support comprising an appropriate mix of the following elements tailored to individual needs (i) issuance of certificates of service and training in resume preparation, (ii) career counseling and assistance with outplacement, (iii) training and retraining with an emphasis on business and commercial skills, (iv) redeployment benefits based on number of years of service, (v) normal entitlements of leave credits and superannuation payments, (vi) financial advice and access to credit at market rates, and (vii) mobilization of community support for those displaced.

68. Some of the other reform measures, notably the new indirect tax system; review of public sector pay and allowances; and the introduction of policies for privatization and cost recovery for certain Government services, may impact adversely on vulnerable groups. The CRP will establish capacity within DSM to monitor CRP impacts based on key variables, i.e., poverty, gender, location, age, employment, and income. DSM will also take responsibility to coordinate policy responses to the regular CRP monitoring and impact assessment reports, and mobilize NGO and community resources to help mitigate adverse effects.

69. The measures to equitably distribute the benefits of reform include the preparation of a medium-term strategic framework for HRD specifically to support the CRP, and to provide direction for increased budget allocations for health and education. Specific measures have been designed to improve the management, quality, and coverage of education and health services, with a focus on reducing urban-rural disparities. These include preparing and implementing an education master plan designed to provide every child in Vanuatu with primary education by 2010, and a comprehensive national health plan to improve the quality, accessibility, and delivery of health care services. Both these planning efforts involve extensive stakeholder consultations and mobilization of NGO and community resources. Measures to improve industrial relations include activation of the Labor Advisory Board and a review of labor legislation. Measures to promote gender equity include the appointment of an economic planner to develop gender equity policies and implementable measures to mainstream women's interests in policy development. An action plan for gender equity will be prepared, and policy and legislative frameworks on gender and development, and violence against women and children, will be developed and implemented.

70. Sustainability of the CRP will be enhanced through a broadly based, proactive strategy for informing and consulting with the people of Vanuatu. DSM will develop a consultation and communication strategy. The decentralization review will also enable assessment of the prospects for enhancing provincial and municipal resource mobilization and management to

increase empowerment at the local level. It is important to ensure that the social safety nets currently provided by kin groups following traditional customary practices are not undermined by CRP developments. This issue will be a key feature of the component on sustainability, and will be addressed directly during the ongoing process of wider community consultation. Measures to promote sustainable environmental management include improved legislation, conservation of natural resources, preservation of biodiversity through protected sites, and efforts to draw on customary traditions to enhance local awareness of environmental issues. In addition to such measures that have a direct positive impact on the environment, activities under the CRP that promote sustainable growth and enhance the efficiency of PS delivery and management of public utilities are expected to provide improved environmental benefits.

E. Implementation Strategy

71. The effective implementation of the CRP, and ensuring that the reform measures take hold and have the desired impacts, will essentially be a long-term process. The Government recognizes this. However, in view of the strong momentum that developed during the CRP formulation phase, and the broad-based community and bipartisan political support for the CRP, the Government has adopted an implementation strategy that involves a heavy front-loading of major actions. This front-loading focuses mainly on items that are critical preconditions to ensuring the longer term sustainability of the reform process. In the short to medium term, therefore, priority has been given to improving governance and establishing the institutional framework and mechanisms to pursue wider public sector reforms, such as through the introduction of new or amended legislation; establishing and making operational an appropriate structure of Government; and ensuring more predictable and transparent policies. Also, high priority is being given to restoring structural stability of the Government finances by reducing public expenditure and increasing revenue mobilization. A stable governance and fiscal environment are critical to the restoration of confidence, and also to the attainment of private sector-led sustainable growth. In the longer term, an ongoing challenge for the reform effort is to ensure that the new systems and the streamlined processes work effectively, especially through improved skills and enhanced institutional capacities. External financial and technical assistance, therefore, will be required over the longer term for a vigorous and sustained effort at institutional strengthening and capacity building. While the Bank's initial support, as proposed, covers the first three years of what essentially is a long term program, it is anticipated that further financial and technical assistance will be provided beyond the initial three-year time frame to ensure the sustainability and effectiveness of the reforms.

72. While the reforms need to be implemented with urgency, care also has to be taken to carefully sequence the reform effort and to ensure that it is properly coordinated and managed. The Bank is giving priority to assisting (i) those aspects of the reform process that are critical to the CRP's overall success, such as PS rightsizing, and restructuring and clarifying roles and responsibilities within the public sector; (ii) areas where relatively small investments can reap significant benefits in enhancing the transparency, predictability, and accountability of Government, such as strengthening PSC, DSM, MFEM, and the Office of the secretary general of CoM; and in building capacity for sound financial and economic management; (iii) strengthening the performance of public financial institutions as an integral part of wider financial sector reforms to support private sector growth; and (iv) initiatives that will be essential for laying the groundwork for the sustainability of reforms, such as institutional strengthening and developing a strategy for HRD within the public service.

F. Financing

73. The fiscal outlook for the three years 1998-2000, is shown in Table 1.

Table 1: Fiscal Outlook
(Vt billion)¹

Item	1997 (Actual)	1998 (Est.)	1999 (Est.)	2000 (Est.)
Total cash inflow	6.5	7.2	7.6	8.3
Total cash outflow	7.0	11.3	9.2	8.0
Operating balance	(0.5)	(4.1)	(1.6)	0.3

Est.= estimate.

74. The size of the deficit envisaged for 1998 (equivalent to about 14 percent of GDP, if the key CRP-related expenditures are included) is a matter for serious concern. The prospective deficit in 1998 has been increased greatly by the former Government's undertaking, pursuant to its role as guarantor of members' deposits in the VNPF, to advance up to Vt1.6 billion to enable payouts to the VNPF members who requested a refund of their contributions. The two other major elements explaining the large increase in the deficit for 1998 are (i) the increased provision for restructuring and refinancing of the Government-owned financial institutions (estimated at Vt720 million); and (ii) the costs of restructuring and rightsizing the public sector (estimated at Vt600 million).

75. The advance to the VNPF was a one-off cost, and the other two items also involve large outlays in 1998 (particularly for the recapitalization of the NBV) with much smaller consequential commitments in year two of the Program, and no such large one-off expenditures in 2000.

76. By April 1998, the Government had already reduced the expenditure initially proposed for 1998 by about Vt1 billion. The expenditure cuts included the following: (i) postponing proposed increases in Parliamentary allowances (Vt100 million), (ii) deferring a backpay claim by the police (Vt126 million), (iii) declining to approve an electoral computerization project (Vt150 million), (iv) reducing payments to the provinces (Vt125 million), (v) reducing the costs allowed to ministries for downsizing (Vt100 million); and (vi) other miscellaneous expenditure reductions (about Vt150 million).

77. The Government continues to pursue other measures that may further reduce the size of the 1998 deficit. These include reductions in the education and health allocations, and an increase in the rate of the new VAT. The advance to the VNPF, in particular, may be up to Vt200 million less than budgeted if the VNPF can successfully liquidate some of its assets, such as its buildings, during 1998.

78. A deficit of the size forecast for 1998 has created major problems for fiscal and monetary policy and will put additional pressure on the currency unless the financing issues are handled carefully. The Government proposes to finance the advance of up to Vt1.6 billion to the VNPF by domestic borrowing from the commercial banks. Of this sum, Vt900 million has already been borrowed. External funding from the Bank is anticipated to fund the costs of public sector restructuring; the restructuring and rehabilitation of Government-owned financial institutions; and fiscal stabilization. Loans from other external funding agencies will fund expenditures amounting to Vt707 million. This will leave a residual domestic deficit of Vt485 million to be funded by further borrowing from the commercial banks or other domestic sources.

¹

This table excludes the value of donor grants (most of which are paid directly by donors and do not pass through the Government account), and aid-in-kind. The cash outflow figure includes major CRP-related expenditures (i) on public sector restructuring (Vt600 million in 1998 and Vt240 million in 1999) and (ii) on the rehabilitation of financial institutions (Vt720 million in 1998 and Vt240 million in 1999).

79. For fiscal stabilization, monetary stability could be restored more speedily if the Government ceased borrowing from the commercial banks. The substantial payouts from the VNPF, financed in large part by the monetary authorities, have led to a significant loosening of monetary conditions. It is not possible to tighten monetary conditions while the Government continues to borrow and then spend the proceeds of its borrowings on further VNPF payouts. An end to the Government domestic borrowing program is an essential precondition to monetary tightening, and urgent action on this is essential to defend the exchange rate. This would be facilitated if external funding were available to enable the Government to achieve fiscal stabilization, and thereby restore macroeconomic stability.

80. With additional external assistance from funding agencies, the Government's funding plan would then be as shown in Table 2. In years two and three of the Program, the Government intends to return to a balanced budget as quickly as possible. The Government is determined to restore its working capital and rebuild some modest financial reserves. This financing plan envisages the restoration of a reasonable level of working capital by the end of 1999, and a build-up of reserves during 2000.

Table 2: Government's Funding Plan
(Vt million)

Items	1998	1999	2000
Receipts	10,752	7,610	8,273
Domestic revenue	7,162	7,610	8,273
Aid grants	1,784	n.a.	n.a.
Aid-in-kind	1,806	n.a.	n.a.
Outlays	14,864	9,212	8,019
Parliamentary appropriation			
Domestically financed expenditure	9,247	7,489	7,854
Aid funded loan expenditure	2,027	1,723	165
Aid funded grant expenditure	1,784	n.a.	n.a.
Aid-in-kind	1,806	n.a.	n.a.
Overall Deficit	(4,112)	(1,602)	254
Financed by			
Domestic loans (for VNPF)	1,600	-	-
Program loan	1,800	600	-
Other Aid Loans	707	1,243	165
Residual domestic borrowing (+)			
or repayment of loans (-)	5	-242	-419

81. The Government will embark on a program of asset sales, initially establishing a Government Business Unit in MFEM to formulate policy and strategy including transparent guidelines for a program of commercialization, corporatization and privatization. An asset sales program is expected to commence in late 1998, and to be more vigorously implemented during 1999 and 2000. The proceeds of any asset sales will be allocated to reserves.

82. The 1998 Budget has been prepared, for the first time, in a program budget format. This has made it easier for the Government to align the budgetary allocations with its strategic objectives. The new budget format integrates the costs of aid-funded projects with the

Government budget. The value of aid-in-kind contributed by funding agencies is also shown in each program where relevant.

83. The sectoral priorities in the 1998 Budget closely reflect the priorities of the CRP. High priority has been given to the factors driving long-term growth, namely, investment in people, particularly in education, and in training the labor force to enhance the skills base of the economy. The Budget allocations also recognize the need to strengthen institutions that are important for the good governance of the country. The priorities reflected in the Budget are (i) education budget increased by 15 percent to cater for school enrollment growth and further expansion of the secondary school system; (ii) health budget increased by 3 percent to allow for growth of services in line with population growth; (iii) the budgets of constitutional bodies, such as the Ombudsman's Office and the Public Prosecutor's Office, have been protected or even increased, albeit by small amounts; (iv) a significant increase in the grant to the National Tourism Office to assist tourism growth; (v) increased provision made for MFEM to cater for implementation of the new VAT; (vi) the Agriculture, Livestock, Forestry, and Fisheries budget maintained at least at 1997 levels; and (vii) all remaining areas reduced by 15 percent to reflect the decision to reduce staff numbers by 10-15 percent.

G. Medium-term Prospects

1. No Reform Scenario

84. In the absence of major reforms, the prospects for Vanuatu remain bleak. Economic growth will continue to be lower than the population growth rate. Should political instability continue, this is likely to lead to an even higher rate of turnover in the PS and in the boards and management structures of the State-owned enterprises. These factors will undoubtedly lead to a further deterioration in the volume and quality of the goods and services provided by the public sector, and to continuing financial losses by the State-owned enterprises. The tax base will remain narrow and will continue to erode as imports decline as a share of GDP. This will constrain Government expenditure even more and further deepen the fiscal crisis.

85. Under the no reform scenario, therefore, the burden of low Government revenue and expenditure growth would fall most heavily upon social expenditures in education and health. It would prove difficult to achieve universal primary education or to expand access to secondary education much beyond the 25 percent level currently achieved. The bulk of the population would continue to have its health needs met at aid posts, dispensaries, and health centers that are understaffed and have many underqualified staff. As a result, there will be little further improvement in the health status of ni-Vanuatu. Social and other infrastructure will not be properly maintained and will be allowed to slowly degrade. Public sector support for private sector development is likely to remain minimal and private sector support initiatives will continue to be constrained by the excessively bureaucratic requirements of obtaining business approvals and by the complexity of land administration. Above all, the uncertainties of the regulatory environment and the political climate, combined with the maintenance of inappropriate and conflicting economic policies, will continue to undermine business confidence and deter investment. There will be little direct foreign investment, and the domestic firms that remain profitable will be reluctant to make further investments in new buildings, plant, or equipment within Vanuatu.

86. However, even without reform, there would be some economic growth, especially in the agriculture sector. Copra returns are likely to recover to their long-term trend levels and the beef sector would continue to grow, albeit at slower rates than in the past. The main source of growth, however, would be the subsistence sector, reflecting the steady population growth and the absence of viable alternative avenues of employment. In the absence of any initiatives to

boost other commercial agricultural production and driven largely by growth in the subsistence sector, growth in the agriculture sector as a whole could be expected to reach 2.2 percent per annum. In industry, the manufacturing sector and utilities would probably achieve about 2 percent growth, reflecting the rate of growth of the economy at large and the maintenance of the high tariff regime that protects some productive activities. Construction activity is projected to remain at a relatively low level. Activity in the timber and logging sector will reflect this weakness in demand. There will be no significant new private sector projects that might otherwise reignite growth.

87. Among the service industries, the tourism sector is expected to grow at a modest rate of 2.5 percent as the present hotel plant reaches capacity and no new hotels are opened. This rate of expansion, which is low relative to the potential in this sector, reflects the continuing inability to coordinate tourism activities and the low level of business confidence. The contribution of the OFC will continue to decline as a proportion of GDP. Taken together, annual growth in the services sector as a whole can be expected to fall by about a third, from the 3 percent level achieved in the first half of the decade, to 1.9 percent.

88. Overall, an unreformed economy could be expected to achieve an average growth rate of about 2 percent over the years up to 2005. With an average population growth rate in recent years of about 2.4 percent, this implies a continuing decline in real living standards.

2. Reform Scenario

89. Under the reform scenario, effective implementation of the CRP is expected to lead to improved growth. Preliminary indications are that growth will develop in two stages. During the period up to 2000, while the reform measures are introduced and the essential groundwork laid, growth will be at a moderate rate. Compared with 2.8 percent during the first half of the 1990s, growth of 3.6 percent is forecast for the period up to 2000. In the period from 2000 to 2005, as the fruits of reform begin to manifest themselves, growth is anticipated to increase to an average annual rate of 5.8 percent (Table 3).

90. Two main forces are expected to drive the improvement in the rate of growth: agricultural diversification and tourism. All agricultural producers will benefit from a lower cost structure. This will be a result of the improved economic environment and the greater competitiveness resulting from a more open and efficient economy. Producers of traditional crops such as copra and cocoa will also gain from the development of specialist crops and improved marketing arrangements. As a consequence, the rate of growth of copra and cocoa production is expected to increase to 2 percent in the first period, and for this rate of growth to continue throughout the second period.

91. The faster growth in copra, cocoa, and new commercial crops will be offset by a marginal decline in the growth of the subsistence sector as land and labor is diverted to the cash sector. Annual average output growth in the subsistence sector is expected to decline marginally in the first period to around 2.8 percent as compared with 2.9 percent during 1990-1995, and to about 2.5 per annum in the second period. The rate of growth of the forestry sector is also expected to accelerate. Overall, agriculture is forecast to expand at an annual average growth rate of about 6 percent.

92. A general rationalization and lowering of tariffs, which is to follow fiscal stabilization measures, is one of the significant elements of the CRP. Initially, these measures will induce adjustment in the manufacturing sector as industries dependent upon protection for their financial viability seek their comparative advantage under the new tariff regime. The initial impact, therefore, will be a stall in manufacturing growth. Over the medium to longer term, manufacturing,

Table 3: Gross Domestic Product by Sector Impact of Reform Measures, 1990-2005
(percentages)

Sector	1990-95	2000		2005	
		Base	Reform	Base	Reform
Agriculture, forestry and fishing	2.6	2.2	3.6	2.1	5.9
Copra	-6.1	1.0	2.0	1.0	2.0
Cattle	13.0	2.5	5.0	2.0	5.0
Cocoa	-5.4	0.0	1.0	0.0	2.0
Other commercial agriculture	11.9	2.5	10.0	2.5	25.0
Subsistence agriculture	2.9	2.9	2.8	2.8	2.5
Forestry and logging	7.4	2.0	4.0	2.0	6.0
Industry	2.8	1.8	3.3	2.0	6.9
Manufacturing	1.2	2.0	0.0	2.0	4.0
Electricity	-1.2	2.0	3.5	2.0	5.8
Construction	5.9	1.5	7.5	2.0	10.0
Services	2.9	1.9	3.6	1.9	5.6
Wholesale and retail trade	3.2	2.0	3.5	2.0	5.8
Hotels and restaurants	4.4	2.5	7.5	2.5	10.0
Transport and communication	2.4	2.0	3.5	2.0	5.8
Finance and insurance	-1.5	1.0	2.0	1.0	2.5
Real estate and other services	1.9	2.0	3.5	2.0	5.8
Government services	5.7	2.0	3.0	2.0	4.0
GDP at producer prices	2.8	2.0	3.6	2.0	5.8

Source: *Vanuatu: Economic Performance, Policy and Reform Issues*, ADB, 1997.

including utilities, is expected to grow broadly in line with the medium-term growth of aggregate demand. The manufacturing sector is not expected to make any significant contribution to exports. The construction industry, in contrast, will grow strongly as a consequence of strong demand from the tourism sector for the construction of new hotels and related tourist facilities.

93. Tourism will be the second main driver of economic growth in Vanuatu. This assumes that the reform program helps the industry to overcome its problems of internal and external coordination through the adoption of a tourism master plan. The projections assume that visitor arrivals reach 60,000 by year 2000 and 100,000 by 2005 as more tourism-related infrastructure is built in Santo. This represents a compound growth rate of 10 percent, which is seen as achievable.

94. Both the financial sector and the Government sector are projected to grow at a rate less than the economy-wide average. Lower growth in the financial sector can be attributed entirely to the much lower growth rate of OFC, which is only expected to maintain its current level of services. Growth in the domestic financial sector is expected to parallel growth in the economy as a whole. Government services will expand primarily in response to growing demand for educational and health services, but this will be offset by the effect of public sector reforms designed to improve public sector productivity and impose a cap on public service recruitment.

V. THE PROPOSED LOAN

A. Objective and Scope

95. The objective of the Program is to support implementation of key elements of the CRP by means of a loan and TA. The components of the CRP to be supported by the Bank's loan are presented, in summary, in the Government's Development Policy Letter in Appendix 1, and in more detail in the Program Loan Reform Matrix in Appendix 2.

B. The Program Loan

1. Amount and Source of Funds

96. It is proposed that the Bank provide a loan of US\$20 million equivalent from the Bank's Special Funds resources. The size of the loan was determined on the basis of the substantial financing requirements of the policy and institutional changes, particularly in the public sector, and the financial and economic reforms being pursued.

2. Interest, Maturity, and Utilization

97. The loan will have a repayment period of 40 years, including a grace period of 10 years, and carry a service charge on the amounts disbursed of 1 percent per annum. The loan is expected to be utilized within a two-year period and funds will be released in two tranches.

3. Procurement and Disbursement

98. The proceeds of the loan will be utilized to finance the foreign exchange costs of items produced and procured in member countries of the Bank other than those items specified in a negative list in the Loan Agreement, and items already financed by official direct assistance. Expenses for eligible items incurred upto 180 days prior to loan effectiveness may be reimbursed from the loan proceeds. The Borrower will certify that the volume of eligible imports exceeds the amount of the Bank's projected disbursements under the loan in a given period. The Bank will have the right to audit the use of the loan proceeds and to verify the accuracy of the Borrower's certification.

4. Counterpart Funds

99. The counterpart funds to be generated from the proceeds of the loan will be deposited in a special account and will be utilized (i) to finance the PS rightsizing and restructuring program, including modest financial and human resource development support for persons retrenched from the PS under a managed transition service program; (ii) to support the restructuring and rehabilitation of public financial institutions; and (iii) for fiscal stabilization. The allocation of counterpart funds under the two tranches of the loan is presented in Table 4.

5. Implementation Arrangements

100. DSM in the Ministry of the Prime Minister will be the Executing Agency for the proposed loan as it is responsible for overall coordination and implementation of Vanuatu's CRP. MFEM, will be responsible for initiating the withdrawals under the loan, and for managing the special account for the counterpart funds. DSM will ensure that the Government's assurances are met (paras.126-128), in particular that the conditions for the release of the incentive subtranche conditions of the first and the second tranches are complied with. DSM's

Table 4: Allocation of Counterpart Funds
(\$ million)

Purpose	First Tranche		Second Tranche	Total
	Release 1	Release 2		
A. Public Sector Rightsizing and Restructuring	4.0	1.0	2.0	7.0
B. Financial Institutions Restructuring/ Rehabilitation	3.0	3.0	2.0	8.0
C. Fiscal Stabilization	3.0	1.0	1.0	5.0
Total	10.0	5.0	5.0	20.0

implementation and coordination role will be undertaken in collaboration with MFEM, the Attorney-General's Chambers, PSC, as well as other agencies.

101. The Government will set up a CRP task force, comprising representatives of Government, political parties, traditional chiefs, the private sector, NGOs, community groups, and trade unions, to monitor CRP implementation and to report to the annual National Summit. The minister responsible for the CRP will chair task force. This minister will report directly to the Prime Minister, and will provide CoM with regular CRP progress reports. The National Summit, involving broad representation of the nation as first convened in June 1997, will meet to review and assess progress.

6. Monitoring and Tranching

102. The Government will be responsible for ensuring the effective implementation of the policy, institutional, and legal reforms under the CRP. The Government and the Bank will jointly monitor and review progress to ensure that the time-bound performance conditions specified in the Program Loan Reform Matrix (Appendix 2) are met. This regular review of progress will be facilitated through the mechanism of quarterly program reports, which the Government will submit to the Bank. Representatives of the Government, the Bank, and other major funding agencies will formally meet in Port Vila at least once every six months for the review. The Bank will field review missions during the Program period. In particular, a review mission will be fielded no later than 12 months after loan effectiveness to determine fulfillment of the second tranche conditions. DSM will submit a Program completion report to the Bank within three months after the loan closing date. The report will evaluate the implementation of the reform measures under the Program, and will assess the impact on the economy, describe lessons learned during the Program period, and indicate further reform measures and the assistance needed to ensure sustainability.

103. The loan proceeds will be released in two tranches. The first tranche of US\$15 million equivalent will be in two parts: (i) US\$10 million equivalent to be released upon the effectiveness of the loan; and (ii) US\$5 million equivalent to be released when the incentive

subtranche conditions of the first tranche are met. For the release of the second tranche, it is expected that a formal review will be undertaken by July 1999 covering the first 12-month period of CRP implementation. Following this review, and upon the Bank being satisfied that the second tranche conditions have been fulfilled, it is expected that the second tranche will be released for disbursement by October 1999. The Bank's processing and approval of the proposed loan will be conditional on the Government's firm commitment to implement the key elements of the CRP, as specified in detail and with time-bound performance conditions in the Program Loan Reform Matrix (Appendix 2). The tranching conditions for the proposed loan, which are derived from the Program Loan Reform Matrix, include the conditions listed below in paras. 127-128 under the section on Government Assurances.

C. Aid Coordination

104. At the Noumea CG Meeting in July 1997, both bilateral and multilateral aid agencies expressed strong support for Vanuatu's CRP, and a willingness to assist in its implementation. The need for close monitoring and for coordination of any CRP-related external assistance inputs was emphasized. It was agreed that a CRP matrix, specifying in more detail the time-bound performance milestones, the policy actions, and measures to be implemented under the CRP, would enable both the Government and external aid agencies to closely monitor implementation. The Bank was requested, both by the Government and other CG participants, to continue to play a lead role in assisting the Government to translate its CRP into a CRP matrix; in ensuring the monitoring and reporting on CRP implementation; and in aid coordination. As a follow-up to this, the Bank has assisted the Government in generating a CRP Matrix that now serves as a broader framework within which the Bank will monitor and report on progress to the funding community, especially in the context of the CG process for Vanuatu. The Bank has also been coordinating the support of other aid agencies for the CRP. In addition, to coordinate the substantial TA being provided by various funding agencies, a Program coordination committee comprising Government officials and aid representatives will be set up. The role of this committee is explained in Appendix 3. Information on external assistance to Vanuatu is given in Appendix 4.

D. Lessons Learned

105. The Bank has had reasonable success with program lending. Out of 25 program loans with completed project performance audit reports, nine have been rated as generally successful, 14 as partly successful, and 2 had no rating. Among the 14 that are partly successful, two are for PDMCs, namely Fiji¹ and Samoa² and both are for agricultural support services. Postevaluation of the Fiji program loan stressed the need for (i) thorough assessment of the linkages between the reforms pursued and the goals to be achieved; (ii) setting priorities with attention to critical issues, particularly when there are large numbers of reforms to be pursued; (iii) quantifiable and time-bound targets related to policy goals and expected impacts; (iv) performance indicators to monitor progress and make suitable adjustments during implementation; (v) effective coordination mechanisms; and (vi) a pragmatic time frame for the program, recognizing the long time for many policy reforms to have a demonstrable impact. From the Samoa experience, it is learned that program lending can be an effective instrument to introduce policy and institutional reforms, provided (i) the program objectives are clearly focussed and the reforms prioritized; (ii) the scope and complexity activities to be undertaken by the Government match the resources available to the Government; (iii) the reforms are supported by sound macrosectoral policy analyses; (iv) intermediate indicators of policy reforms are clearly

¹ Loan no. 906-FIJ: *Agriculture Diversification Program*, for \$20 million, approved on 29 September 1988, completed on 31 December 1993, and postevaluated on 15 November 1996 (PEO-468).

² Loan no. 995-SAM(SF): *Agriculture Development Program*, for \$15 million, approved on 28 November 1989, completed on 30 June 1992, and postevaluated on 22 May 1995 (PEO-440).

defined; and (v) adequate flexibility is provided in the program to make corrections as warranted by changes in the economic environment.

106. The proposed Program to support implementation of the key elements of the CRP was designed with these pointers in mind, and drawing on the experience with ongoing public sector reform programs of the Bank in the Cook Islands, Federated States of Micronesia, and the Marshall Islands, while at the same time responding to the specific needs and requirements of Vanuatu. The objectives, scope, approach, and time frame of the Program are based on a thorough situational analysis of Vanuatu and assessment of how the Bank can best respond to the Government's request for assistance in the implementation of its CRP, with due regard to the Bank's past experience with program lending, particularly projects in the PDMCs.

VI. THE TECHNICAL ASSISTANCE

107. Institutional and capacity weaknesses are endemic in Vanuatu at almost all levels and across the whole of the public service. One of the major components of the CRP is the institutional restructuring and strengthening of the public service to improve its management and enhance its overall operational efficiency. While the rightsizing of the public service can be attained within a relatively short time span, the institutional strengthening process is longer term and will take considerable resources. There are a number of critical areas for which the Government has requested TA to enable it to effectively implement the CRP. The provision of such TA will be fundamental to ensuring that the momentum of the reform process is sustained. There is little time and opportunity, in the immediate and short term, for meaningful progress to be made in capacity building in order that the Government may acquire the necessary in-house skills. The reforms, especially in the area of PS restructuring, need to be expeditiously implemented to create an administration that will have the capacity, over the medium to long term, to manage more effectively and to pursue the reforms as an ongoing process. The TA requirements to support CRP implementation are substantial. The Bank, in its aid coordination role, has liaised with AusAID, New Zealand Overseas Development Assistance (NZODA), France, United Kingdom, United Nations Development Programme (UNDP), European Union, and other aid agencies to facilitate the timely provision of TA. AusAID, for instance, has agreed to fund major institutional strengthening projects for PSC and MFEM; NZODA is assisting with the introduction of the VAT; and France is providing assistance in the areas of financial and monetary management. The outline of the TA requirement of the Bank follows. In the design of the TA program, the need for both immediate and short-term consulting services, as well as the longer term goal of institutional strengthening, are addressed.

108. The Bank's TA, as Phase II for the provision of ongoing institutional support to the central agencies for CRP implementation, will focus on two key areas: (i) institutional support to DSM; and (ii) institutional strengthening of financial and economic management.¹ The institutional support to DSM, and thereby the Ministry of the Prime Minister, is on national-level policy coordination and development management, and in strengthening it to perform the strategic role of coordinating, monitoring, and reporting on the implementation of the CRP. The institutional support in the area of financial and economic management will focus both on MFEM and the line

¹ At loan fact-finding, the proposal was for two separate TAs to accompany the loan. The two proposed TAs, each covering a three-year program of assistance, were to be provided in three separate phases, each phase covering a duration of 12 months. In late November 1997, while an Appraisal Mission was in Port Vila for the further processing of the loan, the Vanuatu House of Parliament was dissolved and early general elections were announced. In anticipation of some delay in the further processing of the loan, including the accompanying TA proposals, and to respond to the pressing need for technical expertise, the processing of a single, consolidated TA was expedited, as an interim arrangement of support. TA No. 2984-VAN: *Institutional Support to Central Agencies for the Comprehensive Reform Program*, for \$630,000, was approved on 29 January 1998. TA No. 2984-VAN constituted the Phase I TA.

ministries to strengthen sectoral policy and planning, improve economic statistics, and provide financial and accounting training. The Bank's TA, which will also strengthen the linkages between DSM and other central agencies, such as PSC and Attorney General's Chambers, will be provided in collaboration with several key funding bodies, notably AusAID, France, NZODA, the Pacific Financial Technical Assistance Centre, European Union, and the Pacific Operations Centre of the Economic and Social Commission for Asia and the Pacific.

109. Details on the objectives and scope, consulting services to be provided, cost estimates and financing plan, implementation arrangements, and the broad terms of reference for consulting services for the TA are presented in Appendix 3. The consultants will be selected in accordance with the Bank's *Guidelines on the Use of Consultants*.¹

VII. PROGRAM IMPACT, RISKS, AND JUSTIFICATION

A. Program Impact

110. The CRP will have both positive and negative effects. It addresses good governance issues and the root problems contributing to the poor performance of the economy in Vanuatu. In particular, if implemented effectively, the CRP is expected to lead to (i) sound institutions of governance leading to greater political stability; (ii) greater transparency and more certainty and consistency in the regulatory regime and other economic policies, leading to greater business confidence; (iii) a smaller, more efficient, and more effective public sector; (iv) a broader tax base with a lower and more uniform tariff structure; (v) greater expenditure on social programs, especially health and education; (vi) a more dynamic public sector; (vii) a more open economy that attracts direct foreign investment; and (viii) a reformed financial sector, including restructured public financial institutions that operate on commercial principles.

111. On the negative side, direct short-term hardship will be experienced by about 500 displaced public servants who may have to return to subsistence production, mostly in rural areas, or move to urban squatter settlements where essential services are already lacking. The transition services program will help them find alternative jobs or business development opportunities, and provide a redeployment benefit based on number of years of service, together with other entitlements. Other workers may be displaced through privatization of a small number of Government-owned enterprises. These contractionary measures will have negative flow-on effects to urban-based domestic workers and businesses. In addition, they will strain the traditional social safety nets, as contributions of urban-based workers to their kin are cut back. This could disadvantage vulnerable groups that currently depend upon kin networks for support. There are no publicly funded welfare or social security schemes, and none will be introduced. Government workers are not poor, but some, particularly those at the lower levels, may become so if they fail to find alternative livelihoods.

112. The introduction of a VAT will increase the cost of services to poor and nonpoor alike. Rural producers, including those with low incomes, may benefit from the elimination of export taxes if these are passed on to producers, but this is likely to benefit men more than women, as men have higher visibility in cash production. The cost of imported goods, including basic foods, will depend on the extent to which the tariff is lowered, and the level at which the VAT is set. The purchase of imported essential basic goods such as rice, sugar, tinned meat and fish, flour, and matches is widespread in urban and rural areas. Price movements in imported goods will have widespread effects, especially among low income families. Significant increases

¹

At the request of the Government, and to ensure the necessary depth and continuity of support, the services will be retained, under the proposed Phase II TA, of a core team of three advisers who were involved in the CRP formulation stage and engaged under TA No. 2984-VAN.

will cause hardship. Locally produced foods are expensive; it is cheaper for an urban family to subsist on imported rice rather than on the local staple, taro.

113. Measures to introduce fees for certain Government services will cause price increases that would impact especially upon urban areas where such utilities are concentrated. This would probably make it more difficult for squatter settlements to obtain basic utilities. The Bank TA for Institutional Support to Central Agencies includes measures to develop the statistical base and the capacity for impact monitoring, particularly on the effects of reform on vulnerable groups.

114. Measures to enhance equity and the sustainability of the reforms will generally have positive social impacts that help to ease the pain of public sector contraction. Financial and banking reforms will help to create a favorable environment for private sector growth. The ni-Vanuatuan business development program will endeavor to create work in small business in rural areas, in the outer islands, and for women. Increased funding for basic health and education services will be critical to building the HR base, helping to contain population growth, and reducing urban-rural disparities. HRD planning efforts, especially the medium-term strategic framework and education and health plans, will help to ensure improvements in management, quality, and coverage of these services. It is critical that these efforts are undertaken in close consultation with the NGOs and community groups to ensure the best possible matching of service delivery to community needs and resources, as well as to labor market needs.

115. Measures built into the CRP to protect wage-earner interests and improve industrial legislation will help to consolidate the position of workers. Measures to promote gender equity will assist women by developing the policy base and dealing with violence against women and children; and by improving the targeting of resources and entitlements for women. A widely representative Working Group on Ensuring Equity including Gender will be responsible for developing specific measures based on gender benchmarks, and these will be incorporated into the reforms as a whole. A Working Group on Urbanization will address the need for urbanization policy and specific measures to improve conditions in squatter settlements. The Decentralization Review will identify strategies to strengthen and empower provincial, municipal, and local governments with a view to promoting effective government capacity closer to the community base. Emerging environmental problems will be addressed to promote sustainable environment management. This will be through measures such as improved environmental legislation to encourage efficient management and conservation of natural resources. This will also include the protection of biodiversity through a scheme to manage special areas. Efforts will also be undertaken to strengthen community awareness, and build upon existing customary practices to ensure the sustainable use of resources.

116. Continued development of the community consultation process is critical to ensure ongoing support for the reform process. It is also critical to provide continued scope for key stakeholders and community groups to influence developments.

B. Program Risks

117. One of the most critical elements of the Program is to achieve improvements in governance. Under the CRP, several important pieces of legislation were enacted in the early stage of the reform process to put into place rules, regulations, systems, and processes to proscribe behaviors. Among the change sought is the removal of political involvement in the work of PSC. Legislation to reduce political interference in the PS and the passage of the Leadership Code Act will provide a process for dealing with and sanctioning breaches of the standards of behavior expected by the Constitution.

118. Vanuatu lacks the capacity and expertise to implement a number of the intended reforms under the Program. TA under the Program, both from the Bank and other funding agencies, notably AusAID, NZODA, France, UNDP, European Union and the Pacific Financial Technical Assistance Centre, will be provided to support and strengthen the implementation process. The TA will be carefully designed taking due recognition of the limited capability of counterpart staff to absorb training and skills transfer. A realistic longer term timeframe for the technical assistance will be taken to develop and enhance capacities in critical areas. This phased assistance will mitigate this risk. The Program also involves development of new training programs to improve skills in the public sector, through both in-country and external training programs and will include a leadership and development management program that the Bank will offer to the newly appointed director-generals and director-level staff of the ministries.

119. A major risk to the Program is a possible waning of the political commitment to implement the Program as a result of pressure on the leaders to shy away from pursuing the politically unpopular measures, such as the rightsizing of the PS. During the CRP formulation phase, even though several changes occurred in the makeup of the Government, this did not derail the reform process. This is because of the bipartisan political approach adopted, and the broad consensus on and the ownership of the CRP. There is strong bipartisan political support for the implementation of the CRP. The Prime Minister and CoM have given their commitment to implement the measures contained in the Program Loan Reform Matrix. The risk of loss of commitment is also mitigated by the involvement in CRP implementation of representatives across all major groups in Vanuatu society, who have themselves indicated a strong commitment to the CRP. This wider civil society is now exerting increased pressure on the political leaders to implement the CRP.

120. To address the social risks associated with the Program, a detailed Social Impact Analysis was undertaken (Appendix 5).

C. Program Justification

121. The Government has indicated its commitment and the desire to implement the CRP with urgency. The timing is opportune to implement the reforms, including the difficult and politically unpopular measures. This is because of the very strong, broad-based community and bipartisan political support for the CRP. Normally, reform programs are adopted, albeit reluctantly, by governments in the wake of gross fiscal mismanagement or economic shocks beyond their control and when governments are left with little flexibility but to accept difficult adjustment measures. The case of Vanuatu, however, is somewhat different. Apart from the problems of political instability, and a progressive erosion of confidence evident in recent years, the country has generally enjoyed stable macroeconomic conditions. At least until the end of 1997, the country maintained adequate levels of external reserves, and liquidity in the banking system was high. When the CRP initiative was launched in February 1997, Vanuatu was not facing a fiscal or economic crisis. At that time, following policy dialogue with the Bank, the recognition among the country's leaders was heightened that Vanuatu's economy must grow at sustainably higher rates than the population growth rate; and for this to be achieved through the private sector, political stability and confidence needed to be restored. However, since 1996, there have been worrying signs of fiscal mismanagement. Following the last Government's decision to allow VNPF members to withdraw their contributions to the Fund, Vanuatu is now faced with an economic and fiscal situation that is precarious and that poses serious policy challenges. The level of the fiscal deficit is unsustainable, official reserves have declined sharply, and the vatv has been under increased pressure with the sharp erosion of business confidence.

122. The CRP represents an ambitious reform agenda. It seeks to renew the institutions of governance, redefine the role of the public sector, improve public sector efficiency, and foster private sector-led growth. For its successful implementation, restoration of confidence and macroeconomic stability are critical preconditions.

123. The Bank and other aid agencies have been working closely with the Government and assisted it in the formulation of the CRP. Following the Noumea CG Meeting, several aid agencies, notably AusAID, NZODA, and UNDP, have reviewed and refocussed their existing aid programs to give priority support for CRP implementation. In view of this, the proposed Bank assistance would be strategic in enabling the implementation of the CRP. First, it would send a strong message to the Government and people of Vanuatu that the international community believes in their reform program and is willing to give it material support. Second, without such assistance the danger is that the reform program will flounder because of the Government's inadequate financial and technical means to implement the key elements of the CRP. The technical as well as financial assistance under the loan seek to specifically address this. Third, the granting of the proposed assistance gives an opportunity to attach policy conditionalities to ensure that narrower political or other pressures do not cause the reform program to become diluted. It also enables the Bank to proceed with its proactive role of funding agency coordination, as a follow up to the July 1997 Noumea CG meeting. Such conditionalities would lend credibility to the Government, and strengthen its hand in implementing the necessary policies. The momentum to reform that has been built up should not be allowed to dissipate.

VIII. ASSURANCES

124. Commitment to implement the CRP was announced at the National Summit in June 1997 with the signing of the Port Vila Accord on the CRP, and reiterated to the CG Meeting in Noumea in July 1997, and also to the Bank's Fact-finding and Appraisal missions by the former Government. The Government that came into power following the general elections in March 1998 has publicly announced its strong commitment to implement the CRP and has already taken action on several key measures. The Prime Minister and CoM reiterated this commitment to the Bank's Post-appraisal Mission. This is reflected in the DPL (Appendix 1).

125. In particular, assurances have been given by the Government on the following critical aspects of the CRP.

126. The following actions have been accomplished as conditions for loan approval:

- (i) The following acts are passed by Parliament: the Government Act, the Leadership Code Act, the Public Finance and Economic Management Act, the Expenditure Review and Audit Act, the Public Service Act, and the Foreign Investment Act.
- (ii) DSM is fully established with adequate staffing to coordinate the CRP process and to monitor progress and results.
- (iii) Strategic business plans for the restructuring of the NBV and the rehabilitation of the VNPF have been adopted by CoM, and implementation of these plans has commenced.
- (iv) A professionally qualified board of directors for NBV has been appointed.

127. The following actions will be accomplished prior to the release of the incentive subtranche of the first tranche of the loan:

- (i) The total number employed in the PS will be reduced by between 10 percent and 15 percent.
- (ii) The VAT legislation will be enacted by Parliament and its implementation commenced.
- (iii) A Development Committee of Officials consisting of all director-generals, under the chair of the DG-MPM, to coordinate Government-wide policy and technical advice to CoM, will be established and become operational.
- (iv) Legislation to establish an asset management unit will be enacted, and the unit will be operational.
- (v) A professionally qualified board of directors will be appointed for VNPF.
- (vi) Top management staff for the NBV comprising a general manager, operations manager, human resource manager, and senior credit officer will be recruited externally.

128. The following conditions will be met prior to the release of the second tranche of the loan:

- (i) The Expenditure Review Committee to scrutinize public expenditure will be established and operational.
- (ii) A management improvement plan for all Government agencies will be developed and implementation commenced to ensure the effective implementation of key management systems in the PS.
- (iii) The Government Remuneration Tribunal will be established to set salaries and allowances in the public sector.
- (iv) A master plan for national infrastructure development will be prepared.
- (v) The good loans portfolio of DBV will be amalgamated into NBV to create a single bank offering personal and commercial banking services.
- (vi) A comprehensive review of education and health policies and services will be complete, and ministerial submission of five-year development plans made for CoM's endorsement to enhance social indicators in these two sectors.
- (vii) A decentralization commission will be established to develop a policy and implementation strategy for decentralized governance.

IX. RECOMMENDATION

129. I am satisfied that the proposed loan and technical assistance would comply with the Articles of Agreement of the Bank and recommend that the Board approve:

- (i) the loan in various currencies equivalent to Special Drawing Rights 14,977,000 to the Republic of Vanuatu for the Comprehensive Reform Program, with a service charge at the rate of 1 percent per annum and with an amortization period of 40 years, including a grace period of 10 years, and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan Agreement presented to the Board; and
- (ii) the provision of technical assistance, on a grant basis, in an amount not exceeding the equivalent of US\$1,200,000 to the Government of the Republic of Vanuatu for Institutional Support to Central Agencies for the Implementation of the Comprehensive Reform Program.

MITSUO SATO
PRESIDENT

23 June 1998

APPENDIXES

Number		Page	Cited On (page,para)
1	Draft Development Policy Letter	37	26, 95
2	Program Loan Reform Matrix	43	26, 95
3	Proposed Technical Assistance for Institutional Support to Central Agencies for the Comprehensive Reform Program	54	28, 104
4	External Assistance to Vanuatu	58	28, 104
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**GOUVERNEMENT
DE LA RÉPUBLIQUE
DE VANUATU**

BUREAU DU PREMIER MINISTRE

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**Appendix 1, page 1
GOVERNMENT
OF THE REPUBLIC
OF VANUATU**

OFFICE OF THE PRIME MINISTER

16 June 1998

President Mitsuo Sato
Office of the President
Asian Development Bank
6 ADB Avenue
Metro Manila
Philippines

Dear Mr. President,

1. Vanuatu is now at a crossroads. Economic growth has barely kept pace with population growth and we are now facing a serious fiscal crisis. My Government is determined to act with diligence and urgency to restore fiscal balance as well as business confidence. A larger challenge is that faster economic growth is needed to provide for higher levels of per capita incomes, improved social services and adequate quality infrastructure, especially to ensure that the majority of our people living in the rural areas can have access to education and health services of an acceptable standard.

2. Consequently, we have embarked on a programme of major political and economic reforms aimed at strengthening institutions relating to good governance and reform in the public sector, including the public service, and carrying out structural adjustments in the economy through policy and institutional changes to promote private sector-led growth. The reform programme basically seeks to restore stability and confidence; empower ni-Vanuatu and the private sector generally, to lead the process of development; and further, for the government to be more accountable and transparent in performing a supportive and enabling role in relation to economic development and growth.

3. In February, 1997, my predecessor signed a Memorandum of Understanding (MOU) with the Asian Development Bank. Through the MOU, the Government of Vanuatu committed itself to formulate and implement a Comprehensive Reform Programme (CRP). The present coalition Government, under my leadership, is fully committed to implement the CRP. We view the implementation of CRP as key to the realization of our vision to rebuild Vanuatu

into a united, well-governed and truly democratic nation that manages its affairs and resources prudently and wisely for the prosperity of our people and our future generations.

4. As you are aware, the CRP was formulated through a wide national consultative process. A National Task Force was set up under the chairmanship of the former Prime Minister and with representatives from all sections of Vanuatu society. Intensive policy discussions were conducted over a period of four months which provided the basis for formulating the CRP. As the Leader of the Opposition at that time, I was also fully involved in the CRP formulation work. The CRP was endorsed by the Council of Ministers before it was formally adopted at a National Summit in June 1997. The Port Vila Accord on the CRP was signed by over 200 national and community leaders at the end of the National Summit. Subsequently, the ADB successfully organized the first Consultative Group Meeting (CGM) for Vanuatu in Noumea, New Caledonia, on 28 July 1997. At that meeting, donors unanimously expressed strong support for the CRP and also their willingness to contribute to its implementation.

5. The adoption of the CRP by the first National Summit last year reflected wide community support for the vision which the CRP provides for the future development of Vanuatu and the strategy to realize it. The people of Vanuatu want to see an end to political instability in the country. They desire changes in the social and economic conditions to improve their standard of living. For our people, the CRP provides an avenue to bring about good governance, accountability and transparency in the public sector which would, in turn, lead to more efficient and effective delivery of services. For me as Prime Minister, the CRP provides a new impetus towards realizing the fundamental ideals and development goals that we set for Vanuatu at independence in 1980.

6. I am pleased that there continues to remain strong and wide community support in Vanuatu for the objectives and reform agenda of the CRP. I have appointed a full-time Minister responsible for CRP to assist me in further strengthening our national consultative mechanisms and to continue to build on this support, especially at the political level. A Department of Strategic Management was established in September 1997 which is now being adequately resourced with staff to assist the Minister for CRP in overseeing and ensuring the timely implementation of the reform programme. The Minister will convene regular meetings of the CRP National Task Force to monitor CRP measures being implemented and to report regularly to the Council of Ministers. The Minister will also report annually to the National Summit on overall CRP implementation progress.

7. Mr. President, we are convinced that the real reasons for poor social performance and economic stagnation in Vanuatu since independence are poor quality of governance and public sector management; lack of government capacity to make sound financial and economic policies to underpin growth; excessive government involvement in the

commercial sector; and inadequate private sector investment. These issues must now be addressed, not only adequately but with urgency. The CRP addresses the needed policy and institutional changes to promote and sustain dynamic, private sector-led economic growth.

8. I should emphasize that my government is committed to govern in accordance with democratic principles and through institutions established by the national Constitution; administer essential services in accordance with the rule of law; respect the freedom of expression and freedom of the press; recognize the importance of contributions made by the wider community to the betterment of Vanuatu; and recognize the need for the preservation of the environment and sustainable development. We have already taken the necessary steps to immediately implement the policy and legal framework identified in CRP to ensure that our leaders conduct their responsibilities with honesty, transparency, accountability, and in accordance with the rule of law.

9. Redefining the role of government and improving public sector efficiency are critical elements of public sector reforms under the CRP. We have already taken a number of important decisions and actions to achieve this. These include the reorganization of the structure of government from a total of 50 departments and units to nine Ministries; recruitment of Director-Generals of these Ministries through a competitive, panel selection process; and the number of political advisors has been capped and their role rationalized vis-à-vis the executive arms of government. The newly appointed Director Generals will now focus on managing the rightsizing of the public service and also on capacity strengthening across government to improve public sector efficiency.

10. The ADB has provided valuable technical assistance in developing comprehensive plans for the restructuring of the National Bank of Vanuatu, Development Bank of Vanuatu and Vanuatu National Provident Fund. My Government will ensure that the restructuring of these financial institutions are in accordance with the program agreed with the Bank. Also, my Government will ensure the gradual but definite withdrawal from those commercial activities which can best be left to the private sector. We want to focus on strengthening policy and regulatory capacity, as the core of the Government's role in the economy. Strengthening financial and economic management through the enhancement of policy-making capability and fiscal reforms are key elements in this regard, especially to ensure greater discipline, accountability and transparency in the management of public finances.

11. One of the central objectives of the CRP is to restructure the economy in order to encourage private sector-led growth. This is to ensure that output expands at a sustainable rate that is faster than population growth; promote ni-Vanuatu participation in business; safeguard the environment; and to ensure that the costs and benefits of growth are fairly spread

among all sectors of the community and across the country. To these ends, my Government is acutely aware that we must restore macroeconomic stability and business confidence.

12. In the actual process of restructuring the economy, my Government will focus on playing a facilitating role in the three key areas of developing skills and latent talents of our people; encouraging a stronger private sector with greater ni-Vanuatu participation; and opening up the economy to international investment and more modern technology.

13. Vanuatu's economy has to better adapt and be more responsive to the rapidly changing global economy. As Vanuatu re-orientes its economy to an export driven one, it cannot insulate itself from the tendency towards globalisation of markets, international competitiveness and shrinking protectionism. Government is therefore determined to open the economy to the outside world, especially in terms of gradually increasing contributions from exports and encouraging direct foreign investment.

14. I am pleased to note that our principal donors, especially Australia, New Zealand and France, are funding some of the key elements of the CRP for which external financial and technical assistance are needed. I am equally pleased to note that the ADB has been playing an excellent lead role, since February last year, in assisting the Vanuatu Government to formulate the CRP and to coordinate donor support. My Government is particularly grateful to the Bank for assisting our officials to recasting the CRP into the Programme Matrix which clearly describes, in adequate detail, the policy areas and objectives, the strategies and detailed policy and measures for the implementation of the entire CRP. We have requested a Programme Loan from the ADB for the purposes of implementing key aspects of the reform and to restore macroeconomic stability. We need such assistance from the Bank to be able to effectively implement our reform programme. The key areas to be supported by the proposed Program Loan, including the policy conditionalities, are presented in the attached Program Loan Reform Matrix.

15. Mr. President, my Government fully recognizes that the Program Loan Matrix reflects a reform agenda which requires sound management and institutional capacity to ensure its full realization. I am confident that supported by technical assistance from the Bank and other donors, especially towards strengthening central agencies responsible for coordinating CRP implementation, we will achieve the CRP objectives within the agreed timeframes. Our CRP Task Force, consisting of Government, private sector and community leaders, will continue to meet every three months to assist Government to monitor and review the implementation measures set out in the Government's CRP Programme Matrix. The Task Force will also report to the annual National Summit on progress towards implementing the reforms.


16. Furthermore, I wish to hereby reiterate and formally record the assurances which, as Prime Minister, I have given on behalf of the Vanuatu Government to implement the following high priority measures in addition to Loan Approval conditions, within the specified and agreed timeframes, as tranche conditions for the Loan:

- Actions which will be accomplished by 15 September 1998 to enable the Bank to release the Incentive Sub-tranche (First Tranche) of the Loan:
 - (i) Enactment and implementation of the new Value Added Tax (VAT) law to widen the tax base and improve the equity of the tax regime;
 - (ii) Establishment and operationalization of a Development Committee of Officials (DCO) consisting of all Director-Generals, under the chairmanship of the DG-MPM, to coordinate government-wide policy and technical advice to the Council of Ministers;
 - (iii) Enactment of legislation, establishment and operationalization of an Asset Management Unit (AMU);
 - (iv) External recruitment of a core of top management staff for the NBV, i.e. a General Manager, Operations Manager, Human Resource Manager, and Senior Credit Officer;
 - (v) Reduction of the total number employed in the public service by between 10% and 15%; and
 - (vi) Appointment of professionally qualified Board of Directors for VNPF.
- Conditions to be met by 30 June 1999 to enable the Bank to release the Second Tranche of the Loan:
 - (i) Establishment and operationalisation of the Expenditure Review Committee to scrutinize public expenditures;
 - (ii) Development and implementation of a Management Improvement Plan for all government agencies to ensure the effective implementation of key management systems in the Public Service;
 - (iii) Establishment of the Government Remuneration Tribunal to set salaries and allowances in the public sector;
 - (iv) Establishment of a Master Plan for national infrastructure development;
 - (v) Amalgamation into NBV of the good loans portfolio of Development Bank of Vanuatu (DBV) to create a single bank offering personal and commercial banking services;
 - (vi) Completion of a comprehensive review of education and health policies and services and then Ministerial submission of five year development plans for Council of Ministers' endorsement to enhance social indicators in these two sectors; and

- (vii) Establishment of a Decentralization Commission to develop policy and implementation strategy for decentralized governance.

17. Let me conclude, Mr. President, by expressing the profound appreciation of the Government and people of the Republic of Vanuatu for the support and assistance which ADB has been providing towards the realization of our CRP. We look forward to a continuation of this excellent relationship and will greatly appreciate your on-going support as well as that of the Bank's Board of Directors.

Yours sincerely,


Donald Kalpokas, MP
Prime Minister
Government of Vanuatu



PROGRAM LOAN REFORM MATRIX¹

(In support of the Government's Comprehensive Reform Program (CRP),
refer to the Government's CRP Matrix and Development Policy Letter)

A. Overall Objective

1. Enhance and sustain private sector-led economic growth with its benefits distributed equitably within the country.
2. *Performance Indicator.* Current level of growth is less than 3 percent. The Program will help the economy achieve a growth rate of at least 4 percent by 2000; this will increase thereafter. The Program will also assist the country achieve year-on-year improvements in key human development indicators as assessed by the United Nations Development Programme (UNDP) annually.

B. Immediate (and contributory) Objective 1

3. Redefine the role of Government and enhance the quality and delivery of its policy, regulatory, and development services. Performance Indicators follow.

C. Immediate (and contributory) Objective 2

4. Increase the productivity and growth of the commercial and private sector in both the urban and rural areas. Performance Indicators follow.

D. Immediate (and contributory) Objective 3

5. Support improvement of social development indicators, particularly for the disadvantaged and rural population. Performance Indicators follow.

¹ This Reform Matrix is based on a cause-effect analysis (Figure 1, p. 11) on the key variables influencing the economic and social performance of Vanuatu. It also serves as a Program Logical Framework for the loan. The loan is to be released in two tranches. The first tranche is to be released in two parts, the first upon loan approval and effectiveness, and the second part as an incentive subtranche (first tranche). The latter is referred to in this Program Loan Reform Matrix as "First Tranche, 2nd Release Condition."

Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
Immediate Objective 1: <i>Redefine the role of Government, and enhance the quality and delivery of its policy, regulatory, and Development services.</i>			
Component 1.1 Strengthen the legislative and institutional framework of Government to make it more accountable.			
Program Outputs			
1.1.1 Enact the new Government Act to define the boundaries between political leadership and public service.	10 Jun 1998 <i>Condition for Loan Approval</i>	DSM AGC	Clarify functions of various dept/agencies; constrain political interference in public service; and cap number of political advisers at 3/minister and 4/PM and DPM during the Program period.
1.1.2 Enact the Leadership Code Act to establish enforceable standards of ethical behavior of politicians, senior public servants, and other leaders.	10 Jun 1998 <i>Condition for Loan Approval</i>	AGC MPM	Establish greater accountability of leaders to the public.
1.1.3 Enact the new Ombudsman Act to support the Leadership Code and strengthen public accountability.	30 Sep 1998		Establish greater accountability of leaders to the public at large.
Component 1.2 Introduce responsible fiscal management.			
Program Outputs			
1.2.1 Enact the Public Finance and Economic Management Act, which will reform the budgetary process and establish greater transparency in fiscal management.	10 Jun 1998 <i>Condition for Loan Approval</i>	MFEM AGC	Ensure fiscal responsibility and a predictable fiscal policy environment.
1.2.2 Enact the Expenditure Review and Audit Act to strengthen fiscal oversight and performance accountability to Parliament	10 Jun 1998 <i>Condition for Loan Approval</i>	MFEM AGC	Reinforce accountability requirements at all levels of the public sector.
1.2.3 Establish with adequate staffing and resources and operationalize the Expenditure Review Committee to scrutinize public expenditures.	30 Jun 1999 <i>Second Tranche Condition</i>	DSM	Ensure public expenditures are controlled within available revenue.
1.2.4 Program Budgeting fully operational for all Government departments/agencies.	FY 1999	MFEM	Ensure performance and results orientation by developing and enforcing monitorable targets that are assessed periodically.

Monitorable Reform Measures		Target Date	Agency Accountable	Expected Impacts
Components 1.3				
Achieve fiscal balance and stabilization				
Program Outputs				
1.3.1	Achieve a balanced budget by increasing revenue and reducing expenditure, while ensuring real increases in allocations for health and education services	31 Dec 2000	MFEM	Reduce deficit in Program year 2. Achieve balance in Program year 3.
1.3.2	From FY 1999, produce Budget in format integrating recurrent and development revenues and expenditures.	FY 1999		Provide complete information on Government's overall financial operations.
1.3.3	Enact and implement new VAT law to widen the tax base and increase revenue.	1 Aug 1998 <i>First Tranche, 2nd Release Condition</i>	MFEM AGC	A wider and more equitable tax system is in place, and revenue mobilization is increased.
1.3.4	Reduce total number employed in public sector by between 10 percent and 15 percent.	1 Sep 1998 First Tranche 2 nd Release Condition	PSC DSM	Reduce expenditure and facilitate public service rightsizing.
1.3.5	Review policy and regulatory regimes for services and key utilities, and introduce rational pricing/user charge schemes to ensure cost recovery.	1 Dec 1999	MPU MFEM	Adequate policy, regulatory, and cost recovery arrangements in place to ensure sustainability of services at levels required by the public.
Component 1.4				
Restructure public sector institutions and processes to make them results focused, effective, and accountable.				
Program Outputs				
1.4.1	Enact the Public Service Act.	10 Jun 1998 <i>Condition for Loan Approval</i>	PSC AGC	Allow the PSC to professionalize the public service and avoid political appointments.
1.4.2	Restructure Public Service Commission with full powers to manage the public service.	30 Jun 1999	PSC	PSC will provide leadership in professionalizing the public service, and ensure that appointments to the public service are only made on merit.

	Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
1.4.3	Establish the Department of Strategic Management with adequate staffing to coordinate the CRP process and monitor progress and results.	10 Jun 1998 <i>Condition for Loan Approval</i>	MPM	DSM will provide leadership and accountability for successful implementation of the CRP; and effective policy and strategic coordination of all government agencies.
1.4.4	Introduce results-oriented management and performance-based program budgeting system for all Government departments/agencies.	31 Jan 1999	PSC MFEM DSM	Monitorable targets are established to assess the performance of departments.
1.4.5	Establish management information systems and annual ministry performance reports for Parliament.	1 Apr 1999 ongoing	PSC DSM	Make departmental performance subject to public review and thus introduce greater accountability to the public.
1.4.6	The auditor general to conduct review of PSC operations and departmental performance and report to Parliament.	1 Apr 1999 ongoing	AG	Accountability to the public is increased and assurance is given that political interference is eliminated or minimized in the public service.

Component 1.5
Undertake long-term institutional strengthening of public sector institutions

Program Outputs

1.5.1	PSC and DSM to develop and start implementing a management improvement plan for all Government agencies to ensure the effective implementation of key management systems such as corporate planning, program budgeting, and performance monitoring.	1 Apr 1999 <i>Second Tranche Condition</i>	PSC DSM	Show qualitative improvement in agency results annually.
1.5.2	Revise the public service manual to establish professional HR system for management and career development of public service.	1 Dec 1998	PSC	Show qualitative improvement in agency results annually.
1.5.3	Develop and implement an HR development plan to enhance skills at all levels.	1 Dec 1998	PSC MFEM DSM MEYA	Improve capacity and efficiency to deliver better services.

	Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
1.5.4	Establish under legislation a government remuneration tribunal with adequate staff and resources, to set salaries and allowances.	1 Oct 1998 <i>Second Tranche Condition</i>	PSC AGC	Provide consistency and discipline in setting of salary levels.
1.5.5	Introduce systems and processes for policy and strategy coordination, for monitoring impacts, and for managing the development process.	Ongoing	DMS MFEM	Continuing feedback on results is achieved, and there are corrective actions in response.
1.5.6	Establish and operationalize a Development Committee of Officials (DCO) consisting of all director-generals under the chair of the DG-MPM to coordinate Government-wide policy and technical advice to the CoM.	10 Jun 1998 ongoing <i>First Tranche, 2nd Release Condition</i>	MPM DSM	The DCO, supported by DSM as a technical secretariat, will ensure that all submissions to CoM that have a policy, developmental, financial, or legal implication are thoroughly assessed and evaluated at the interdepartment and officials/technical level
1.5.7	Establish and enforce, with the approval of CoM, clear guidelines, standards, and procedures for formal submissions to CoM requiring the approval or clearance of CoM.	1 Sep 1998 ongoing	MPM DSM AGC	CoM has the benefit of technical input and policy advice from senior public servants to support decision making.
1.5.8	Introduce systems and processes to establish, monitor, report on, and adjust financial and economic objectives in line with the PFEM Act.	ongoing	MFEM DSM	Help achieve the goals of increased economic growth and a balanced budget.

Immediate Objective 2

Increase the productivity and growth of the commercial and private sector in both the urban and rural areas.

Component 2.1

Improve investment policy environment to encourage private sector investment

Program Outputs

2.1.1	Enact the Foreign Investment Act to create a favorable environment for private sector operations.	10 Jun 1998 <i>Condition for Loan Approval</i>	AGC MTBD	Simplify and make transparent the regulations governing private sector investments thus encouraging foreign investment.
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	Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
2.1.2	Enact the Credit Union Bill to support domestic resource mobilization and make credit more easily available to ni-Vanuatu.	30 Nov 1998	AGC MTBD	Encourage investment on the part of ni-Vanuatu, especially in the rural areas.
2.1.3	Determine feasibility of the Credit Guarantee Scheme, particularly for rural borrowers; if found feasible and viable, ensure implementation.	30 Jun 1998	MTBD MFEM	If feasible, this will facilitate lending to noncollateralized borrowers, particularly in rural areas.
2.1.4	Establish NGO network to channel credit to ni-Vanuatu.	1 Dec 1998	MTBD MFEM	Enhance credit flows and technical assistance to the rural sector.
2.1.5	Establish a Master Plan for national infrastructure development.	30 Jun 1999 <i>Second Tranche Condition</i>	MIPU MFEM	Improve and maintain infrastructure to support economic growth.
Component 2.2 Reform financial sector policies to support private investment				
Program Outputs				
2.2.1	Lower import tariffs by at least one third on average.	1 Aug 1998	MFEM	Lower input prices and enhance competitiveness of local industry.
2.2.2	Eliminate all export taxes (except on logs).	1 Aug 1998	MFEM	Encourage exports and increase rural industries.
2.2.3	Revoke all import licenses that give monopolies.	1 Aug 1998	MFEM	Open up competition and therefore increase investment.
Component 2.3 Restructure Government financial institutions				
Program Outputs				
2.3.1	Amend the RBV Act to give it responsibility to supervise all domestic financial institutions.	15 Sep 1998	RBV AGC	Supervision of Government banks is more effective.
2.3.2	Restructure NBV to make it commercially viable and effective, particularly in servicing the middle- and low-income market, including the rural areas. In this connection, ensure the following:		MFEM RBV DSM AGC	Enlarge NBV's share of domestic resource mobilization and provide increased banking services to ni-Vanuatu. Strengthen its competitiveness with other financial institutions.

Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
(i) Formally adopt and commence implementation of the NBV Strategic Business Plan (SBP).	10 Jun 1998 <i>Condition for Loan Approval</i>	CoM MFEM	Achieve improved profitability on a sustainable basis. Performance targets clear against which progress can be measured.
(ii) Appoint independent professionally qualified board of directors.	10 Jun 1998 <i>Condition for Loan Approval</i>	MFEM AGC	Governance and policy development improved. Political interference eliminated. Accountability of chief executive strengthened.
(iii) Inject equity of Vt400 million.	30 Oct 1998	MFEM	Restore capital adequacy.
(iv) Enact legislation for and establish an asset management unit (AMU).	15 Sep 1998 <i>First Tranche, 2nd Release Condition</i>	AGC	Improve levels of collections of outstanding loans, and recover bad debts owed to Government and its agencies.
(v) Transfer bad and doubtful loans of NBV and DBV to AMU.	31 Dec 1998	NBV DBV AMU	Rationalize investment in the financial sector. Improve return on investments.
(vi) Amalgamate into NBV the good loans portfolio of DBV to create a single bank offering personal and commercial banking services.	15 Jan 1999 <i>Second Tranche Condition</i>	NBV MFEM AGC	There is a concentration of skilled resources, a broader range of services, and improved profitability. DBV dissolved.
(vii) Implement revised organization and accountability structure in accordance with NBV SBP.	30 Oct 1998	NBV	Performance of bank staff is improved including reporting and accountability.
(viii) Externally recruit and appoint a new general manager, an operations manager, a human resource manager, and a senior credit officer.	15 Sep 1998 <i>First Tranche 2nd Release Condition</i>	NBV MFEM	Appropriate banking expertise and experience are reflected in commercial orientation.
(ix) Establish best practice benchmarks for all operations.	30 Jun 1999	NBV	Efficiency of banking process is improved.
(x) Develop and commence implementation of detailed human resource development program.	30 Jun 1999	NBV	Skilling levels and performances of staff improved.
(xi) Amend NBV Act to facilitate implementation of the SBP.	15 Sep 1998	AGC MFEM	
(xii) Achieve the following minimum performance milestones:			

Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
(a) a 15 percent reduction in costs, (b) return to profitability, (c) average annual return to shareholders of 1 percent of assets, and (d) a 10 percent market share of assets of all registered banks.	31 Dec 1999 31 Dec 1999 31 Dec 2000 31 Dec 2002		Better resource utilization. Increased reserves. Improved service to ni-Vanuatu and other customers. Improved image of Bank; greater ni-Vanuatu participation in monetized economy.
2.3.3 Rehabilitate the Vanuatu National Provident Fund to ensure its viability:		MFEM AGC	Confidence in the Fund is restored.
(i) Amend legislation to enable the last 26 percent of special withdrawals to be paid.	10 Jun 1998	AGC	To avoid further erosion of confidence, demonstrate that the Government fully respects its commitment .
(ii) Amend the VNPF Act to mandate professional, arm's-length funds management; allow off-shore investments; mandate good employer principles for all staffing; and restrict ministerial involvement to matters of policy and performance review.	30 Jun 1998	AGC VNPF MFEM RBV	Restore member confidence.
(iii) Appoint professionally qualified new board of directors.	30 Sep 1998	MFEM	Improve governance; remove political interference.
(iv) Transfer effective control of all direct nonperforming investments to a specialist asset management unit. See 2.3.2 above.	31 Dec 1998	VNPF AMU	Remove operational responsibility for this function from VNPF. Allow focus on new role.
(v) Implement a smaller, flatter organization structure that is focused only on contribution and benefit management.	30 Jun 1998	VNPF	Reduce costs. Demonstrate Government determination to rehabilitate VNPF.
(vi) Review contribution rates and member interest credit rates.	30 Sep 1998	VNPF MFEM RBV	Increase capital formation rate and equity for members.
(vii) Amend the Act to provide a restructuring plan.	30 Sep 1998	AGV	
(viii) Government to appropriate funds to replace members' equity funds lost through bad investments.	31 Dec 1998 and each year until VNPF is self supporting again	MFEM	Restore and maintain member confidence.

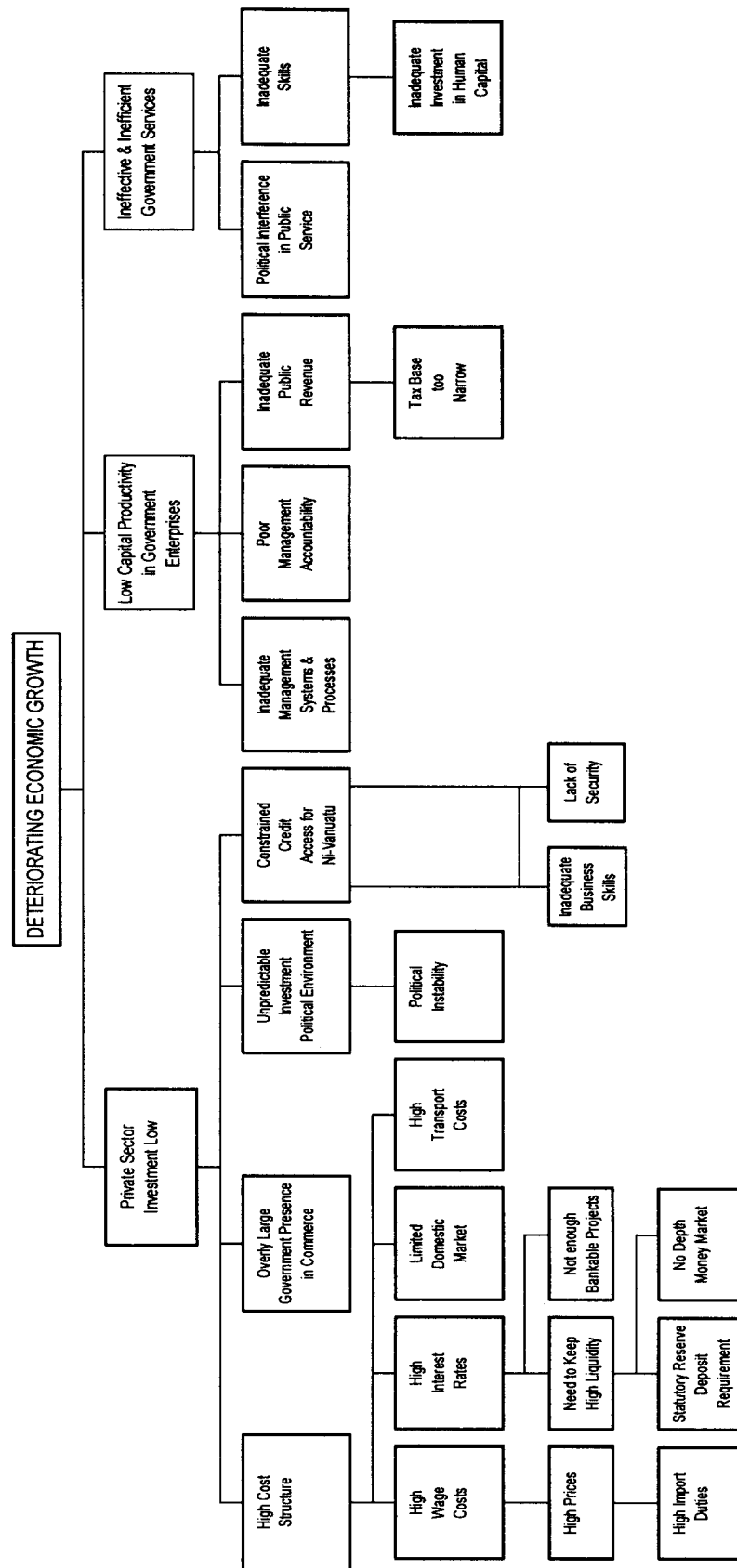
Monitorable Reform Measures		Target Date	Agency Accountable	Expected Impacts
Component 2.4 Redefine commercial functions of Government				
Program Outputs				
2.4.1	Establish a Government Business Unit to formulate policy and strategy for commercialization, corporatization and privatization.	30 Jun 1998	MFEM	Policy and transparent guidelines established.
2.4.2	Identify public sector assets for divestment and commence implementation.	31 Oct 1998 ongoing	MFEM	
2.4.3	Introduce contracting out arrangements.	15 Jul 1998	MFEM Other Ministries	New tendering legislation in place by June 1998.
Immediate Objective 3				
<i>Support the improvement of social development indicators, particularly for the disadvantaged and the rural population.</i>				
Component 3.1 Mitigate the negative impacts on groups that are vulnerable and at risk due to the reform process				
Program Outputs				
3.1.1	Create a transition unit with adequate staff and budget resources to manage the transition arrangements for approximately 500 ex public sector staff: training, career counseling, outplacement, redeployment benefits.	31 Aug 1998	DSM	Minimize the social and economic costs to those displaced.
3.1.2	Establish a mechanism to monitor the social impacts of the CRP and immediate measures to ameliorate negative impacts particularly on disadvantaged groups.	30 Sep 1998	DSM	Minimize social and economic cost to those displaced.
Component 3.2 Enhance social services to disadvantaged groups and rural communities				

Monitorable Reform Measures	Target Date	Agency Accountable	Expected Impacts
Program Outputs			
3.2.1 Double capital budget allocations from current levels of about 6 percent for education and health respectively.	15 Jun 1999	MFEM	Enhance health and education services particularly to rural communities.
Complete a comprehensive review of health and education policies and services, and require ministers to develop five-year action plans for presentation to the CoM, to enhance social indicators in these two sectors.	15 Jun 1999 <i>Second Tranche Condition</i>	Dept. of Health and Education MFEM	Improve performance of the social indicators pertaining to these two sectors within the next five years.
3.2.3 Establish a working committee involving representatives of NGOs, credit unions, women's organizations, etc., to promote government-NGO cooperation in the more effective provision of social services and rural credit to the rural poor. The working committee will meet at least every quarter to review progress.	31 Aug 1998 ongoing	MPM DSM MIA	Enhance cooperation of NGOs in CRP implementation process. Provide more extended outreach to rural communities.
3.2.4 Establish a decentralization commission to develop policy and implementation strategy for decentralized governance.	30 Jun 1998 <i>Second Tranche Condition</i>	MIA DSM	The delivery of services at local/rural levels is improved.

KEY:

DSM = Department of Strategic Management; AGC = Attorney General Chambers; MPM = Ministry of Prime Minister; MFEM = Ministry of Finance and Economic Management; VAT = Value-Added-Tax; CRP = Comprehensive Reform Program; PSC = Public Service Commission; AG = Auditor General; HR = Human Resource; DCO = Development Committee of Officials; DG = Director-General; DPM = ; PM = Prime Minister; PFEM = Public Finance and Economic Management; MTBD = Ministry of Trade and Business Development; MIPU = Ministry of Infrastructure and Public Utilities; NGO = Nongovernment Organization; RBV = Reserve Bank of Vanuatu; NBV = National Bank of Vanuatu; SBP = Strategic Business Plan; VNPF = Vanuatu National Provident Fund; MIA = Ministry of Internal Affairs.

Figure 1: VANUATU COMPREHENSIVE REFORM PROGRAM: CAUSE EFFECT ANALYSIS



PROPOSED TECHNICAL ASSISTANCE FOR INSTITUTIONAL SUPPORT TO CENTRAL AGENCIES FOR THE COMPREHENSIVE REFORM PROGRAM

A. Introduction

1. As part of overall Bank assistance, ongoing technical assistance (TA) is proposed to be provided for institutional support to Central agencies, i.e., the Department of Strategic Management (DSM) and the Ministry of Finance and Economic Management (MFEM), for implementation of the Comprehensive Reform Program (CRP). TA fact-finding was undertaken concurrently with the processing of the proposed Program loan. The TA was discussed with concerned Government agencies, and an understanding was reached on its terms of reference, cost estimates, and implementation arrangements.

B. Background and Justification

2. The CRP has identified major weaknesses in policy coordination and the development management process at the national level. The weaknesses are pervasive, and at the administrative, organizational and also technical levels. The tendency has been to take important decisions without the benefit of analytic and technical assessment and policy advice. The Council of Ministers (CoM) needs effective backup in the form of well-coordinated technical advice and policy analysis to improve its decision making on development policy and the handling of strategic management issues. There is a need to strengthen the functioning of the Ministry of the Prime Minister (MPM) including the Secretariat to CoM to ensure that the Prime Minister and CoM have the benefit of well-coordinated technical and professional advice from both the central agencies and line departments. Policy advice by DSM, MFEM, and the Public Service Commission (PSC) needs enhancement to improve strategic policy decision making and management. Also more effective policy coordination is needed to ensure that submissions to CoM reflect the full range of issues and options that should be addressed.

3. DSM's central coordination role is being undertaken at two main levels: (i) within Government, in ensuring policy coordination and monitoring of implementation by liaising with other Central agencies, and the line ministries, and (ii) at the national level, in ensuring that all key stakeholders are involved in and made fully aware of the ongoing reform progress. This role of DSM is both strategic and pivotal. The Bank's support is being provided through a multiphased, long-term assistance program, designed for institutional strengthening and building the capacity of the counterpart staff in DSM, as well as other Central agencies such as MFEM and PSC, to effectively perform the policy coordination and implementation monitoring role. The need for external expertise is pressing, for both the immediate tasks of implementing the key actions under the CRP, and also, to progressively build the technical and managerial capacity to ensure the sustainability of reforms.

C. The Technical Assistance

1. Objectives

4. The proposed TA constitutes Phase II of a three-year program of assistance to strengthen the institutional capacity of DSM as well as MFEM.¹ The institutional support to DSM, and thereby, MPM, is in national-level policy coordination and development management, and in performing the strategic role of coordinating, monitoring and reporting on the implementation of the CRP. The institutional support to MFEM is in the areas of strengthening sectoral policy and planning, improving, economic statistics, and financial and accounting training. The TA will also strengthen the linkages between DSM and other Central agencies, such as PSC and AGC.

5. The three-year proposed program of TA involves process-oriented institutional strengthening in accordance with the Bank's Initial Staff Guidelines on Capacity-Building Services to developing member countries (DMCs). The approach adopted in its design takes account of the new organizational structure of DSM, the overall management framework for the CRP, as well as policies, strategies, and coordinating mechanisms, with strong emphasis on the transfer of skills. The delivery of the TA program is in three phases, covering the fiscal years 1998-2000. The Interim Phase I TA covers the period April - August 1998. The proposed TA is for Phase II, which will cover the period commencing mid-September 1998 up to mid-December 1999. The third phase will cover the year 2000. Each phase of the three-year assistance program, the scope of which covers four key areas (described in summary in para. 10), has monitorable objectives and performance milestones to ensure the accomplishment of a range of activities. The Bank's approval of each successive phase is dependent on satisfactory performance being achieved in the preceding phase of the assistance program. For the Phase II TA, a review will be undertaken at least three months before the end of the phase. A basic requirement in the provision of consulting services, under the three-year assistance program, is the ongoing transfer of skills, on-the-job training, and professional skills development of the counterpart staff.

2. Scope

6. The institutional support to be provided under the Phase II TA will be in four key areas:

- (i) overall national-level policy coordination, development management, and monitoring of the implementation of the CRP;
- (ii) coordination of the good governance and public sector reform component of the CRP;
- (iii) coordination of the economic and financial management reform component of the CRP; and
- (iv) development of leadership skills and managerial capacity at the level of the directors-general of ministries and the directors of departments.

¹ The Phase I TA, TA No. 2984-VAN: *Institutional Support to Central Agencies for the Comprehensive Reform Program*, for US\$630,000, was approved on 29 January, 1998. As background, it may be noted that in late November, 1997 while the Appraisal Mission was in Port Vila for the processing of the proposed Program loan, the Vanuatu House of Parliament was dissolved and early general elections announced. In anticipation of some delay in the further processing of the program loan including the accompanying TA proposals, and to respond to the pressing need for technical expertise in DSM as well as other key Central agencies, the processing of TA No. 2984 was expedited as an interim arrangement of support.

3. Cost Estimates and Financing Plan

7. The total cost of the TA is estimated at US\$1,510,000 equivalent, of which US\$1,115,000 is the foreign exchange cost and US\$395,000 equivalent is the local currency cost. Of the total cost, the Bank will finance all the foreign exchange cost and US\$85,000 equivalent of the local currency cost, on a grant basis from the Bank-funded TA Program. The Government will fund the remaining US\$310,000 equivalent to meet the cost of counterpart staff; counterpart contribution for the conduct of training seminars and workshops; office accommodation; support services including supplies; secretarial support, local telecommunications, photocopying; and local transportation for official purposes (see following Table).

COST ESTIMATES AND FINANCING PLAN (\$'000)

Item	Foreign Exchange Cost	Local Currency Cost	Total Cost
A. Bank Financing			
1. Consultants			
a. Remuneration, Per Diem. and Housing (International Consultants)	885.0	—	885.0
b. International Travel	85.0	—	85.0
c. Reports and Communication	5.0	—	5.0
2. Seminars, Workshops, and Training ^a	90.0	85.0	175.0
3. Contingencies	50.0	—	50.0
Subtotal (A)	1,115.0	85.0	1,200.0
B. Government Financing			
1. Office Accommodation	—	45.0	45.0
2. Support Services ^b	—	40.0	40.0
3. Counterpart Staff Costs	—	130.0	130.0
4. Seminars, Workshops, and Training ^c	—	75.0	75.0
5. Internal Travel	—	20.0	20.0
Subtotal (B)	—	310.0	310.0
Total	1,115.0	395.0	1,510.0

^a Includes provision for both in-country and external skills development and training costs for local counterpart staff. The in-country training include three leadership and development management workshops for heads of ministries/departments and at least two middle management training events. The external training include short-term attachments to other developing member countries, and provision for participation in at least two short-term executive management programs.

^b Includes secretarial, in-country communication, and other support service costs.

^c Government's contribution toward the training activities listed under footnote ^a

Source: Staff estimates.

D. IMPLEMENTATION ARRANGEMENTS

8. The TA will consist of 58 person-months of consultancy services, which will include a CRP coordination adviser¹ (14.0 person-months), economic reform adviser¹ (7.0 person-months); public sector reform adviser¹ (7.0 person-months); economic statistician (11.0 person-months); sector policy economist (8.0 person-months); a monitoring and impact assessment specialist (3.5 person-months); accounting adviser (3.0 person-months); public finance training adviser (3.0 person-months); and a human resource development specialist (1.5 person-months). In addition, the Government of France will provide the services of an economic reform adviser (long-term), a financial adviser (short-term), and an agronomist. The CRP coordination adviser will be the TA team leader. The Bank-funded consultants, recruited on an individual basis, will be selected in accordance with the Bank's *Guidelines on the Use of Consultants*.

9. The Executing Agency for the TA will be DSM, with the director of DSM serving as the principal coordinator. The director of DSM, together with the directors-general of MPM, MFEM, chairperson of PSC, and the CRP coordination adviser, will constitute the TA Steering Committee, responsible for overseeing the implementation of the activities under this TA. The director of DSM, as principal coordinator, will submit an inception report to the Bank, and a final report at the conclusion of the TA. The TA is expected to commence in early September 1998.

10. The Public Sector Reform component of this TA is linked to an ongoing capacity-building project in PSC, which is funded largely by the Australian Agency for International Development (AusAID). Establishment of the AusAID-funded assistance recognizes the central role that PSC has to play in restoring the independence, capacity, and professionalism of the public service. The activities of the largely AusAID-funded assistance program for PSC, and also the largely AusAID-funded institutional strengthening TA for MFEM, will need to be closely coordinated with the Bank's institutional support to the central agencies. To facilitate aid coordination between the principal funding sources for CRP-related TA that will be provided to DSM, PSC, and MFEM, a program coordinating committee (PCC) will be set up, chaired by the director general of MPM on behalf of the Government. The PCC, which will include the chairperson of PSC and the director-general of MFEM, with director DSM as secretary, will comprise a representative each from the Bank, AusAID, France, New Zealand, United Kingdom, and the European Union. The PCC will meet at least once every six months in Port Vila to review progress and to coordinate external inputs for the CRP-related TA programs, including the Bank's TA for Institutional Support to the Central Agencies.

¹ In response to the request of the Government, and to ensure the necessary depth and continuity of support, the services of these advisers, as the core team involved in the CRP formulation stage and engaged under TA No. 2984, will be retained for this Phase II TA.

EXTERNAL ASSISTANCE TO VANUATU

A. Introduction

1. Vanuatu depends largely on external assistance to finance its development activities. Since independence in 1980, external aid has not only financed the bulk of the Government's development expenditure but also effectively underwritten the stability of the country's balance of payments and external reserves position. In fiscal year 1995/96 Vanuatu received about Vt6 billion in aid, which was almost equivalent to the Government's annual recurrent budget of Vt6.8 billion. Of this, 73 percent was in grants and the remainder in the form of concessional loans. Seventy-three percent of the aid is provided by bilateral donors and the balance by multilateral agencies. The social infrastructure sector, which includes health and education, accounts for about 48 percent of the total development assistance program.

B. Bilateral Assistance

2. Australia is one of Vanuatu's major donors providing about A\$10.2 million annually. The 1997/98 budget allocation for Vanuatu is A\$11.2 million with a further A\$0.3 million provided to meet the costs of scholarships. A further A\$1 million has been allocated to Vanuatu from the regional Policy and Management Reform to support CRP implementation. In August 1997, it was agreed that Australia's assistance to Vanuatu, both in the short and medium term, would be mostly for the CRP in the areas of public sector reform and fiscal and economic management. Almost 40 percent of the Australian aid program is directed at human resource development. Other priorities include increased support for private sector development, sustainable resource development, and support for economic and social infrastructure projects. New Zealand's bilateral (NZODA) program is currently NZ\$4.75 million a year, 60 percent of which is allocated mainly for human resource development. This includes long- and short-term study in New Zealand at regional tertiary institutions, assistance to enhance curriculum development, and in-service teacher training in Vanuatu. New Zealand is also assisting Vanuatu improve its agricultural quarantine service, both to protect its disease-free status and help promote exports. Other areas supported include forestry, water, women in development, good governance, private sector development, and the health sector including medical treatment in New Zealand.

3. France provides about F32,560,000 as part of its development assistance to Vanuatu, mainly to support a limited number of large projects, including the construction of the television and broadcasting facilities and associated works in Port Vila and Luganville. The areas of focus remain education, health, and agriculture. France is also providing technical expertise to support CRP implementation. The United Kingdom's development assistance has declined in recent years. In 1997, it provided about Vt309 million, concentrating on two main themes: education and good governance.

4. Japan usually does one large project each financial year as grant aid in kind. The most recent projects financed by Japan are the hospital equipment project and waste disposal equipment for the two municipalities in Port Vila and Santo, and the Efate ring road. Japan also provides volunteers. Assistance from the People's Republic of China consists of development assistance that has been a series of loans used for large construction projects such as the National Parliament complex in Port Vila, the Brenwe Hydropower project in Malekula, the Law Complex at the USP Center in Port Vila, and the dental clinic in Luganville, Santo. Canada's bilateral program supports small projects for many local government HF radios and rural water supply projects. The United States has been assisting Vanuatu with the provision of Peace Corps volunteers and a few scholarships through the East West Center.

D. Multilateral Assistance

5. Loans from the World Bank have funded the construction of new schools and other activities under the Primary and Secondary Education Project, and it is currently lending money for the provision of low cost housing in Port Vila. Assistance from the European Union is in the framework of the various Lome conventions. The 8th National Indicative Program for the five-year period (1997 to 2001) has made available ECU9.5 million to Vanuatu. Of this, ECU7.00 million is earmarked for the education sector, and the remainder for natural resource development and environment, decentralization, and gender and development. Projects funded by UNDP have included water and sanitation, energy planning, tourism development, economic management and public sector reform, strengthening of community groups in watershed management, development of a national forestry policy, and disaster relief. The Commonwealth Fund for Technical Cooperation targets technical assistance and human resource development projects including an adviser each to the Development Bank of Vanuatu and to the Ombudsman's Office. It is also funding long-term scholarships for some Ni-Vanuatu students.

SOCIAL IMPACT ANALYSIS

A. Introduction

1. The Comprehensive Reform Program covers political, economic, and social aspects of reforms. This Appendix focuses on the social underpinnings of the reform process, on its likely social impacts, and on the measures to improve equity and social sustainability, which are integral to the continued momentum of the reform program. The social rationale for the reform process is clear. People throughout the country are disenchanted with "continuing economic stagnation, poor social services, increasingly unstable government, inefficient public administration and the abuse of power" (Vanuatu CRP, 8). If the CRP can improve these elements quickly and in tangible ways, then it is likely to sustain broad-based community support.

2. Multiple social problems are emerging in Vanuatu. Economic growth is barely keeping pace with population growth, and the creation of employment opportunities and services cannot meet the demand. The pressure on land and natural resources is increasing. Education and health services have limited coverage and their service quality is poor. Women have limited access to resources and entitlements. Disparities between rural and urban areas are reinforced by the problems of providing services to 178,000 people scattered through 68 islands, speaking more than 100 languages. Threats from cyclones and related natural disasters exacerbate difficulties with service provision and economic production. Peri-urban squatter settlements are developing without access to basic utilities.

3. Representatives of the wider society contributed significantly to the CRP preparation through several task teams. Two task teams had about 30 members each, drawn from Government, traditional leaders, business, the trade union movement, NGOs, churches, women's organizations, and state-owned enterprises. The CRP coordinator together with some members of the task teams visited the outer islands to inform and consult citizens about the content of the reform package. The CRP was ratified publicly at a National Summit on 26-27 June 1997, with the signing of the Port Vila Accord on the CRP. The momentum generated so far must be sustained, with consultation with key stakeholders and the wider community at important points during the reform implementation process. The Government's CRP Matrix highlights certain critical points at which stakeholder groups will be consulted. Working groups will prepare action plans and other documents. Workshops and discussions will be held with NGOs, coordinated through Vanuatu non-government organizations (VANGO), which would take place in rural as well as in urban areas. The media including radio will be employed to reach the outer islands. A consultative strategy will be prepared to give further substance and direction to the consultation process.

B. Social Indicators

1. Population

4. Vanuatu's population growth rate declined from 3.2 percent per annum in 1979 to 2.4 percent in 1989. Since then, the population growth has remained at a high 2.4 percent level. For Ni-Vanuatu, the growth rate is higher at 2.8 percent. Fertility rates are still high, especially in rural areas (See Table 1). Women with up to six years of education have fewer children than women without schooling. International migration is not a safety valve for the

surplus labor in Vanuatu as it is in some other Pacific developing member countries, such as the Cook Islands and Samoa.

5. With nearly 46 percent of the population under 15 years, dependency ratios are high. Households headed by women comprised over 11 percent of the population in 1979, and are likely to have risen since then, especially in urban areas. The population density of 12 persons per square km is distributed unevenly through small scattered settlements, complicating the task of service provision. Many rural people migrate to urban areas (Port Vila and Luganville) in search of better schooling and income earning opportunities. Shortage of land in densely populated islands also leads to rural-urban migration, for example, in Shepherds, Paama and Pentecost Islands. Table 1 shows the urban population increased from 18 percent to 25 percent of the total population between 1989 and 1997. Rural migrants often pay rents for uncertain informal settlements with crowded housing and virtually no provision of basic water, sanitation and electricity. Formerly most migrants were males but now whole families are moving, to take advantage of health and education services. However, since jobs are scarce there is a rising incidence of crime and social problems, especially amongst younger people.

Table 1: Key Demographic Indicators

Indicator	1979	1989	1994	1997
Total Population	111,251	142,944	160,700	177,400
Male	59,072	73,674	82,500	
Female	52,177	69,270	78,200	
Population of Port Vila	14,598	19,311		33,700
Population of Luganville	5,183	6,983		10,600
Urban Population as Percentage of Total	n.a.	18		25
Rural Population as a Percentage of Total	82	82		75
Ni-Vanuatu as a percentage of Total	94	98	96	98
Annual Population Growth Rate	3.2	2.4		2.4
Crude Birth Rate /1000	45	38		33
Crude Death Rate/1000	12	9.1		
Life Expectancy	56	61.5		65
Male	54	64.2		69
Female				
Fertility Rate	6.5	5.3		4.4
Maternal Mortality Rate per 1000 live Births			92-138	
Percentage of Women Headed Households	11.4			

Source: UNDP 1996 *Sustainable Human Development in Vanuatu*, Fiji based on National Statistics Office Data; 1997 Data obtained from National Statistics Office *Statistical Indicators Second Quarter 1997*; *Second National Health Development Plan, 1997-2001*.

2. Human Development Index

6. The Human Development Index (HDI) measures quality of life and levels of educational attainment. Of 11 PDMCs reviewed recently, Vanuatu had the third lowest HDI (see Table 2), ahead of Solomon Islands and PNG. Vanuatu ranked 119th in global terms.¹

¹ See UNDP 1996.

Table 2: Human Development Indicators

Indicator	1991	1994
Human Development Index		0.424
Adult Literacy Rate	30	
Mean Years of Schooling		4
Gross Enrollment ratio (Primary and Secondary)		63
Public Expenditure on Education as a Percentage of GNP (%)	4.6	4.6
Percentage of Population with Access to Safe Water		77
		96(urban)
		53(rural)
Infant Mortality per 1,000 Live Births	55-60	58
GDP per capita		1,020
Daily Calories food supply as a Percentage of Requirements		111
Percentage of Malnourished Children under 5 years		23
Public Expenditure on Health as a Percentage of GNP		2.4

Source: ADB 1996; UNDP 1996; and Asian Development Bank 1997.

3. Education

7. While enrollments continue to grow in the 1990s there are very limited places in secondary schools — three quarters of children leave the school system without practical skills or sufficient qualifications for most jobs. A few students obtain tertiary education overseas. Five Government institutions provide tertiary training for teachers, nurses, agricultural extension workers, seamen and for general vocational skills, but enrollments are low and the level of education is generally poor. Non-formal education and kindergarten education is mainly provided through NGOs. Problems in the education system include

- (i) Absence of strong planning
- (ii) Expenditure on education is not keeping pace with population growth
- (iii) Population growth resulting in growth in demand for education at all levels
- (iv) High cost of education and lack of fee structures
- (v) Difficulties in providing education in remote and inaccessible places
- (vi) Limited primary school places in urban areas and limited secondary places everywhere
- (vii) Focus on academic training leaves the dropouts without practical, useable skills
- (viii) Lack of non-formal educational opportunities
- (ix) Shortage of trained teachers
- (x) Vocational training inappropriate to the needs of the job market, and
- (xi) Additional effort and cost to maintain dual-language education streams in English and French.

8. The education system is not, at present, providing young people joining village life with "skills that will enable them to survive as small-scale natural resource based entrepreneurs able to identify and adapt appropriate technologies for sustainable rural living".¹ The secondary school leavers compete for a very small number of jobs created each year. At higher levels, there is a shortage of Ni-Vanuatu with skills for professional and skilled technical

¹ ADB 1997 *Vanuatu: Economic Performance Policy and Reform Issues*, Pacific Studies Series, Manila 231.

positions, leading to the continued dependence on international experts to provide such expertise.

4. Health, Nutrition and Family Planning

9. Vanuatu is in a health transition from mortality dominated by communicable diseases to chronic and lifestyle related diseases. Traditional killers such as tuberculosis, yaws, leprosy and malaria are giving way to cardiovascular and malignancy diseases - at least in those 40 percent of deaths reported in the official statistics. Malaria, however, is still the number one cause of death for infants in rural areas. Morbidity continues to be dominated by respiratory ailments, and infectious and skin diseases, reflecting, in part, poor housing, sanitary conditions, and personal hygiene.

10. Preventive and curative health care is provided in a four tier system, based on the aid post, staffed mainly by volunteers, at the community level. NGOs run community health education and health services. The main problems in health and nutrition include

- (i) three quarters of the health budget spent on urban-based services;
- (ii) health facilities are poorly managed, with weaknesses in essential supply systems and maintenance of equipment;
- (iii) health data information systems and planning are weak;
- (iv) nursing staff and volunteer aid post workers need more training - they are underpaid and undervalued, with low morale;
- (v) malnutrition has been rising recently among children;
- (vi) women's heavy workloads often prevents them reaching health care early;
- (vii) women's heavy workloads, together with closely spaced children, poor housing and sanitary conditions and poor nutrition lead to high child mortality and maternal mortality, even though three quarters of births are attended by midwives; and
- (viii) health facilities are frequently far away.

5. Gender

11. Traditionally, women in Melanesian societies have had lower status than in Polynesian and Micronesian societies. Gender differences in primary schooling have largely been overcome in Vanuatu (46 percent of six year olds attending school in 1995 were girls). This has potential spin-offs to reduce population growth rates. Remaining problems include:

- (i) major differences persist in postprimary education rates with preference to education of boys.
- (ii) gender biases restrict girls at higher levels of education to traditional female-dominated areas of nursing, teaching and secretarial work.
- (iii) women undertake most of the subsistence food production, household maintenance and informal marketing and make an input to commercial agriculture, with very little assistance provided to them in undertaking these tasks.
- (iv) women undertake heavy carrying of garden produce, firewood, water, etc. and can have a major impact on the environment - but receive little assistance in ensuring sustainable resource use.

- (v) women are largely excluded from community activities, except for church groups.
- (vi) women have an economic value; bride price is still common.
- (vii) there is growing violence against women and children.
- (viii) women have fewer income-earning options, fewer marketable skills, and fewer assets than men.

12. The CRP states that the Business Development Program will give special encouragement to women, for reasons of equity and also because women are generally "more successful in small business than men, with better loan repayment records".

6. Income and Employment

13. Recent data on wages and employment are scarce. The 1989 Census reported that 80 percent of employment in Vanuatu was in rural areas, largely in traditional agriculture, comprising a mix of subsistence and cash crops, with some paid work. While, officially, unemployment is very low, underemployment is a major problem. In urban areas, 64 percent of the workforce are employed in the service sectors of trade, hospitality, transport, finance, and public service. Forty percent of urban jobs are in the public sector. Formal sector job opportunities are not keeping pace with demand. The modern business sector is dominated by foreign nationals, with little participation from Ni-Vanuatu. Time series data on wages and employment are required for planning purposes.

14. Constraints to small business development by Ni-Vanuatu include lack of commercial and entrepreneurial skills; little access to capital or credit, including working capital for agriculture and other enterprises; and customary values that favor redistribution of products rather than accumulation and savings.

15. The minimum wage has been rising rapidly. In 1987 the minimum wage was revised and split into an urban wage, set at Vt8,500 per month and a rural wage, set at Vt 7,700. After several revisions, both wages were set at Vt16,000 per month. The rural wage is above market rates while the urban wage is below. Wage increases in the public sector have, in contrast, stagnated. Real public service wages have "fallen significantly by an average of 4.4 percent per annum, although this is unadjusted for either the cost of living or housing allowances". This seems to reflect Government policy to hold down wages to allow for the creation of new public service jobs.

C. Custom and Development

1. Social Organization, Production, and Land Tenure

16. Traditionally Vanuatu island communities comprised small-scale, kin-based social systems supported by subsistence farming of tree and root crops, supplemented by livestock, and products from forest, sea, and rivers. Customary land tenure usually includes forest and marine resources. Traditional systems, referred to as kastom by ni-Vanuatu, provided security and sustenance for family members, sets of beliefs, methods for resolving disputes, social organization, and a critical sense of identity. Kastom emphasized redistribution rather than individual accumulation, partly a response to the perishable nature of most food products. Surplus production "was converted into social prestige through gift-giving and the

creation of networks of givers and receivers". In Vanuatu, men controlled production, while clan leaders regulated the distribution of goods and services, competing to become "big men" by outdoing their rivals in gift exchange. Where land rights are held in common with other members of a kin group, customary gift giving and exchange is widespread, motivated by competition for prestige and the need to publicly validate rights to common property. This constitutes a strategic use of resources for social and political purposes in the face of a fragile social cohesion.

2. Kastom and the CRP

17. The CRP refers to kastom in positive terms, as something to be preserved for future generations. Kastom has many positive features. The Government cannot provide the full social safety net that kastom ensures, which includes

- (i) sharing of productive resources, such as land, forest and fishing areas, for subsistence and income;
- (ii) providing for members who cannot work due to sickness, disability, maternity or old age; or who experience disaster of some kind; this includes nursing and care for the aged, sick and disabled members of the family; and the expertise of traditional health curers;
- (iii) physical protection of members through community sanctions and rules;
- (iv) confirming identity, and reinforcing values, and building self-esteem by providing opportunities to take on family and community responsibilities;
- (v) traditional practices to preserve fragile environments and sustainable resource use, (the declaration of "taboo" areas or practices to support subsistence fishing.)

18. Despite these important functions, elements of custom are perceived as constraints to development.

19. **Land.** Most of Vanuatu's land ownership is not formally recorded, cannot be sold or alienated, making it difficult to lease land for commercial and development purposes, to transfer land and use it as security for loans. This applies to ni-Vanuatu wishing to develop their own land, and foreigners applying for leasehold. Approximately 80 percent of land in Vanuatu is under kastom usage in rural areas, with the remaining 20 percent, under lease or owned by Government. Developing kastom land is difficult because of the lack of formal title, disputes over ownership and difficulty of pinpointing boundaries when they are verified 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 obtain a certificate from the Department of Lands, negotiate with kastom owners, and ensure all outstanding disputes are resolved. The kastom owners can re-negotiate the lease terms at any time.

20. **Business development.** Redistribution of goods through consumption, in the interests of gaining status and ensuring welfare, rather than accumulation and savings, is perceived as a major constraint to business development. Few ni-Vanuatu are involved in modern businesses.

21. **Traditional ties.** Kin group members make claims on politicians and decision-makers which, in practice, override legal or Government processes.
22. **Customary Law.** While the national legal system recognizes individual ownership of property, gender equality and individual rights, customary law allocates rights according to status in society, roles, age and gender. These may differ between language and cultural groups.
23. **Identity.** Kastom, rather than nation or place of residence, still determines identity, even in urban settlements where rural migrants live in close proximity to people from other islands.
24. **Gender.** The Constitution provides for the full participation of women in development, but traditional values often exclude women from decision-making processes.
25. **Environment.** The environment, which used to provide for all needs and form the basis of kastom exchanges, is under increasing pressure from urban developments, commercial activities and the spread of cash cropping.
26. **Health.** Traditional curers and healers may be very effective for certain types of conditions and save the Government money.
27. Development has already led to many signs of strain on these kastom mechanisms. Now, surplus production can be converted to cash through sale. Forces for change promote individualism, diminishing traditional forms of cooperation. Monetization, and rapid population growth, urbanization, displacement of people from their traditional support systems, and unemployment, rapid information exchange of new ideas have created a sense of transition and uncertainty. While some individuals have benefited, there have also been social costs. The economic vulnerability of less able members of society increases in the absence of other forms of social security. The Government does not have the resources to assist the disadvantaged, but the pressures to move to individual value systems mean that the most vulnerable may be increasingly exposed. Examples of strains in kastom systems include the following:
 - (i) Population pressure threatens resources in some islands with insufficient land to ensure a productive base for all families, and increased pressure on the environment.
 - (ii) Cash crops use land which was available for crop rotation, so subsistence agriculture encroaches on virgin forest or shortens the fallow time, leading to soil exhaustion and erosion.
 - (iii) Marine resources are showing signs of depletion.
 - (iv) Traditional systems for ensuring sustainable resource use, for example regulation of subsistence fishing by the chiefs, are breaking down in some areas.
 - (v) Growing rural to urban migration leads to the formation of squatter settlements where people are more remote from their kin networks, although they still identify more strongly with them than with their new neighbors.
 - (vi) Rising expectations in rural and urban areas increase involvement in the cash economy. An emerging issue is whether kastom will be able to keep pace with

the growing cost of meeting kin-based expectations. Urban wage earners already have heavy expenses through high cost of living in urban areas; their ability to keep meeting rising expectations from rural kin is constrained.

3. Drawing on Kastom for Development

28. It is important that the CRP creates a climate in which both national and community based partnerships can be drawn upon to foster development. Ni-Vanuatu need the opportunity to decide for themselves the right responses to safeguard important elements of kastom while at the same time permitting beneficial change. The CRP will foster

- (i) consultation on all aspects of the reform process;
- (ii) creation of a more enabling framework of government policies through public sector reform;
- (iii) the decentralization review, which aims to strengthen the role of provincial and local governments, and provide more responsibility for community level decision making;
- (iv) ni-Vanuatu business development to build upon existing systems and economic activities at the village level, providing more options for income generation;
- (v) community consultations and community resource mobilization to form an integral part of the education and health development work;
- (vi) environmental measures emphasizing community consultations, drawing on and strengthening community-based systems for environmental management; and
- (vii) careful monitoring of the impacts of the CRP upon society generally, and particularly upon groups identified as particularly vulnerable.

D. Social Impacts of The CRP and Poverty Assessment

1. Poverty and Vulnerable Groups: Methods of Assessment

29. Poverty means the limited command over resources by individuals or groups. Command over resources depends on the assets owned (land, labor, and capital), the prices gained for use or sale of the assets, net transfers received in money or kind, and the prices households have to pay for goods and services. There is no official definition of poverty or systematic studies of poverty in Vanuatu. The popular view is that most people have access to land and can therefore achieve subsistence production. The traditional social safety net is thought to support people losing jobs, or people suffering hardship because of disability, illness, age, or other factors. There is no Government-funded public social safety net, that would target and support disadvantaged groups.

30. Income is one important measure of poverty and is becoming increasingly important to afford basic minimum standards of living, including health care, education, other services, and associated transport costs. There are, however, two main problems with using income to measure poverty, for example through identification of a poverty line. First, reliable income and expenditure data are scarce in Vanuatu. Second, income is not a sufficient indicator for poverty, because, outside the towns families share goods and make exchanges in kind outside of the formal market.

23. Other important variables signaling the level of command over resources include access to basic services such as education, health care, and clean water. Some households face increasing problems in finding the cash necessary to afford these services. Low levels of literacy and education, poor health, and low material standards of living actually amount, in some cases, to circumstances comparable with people in the world's poorest and least developed countries. The emerging vulnerable groups in Vanuatu may be categorized as follows.

- (i) Restricted Access to Traditional Social Safety Net
 - (a) People without access to land for subsistence cultivation due to growing population pressure and resulting landlessness and / or resource exploitation on some islands;
 - (b) Women heading households whose access to traditional entitlements varies between groups; and
 - (c) People in urban areas who do not have immediate access to the traditional safety net.
- (ii) Restricted Access to Cash Income
 - (a) People located in places where, for reasons of distance or terrain, access to markets is difficult;
 - (b) People who do not have family who can send cash remittances;
 - (c) People in urban areas without jobs, due to inappropriate skills, disability, lack of opportunity.
- (iii) Restricted Access to Basic Services
 - (a) People located in places where, for reasons of distance or terrain, access to services is difficult, for example small islands remote from Port Vila;
 - (b) People in urban non-formal settlements with insufficient cash to afford access to basic services; and
 - (c) People who are unable to access resources and entitlements due to personal characteristics such as age, gender, language, or physical disability.
- (iv) Transient Poverty - Victims of Disaster includes victims of cyclones and natural disasters who normally are not poor but who may need assistance to restore their livelihoods and quality of life.

31. There are growing inequalities within Vanuatu society, between rural areas (some are more accessible, better endowed, and serviced than others); between urban and rural, and within urban areas (formal versus nonformal settlements). There are increasing disparities between noncitizens and ni-Vanuatu. Vulnerable families can be poised at the start of a vicious circle: low educational attainment is a major factor in unemployment, high fertility, poor nutrition, housing and health, and, again, limited ability to afford education. Up to 40 percent of Port Vila's population live in nonformal urban settlements, this proportion is growing. People move to squatter settlements for a range of reasons:

- (i) migrants looking for jobs or better access to services,
- (ii) no access to family in occupying formal housing in Vila where they can stay,
- (iii) no or low cash incomes with which to pay higher rents elsewhere,
- (iv) loss of urban sector job, for example the public servants who lost their jobs during the 1993 strike, and
- (v) young people in conflict with their families.

32. The settlements are marked by cramped living conditions, no water supply or sanitation, and poor nutrition, although some residents might have access to small gardens. They are perceived as temporary, but research has shown that nearly 40 percent of residents had been in place for up to five years. Families can, however, be evicted and have uncertain tenure. Many of these people look to Government to provide them with basic services. These areas are not within the responsibility of the Municipality of Port Vila City. The landowners are generally of a different language group. NGOs have started work in squatter areas.

2. Reform Scenarios: Predicting Social and Poverty Impacts

33. The Bank's President's Staff Instructions of 28 March 1995 provide a method for analyzing the overall social impact of Program loans including assessment of the direct and indirect impacts upon the poor. The purpose of this analysis is to ensure that, if the loan is likely to cause distress for the poor, then appropriate mitigative measures will be introduced. This includes transition management when public sector personnel are displaced.

34. The CRP is a broad-based program that involves a wide range of actions by government, often in consultation with stakeholders and communities, supported by the Bank and other financing bodies. The analysis of likely impacts is, therefore, based on the total package, rather than certain elements of it. Two reform scenarios are compared and contrasted below. The likely economic impacts are examined as a basis for predicting social and poverty impacts.

35. Scenario 1 provides for full implementation of the CRP, complete with the measures to improve equity and sustainability. Scenario 2 assumes that there is insufficient political will to follow through with the full provision of equity and sustainability measures, once the loan is approved.

36. There are, however, good reasons to treat this analysis with some caution. While economic theory provides a framework for hypothesizing possible links between macro policies and the command of individuals and households over resources, there are many factors that determine the nature, magnitude, and timing of such changes in practice. In Vanuatu, many of these factors are uncertain. First, there is a paucity of recent, reliable data on which to base this analysis. The last census was in 1989 and there are no recent systematic surveys of income and expenditure at the household level or analyses of wage rates. There is no official definition of poverty.

37. Second, Vanuatu has a large and fragmented subsistence sector within the economy. Many households are not well integrated into the cash economy, and rural urban linkages are often weak. There are no publicly funded social safety nets and the resilience of the traditional safety nets has yet to be fully tested under these new circumstances. It takes

time for macro-level policy reforms to work through the system to the household level in this context. Thirdly, although similar reform packages have been introduced into other PDMCs, there is, as yet, little systematic analysis of social and poverty effects that might provide precedents for the Vanuatu case.

38. These factors reinforce the need for improved statistical bases for planning and for specific social impact and poverty monitoring efforts. Such initiatives have been built into the Bank's proposed TA package. In addition, under the Program, a report will be completed on social impact of the CRP, especially assessing the impact on vulnerable groups. This report will include recommendations for mitigative measures, if there are found to be significant negative impacts.

3. The Impact of the CRP

39. The CRP will have both negative and positive social effects. Direct short term hardship will be experienced by about 600 displaced public servants who may have to return to subsistence production in rural areas or move to urban squatter settlements where they will lack essential services. The transition services program will help them find alternative jobs or business development opportunities, and provide a redeployment benefit based on number of years of service, together with other entitlements. Other workers may be displaced through privatization of a small number of Government-owned enterprises. The remaining public servants will experience wage and allowance cutbacks. These contractionary measures will have negative flow-on effects to urban-based domestic workers and businesses. In addition, they will put strain on the traditional social safety nets, as urban-based workers contribute less to their kin. This could disadvantage vulnerable groups who currently depend upon kin networks for support. There are no publicly funded welfare or social security schemes, and none will be introduced. Government workers are not poor but some may become so if they fail to find alternative livelihoods.

40. The introduction of value-added-tax (VAT) will increase the cost of services to the poor and nonpoor alike. Rural producers, including those with low incomes, may benefit from the elimination of export taxes, if these are passed on to producers, but this is likely to benefit men more than women, as men have higher visibility in cash production. The cost of imported goods, including basic foods, will depend on the extent to which tariffs are lowered, and the level at which the VAT is set. Purchase of imported essential basic goods such as rice, sugar, tinned meat and fish, flour, and matches is widespread in urban and rural areas, even among low-income families, so price movements in imported goods will have widespread effects. Significant increases would cause hardship. Locally produced foods are expensive now, it is far cheaper for an urban family to subsist on imported rice rather than taro.

41. Measures to introduce fees for certain Government services will cause price increases, that would impact especially upon urban areas where such utilities are concentrated. This would probably make it more difficult for squatter settlements to obtain basic utilities. The Bank TA technical assistance accompanying the Program loan includes measures to develop the statistical base and the capacity for impact monitoring, particularly the effects of reform on vulnerable groups. The CRP will develop a policy response to mitigate the broader adverse social effects of reform.

42. Measures to enhance equity and sustainability of the reforms will generally have positive social impacts that help to ease the pain of public sector contraction. Financial and banking reforms will help to create a favorable environment for private sector growth. The Ni-Vanuatu business development program will endeavor to create work in small business in rural areas and outer islands and for women. Increased funding for basic health and education services will be critical to building the human resource base, helping to contain population growth and reducing urban-rural disparities. HRD planning efforts, especially the medium-term strategic framework and education and health plans, will help to ensure improvements in management, quality, and coverage of these services. It is critical that these efforts are undertaken in close consultation with NGOs and community groups, to ensure the best possible matching of service delivery to community needs and resources, as well as to labor market needs.

43. Measures built into the CRP to protect wage earner interests and improve industrial legislation will help to consolidate the position of workers. Measures to promote gender equity will assist women by developing the policy base and dealing with violence against women and children; and by improving the targeting of resources and entitlements for women. A widely representative Working Group will be responsible for developing specific measures based on gender benchmarks, and these would be incorporated into the reforms as a whole. A Working Group on Urbanization will address the need for urbanization policy and specific measures to improve conditions in squatter settlements. The decentralization review will identify strategies to strengthen and empower provincial, municipal, and local governments, with a view to promoting effective Government capacity closer to the community base. Emerging environmental problems would be addressed through measures to improve the environmental legislative base, protect biodiversity, and strengthen community awareness, building upon existing kastom practices to ensure sustainable use of resources.

IMPACT OF VANUATU COMPREHENSIVE REFORM PROGRAM **Scenario 1: Full Program Implementation**

Type of Effect				
Channel	Direct	Indirect	Macro/Structural	Non-Poor
Labor Market	<p>Immediate job losses of 10-15% in Public Service (approximately 600 positions)</p> <p>Eventual job losses from privatizing State-owned enterprises (small number of stores, estates)</p> <p>Those losing jobs may become poor if they do not find alternative employment through Transition Management in private sector or can be reabsorbed into subsistence.</p>	<p>Job and/or income losses for those dependent on public sector spending (domestics labor, shops, etc.)</p> <p>Banking reforms and Ni-Vanuatu Business Program will create work in small businesses including rural areas, outer islands and for women, assuming within environmental limits and lower income people may benefit.</p> <p>Better HRD plans will match education to job market</p>	<p>Public sector contribution to GDP declines with contraction – but subsistence contribution to GDP may rise as displaced workers re-enter subsistence sector</p> <p>Privatization will affect structure of asset ownership</p> <p>Financial reforms redirect credit to small business</p> <p>Better match between skills and labor market</p>	<p>Public servants and government enterprise employees losing jobs are currently non-poor and will bear the direct impacts of contraction in government sector</p> <p>Non-poor will also benefit from improved job opportunities in business and private sector</p> <p>Non-poor will also benefit from better HRD/jobs match</p>
Prices	<p>Prices of imported food and other essential goods may increase; locally produced goods likely to be below VAT threshold. Cost of services will increase with VAT.</p> <p>Reduced export taxes may provide higher income to low income producers – more likely to benefit men than women.</p>	<p>Indirect impacts on local and imported goods prices – needs to be monitored</p> <p>Change in price structure to favor production of exportables may provide new employment opportunities</p> <p>Better access to markets and services though improved, cheaper transport will benefit producers and service users.</p> <p>Tariff reduction may make local industries less competitive, with possible job loss, with flow-on effects to low income groups</p>	<p>Tax reforms to shift the burden from income to consumption. Removal of export taxes, removal of turnover tax, lowering of tariffs and introduction of VAT for goods and services.</p> <p>(Levels for tariffs and VAT still to be set.)</p>	<p>Non-poor services costs will increase with VAT; prices paid for imported goods may fall depending on levels set for tariffs and VAT</p> <p>Non-poor producers would benefit from any price increases due to removal of export taxes- men more than women</p> <p>Non-poor will benefit from reduced transport costs</p> <p>Tariff reductions may make local industries less competitive, leading to possible job loss</p>
Transfers	<p>There are no government welfare or pension schemes which currently benefit low income people</p> <p>Private transfers to low income people operate under the traditional social safety nets. These may be placed under strain through reduced remittances from wage earners. Greater pressure on traditional social safety nets from public sector contraction.</p>	<p>Displaced public servants will find it difficult to continue remittances to kin groups until they re-establish livelihoods. Retained public servants face cuts in salaries and allowances, reducing their ability to remit funds to kin</p>	<p>There are no publicly available government transfers or social safety nets. Transition Management Service will be introduced to assist displaced public sector staff who are currently not poor.</p>	<p>The non-poor will feel increasing pressure to make up shortfalls in traditional social safety nets</p> <p>The non-poor displaced will be assisted by the Transition Management Service.</p>
Access to Public Goods and Services	<p>Introduction of user fees for certain government services might improve access of low-income urban groups – if services can be provided.</p> <p>Increased education and health expenditure plus management improvements will increase quality; coverage and access</p>	<p>Reduced ability of urban dwellers to remit funds to kin</p> <p>Deteriorating conditions in squatter areas, especially if displaced public servants move there, without specific planning measures</p> <p>Improved HRD will benefit well-being, employment prospects and help contain population growth rates</p>	<p>Government's revenue falls but essential education and health services are protected</p> <p>Policy on urbanization and squatter settlements to be developed</p> <p>Better matching of skills to labor market needs through Strategic HRD Framework</p>	<p>Non-poor will pay more for certain government services. Non-poor may benefit from better urban planning</p> <p>Non-poor will benefit from better quality and coverage of essential health and education services</p>
<p>Total Net Effects: Direct short term hardships will be experienced by displaced public servants who may have to return to subsistence production in rural areas or move to urban squatter settlements where they will lack essential services. Reduced employment and public sector pay and allowance reductions will put strains on the traditional social safety nets. Social and poverty impacts will be subject to consultation with communities, monitored closely and policy responses developed in case of need. The ni-Vanuatu business program and financial sector reforms are essential to foster alternative income generation sources in rural and urban areas.</p>				
<p>Assumptions about crucial variables: Government remains fully committed to equity aspects of CRP; the CRP creates enabling framework for business development in the medium to long term; that environmental pressures do not undermine business development opportunities; that <i>kastom</i> does not undermine reform process and business development opportunities but remains sufficiently resilient to provide a continued safety net where needed.</p>				

IMPACT OF VANUATU COMPREHENSIVE REFORM PROGRAM

Scenario 2: Program Implementation without Equity and Sustainability

Channel	Type of Effect			
	Direct	Indirect	Macro	Non-Poor
Labor Market	<p>Immediate job losses of 10-15% in Public Service (approximately 600 positions)</p> <p>Eventual job losses from privatizing State-owned enterprises (small number of stores, estates)</p> <p>Those losing jobs are likely to become poor if they do not in private sector or can be reabsorbed into subsistence – no help from Transition Management.</p>	<p>Job and/or income losses for those dependent on public sector spending (domestics labor, shops, etc.)</p> <p>Banking reforms and Ni-Vanuatu Business Program will create work – but without special measures these are unlikely to assist outer islands and women, and lower income groups</p>	<p>Public sector contribution to GDP declines with contraction – but subsistence contribution to GDP may rise as displaced workers re-enter subsistence sector</p> <p>Privatization will affect structure of asset ownership</p> <p>Financial reforms redirect credit but small business might not benefit without special measures</p>	<p>Public servants and government enterprise employees losing jobs are currently non-poor and will bear the direct impacts of contraction in government sector</p> <p>Non-poor will also benefit from improved job opportunities in business and private sector</p>
Prices	<p>Prices of imported food and other essential goods may increase; locally produced goods likely to be below VAT threshold. Cost of services will increase with VAT.</p> <p>Reduced export taxes may provide higher income to low income producers – more likely to benefit men than women.</p>	<p>Indirect impacts on local and imported goods prices – needs to be monitored</p> <p>Change in price structure to favor production of exportables may provide new employment opportunities</p> <p>Tariff reduction may make local industries less competitive, leading to possible job loss, with flow-on effects to low income groups</p>	<p>Tax reforms to shift the burden from income to consumption. Removal of export taxes, removal of turnover tax, lowering of tariffs and introduction of VAT for goods and services.</p> <p>(Levels for tariffs and VAT still to be set.)</p>	<p>Non-poor services costs will increase with VAT; prices paid for imported goods may fall depending on levels set for tariffs and VAT</p> <p>Non-poor producers would benefit from any price increases due to removal of export taxes- men more than women</p> <p>Tariff reductions may make local industries less competitive, leading to possible job loss</p>
Transfers	<p>There are no government welfare or pension schemes which currently benefit low income people</p> <p>Private transfers to low income people operate under the traditional social safety nets. These may be placed under strain through reduced remittances from wage earners. There will be greater pressure on traditional social safety nets from public sector contraction.</p>	<p>Displaced public servants will find it difficult to continue remittances to kin groups until they re-establish livelihoods. Retained public servants face cuts in salaries and allowances, reducing their ability to remit funds to kin</p>	<p>There are no publicly available government transfers or social safety nets.</p>	<p>The non-poor will feel increasing pressure to make up shortfalls in traditional social safety nets. The full impact will be unmitigated by Transition Service.</p>
Access to Public Goods and Services	<p>Introduction of user fees for certain government services is unlikely to be affordable by low income urban groups</p> <p>No direct assistance to improve human resource base and employment options of lower income and vulnerable groups.</p>	<p>Reduced ability of urban dwellers to remit funds to kin</p> <p>Deteriorating conditions in squatter areas, especially if displaced public servants move there</p>	<p>Government's revenue falls and essential education and health services are NOT protected</p>	<p>Non-poor will pay more for certain government services.</p>
<p>Total Net Effects: Direct short term hardships will be experienced by displaced public servants who may have to return to subsistence production in rural areas or move to urban squatter settlements where they will lack essential services. Reduced employment and public sector pay and allowance reductions will put strains on the traditional social safety nets. The absence of transition service means the full burden will fall upon traditional safety nets, which may be overstrained, especially if there are no measures to generate income and employment in remoter areas and for lower income people. Quality and coverage of essential health and education services will continue to decline, and population growth is likely to continue, putting additional pressure on environment, basic services and limited labor market.</p> <p>Conditions in rural areas, especially more remote islands, are likely to deteriorate significantly in terms of income and access to services.</p>				
<p>Assumptions about crucial variables: Government remains partially committed to CRP; the CRP creates enabling framework for business development in the medium to long term; population and environmental pressures are not addressed and are likely to undermine all gains from reform; <i>kastom</i> may undermine reform process and business development opportunities; and, might result in increasing cycle of shared poverty.</p>				