DRAFT REPORT

Volume 1

VANUATU

Diagnostic Trade Integration Study

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FOREWORD

The Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (IF) was established in October 1997 under the auspices of the World Trade Organisation (WTO).

The IF was conceived as a country-driven process leading to the integration of trade policy into national development strategies, and to coordinated delivery of trade-related technical assistance (TRTA) by development partners in response to identified needs. Accordingly, the IF can be seen as an instrument of coherence to ensure maximum use of scarce resources in support of Least Developed Countries (LDCs) to become full players and beneficiaries of the world's economy and the multilateral trading system. To this extent, it is a unique international initiative based on partnership through which the six core agencies, the International Monetary Fund (IMF), the International Trade Centre (ITC), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Program (UNDP), the World Trade Organisation (WTO) and the World Bank, combine their efforts with those of LDCs and donors to respond to the trade development needs of the beneficiary countries.

An essential part of the IF process is the preparation of a Diagnostic Trade Integration Study (hereafter referred to by its acronym, DTIS) as the analytical foundation for policy recommendations and actionable TRTA/capacity building interventions. The DTIS has five major components:

- A review and analysis of the country's economic and export performance.

- A description and assessment of the country's macroeconomic environment and investment climate.

- A focus on the international policy environment and specific constraints that exports from the country faces in international markets.

- A focus on a small number of key labour intensive sectors where the private sector can contribute to a significant expansion of output and exports and a good *a priori* case can be made that the poor stand to benefit either in terms of employment and/or lower prices.

- A set of policy reform priorities and required capacity strengthening at the sectoral level to capitalize on the major opportunities identified in the strategy.

On the strength of the detailed analysis, the DTIS provides an action matrix comprising policy reform measures and capacity strengthening activities to serve as the basis for trade-related assistance and support.

The team leader was Daniel Gay, who compiled the DTIS and wrote the chapter on trade policy. Eleven other consultants contributed reports in specific areas. Their contributions were in some cases distributed between different chapters during the editing process. The consultants, with their areas of expertise in brackets, are as follows: Yurendra Basnett (human development); Nikunj Soni (macroeconomic

framework); Ameir Mbonde and Betty Zinner Toa (business environment and investment policy); Ruben Markward and Ana Fusipala (institutional framework); Danny Lui (trade facilitation); Simon Milne (tourism); Duncan Burnett (agriculture) and Francis Hickey and Robert Jimmy (fisheries). It should be noted that nine of the consultants have either lived in Vanuatu for extended periods or are nationals.

The team would like to express its thanks to the Honourable Prime Minister, Mr Ham Lini, for his time and support in facilitating the DTIS, as well as the Honourable Minister for Trade, Industry and Tourism, Mr James Bule and the Ambassador to the European Union and the Kingdom of Belgium, His Excellency Mr Roy Mickey Joy. The staff of the Department of Trade, Industry and Investment have been particularly helpful throughout the project.

The team would also like to register its appreciation for the professional guidance and support of the UNDP Trade and Human Development Unit in Geneva and in particular to Mr David Luke and Mr Luca Monge-Roffarello. The staff at UNDP Fiji must also be thanked for their administrative assistance.

An exchange rate of approximately USD1 = VT110 has been assumed throughout.

EXECUTIVE SUMMARY

Vanuatu’s economy is now one of the fastest growing in the Pacific region. The country is scheduled to graduate from Least Developed Country (LDC) status in coming years. This strong macroeconomic performance is a result largely of an upturn in construction, tourism and agriculture, and has been underpinned, until now, by fiscal discipline and strong financial management. The central bank, the Reserve Bank of Vanuatu, operates effectively and the exchange rate is stable. Yet risks remain, including the possibility of overheating as aid inflows increase and the public sector wage bill rises relative to overall recurrent government expenditure. The distribution of donor funds to areas outside Port Vila would help reduce the risks of overheating and help counteract the tendency toward dualism in the economy. How the increase in the money supply is managed, including its eventual slowdown, will significantly determine Vanuatu’s macroeconomic performance over the next five years.

Vanuatu ranks as one of the best LDCs in which to do business, according to the World Bank. The Government is committed to improving the business environment. Yet a number of perceived challenges remain, including a lack of economies of scale, high domestic costs, economic vulnerability, a lack of policy co-ordination, poor infrastructure and high transport costs. Rather than attempting to tackle all of the binding constraints head-on and simultaneously, it is worth making changes in a select number of areas which have the potential to combine with existing initiatives. A prime example is the cost of port charges and stevedoring, which are the highest in the Pacific region. Improvements in this area can help maximise the benefits of infrastructural changes under the US-funded Millennium Challenge Account. Similarly Vanuatu’s e-business environment is in its infancy, and needs strong encouragement. Upgrading science, technology and innovations policies, which are often neglected in LDCs, would help improve the business environment and establish consistent long-term economic growth. Improvements to science, technology and innovation or value-adding are dealt with in the chapters on the business environment, trade facilitation, agriculture, tourism and fisheries.

For Vanuatu fully to benefit from the IF the various institutions involved in trade policy need to be improved and better co-ordinated. Vanuatu already has a strong focus on gender issues in trade, but the relevant institutions dealing with women’s affairs must be systematically represented in trade policy decisions. The principal institutional changes recommended in the DTIS are to move the Department of Trade and Industry (DTII) to the Ministry of Foreign Affairs; to improve facilities at the DTII; to consider legislation aimed at involving the DTII in trade-related tax decisions; and to revitalise the National Trade Facilitation Committee. Building up the domestic capacity for economic and legal research would also help improve the institutional framework for trade mainstreaming.

As in several other LDCs, trade and trade policy have long been seen as peripheral to development. In Vanuatu this is largely because of the desire after independence to achieve national autonomy. Partly as a result of the marginalisation of trade policy, goods exports now comprise an average of 10 percent of GDP, low by Melanesian – or indeed any – standards. From the point of view of the balance of payments, one way of looking at the Vanuatu economy is that it relies on foreign aid in order to pay its foreign-exchange bill. If national autonomy is still considered a national objective, then developing goods and services exports will help achieve this goal.

Whilst Vanuatu's access to other markets is generally good, it is worth singling out neighbouring New Caledonia for special attention. Bilateral trade between the two territories is currently minimal, yet an increase would carry advantages for both. A formal trade agreement would be better than ad hoc measures since it would allow for the future development of as-yet unforeseen commercial opportunities. Vanuatu's participation in other trade agreements involves special sensitivities – including the need to stabilise government revenue and to enact the institutional requirements to take advantage of trade liberalisation. The services sector dominates the economy and will grow in the years ahead, a reality which should be recognised whilst negotiating and participating in trade agreements. It will be important to monitor the potential loss of privileges as a result of Vanuatu's possible graduation from LDC to developing country status.

In spite of a number of oft-cited disadvantages, Vanuatu's trade environment already has some valuable assets, including a relatively efficient administration, a favourable Sanitary and Phyto-Sanitary (SPS) and agricultural environment and a comparative advantage in several high-quality products. Yet the conduct of trade facilitation remains mixed. Whilst overseas markets are ostensibly open to Vanuatu's products, exporters often cannot meet the standards required. A number of changes can be made to SPS standards, principally involving institutional co-ordination. Port charges and stevedoring are two other areas in which trade facilitation can be improved, while Vanuatu will have to ensure that it has in place the legal framework to deal adequately with increasing labour mobility in the years ahead.

The concept of human development suggests that other dimensions of development must complement income. As such human development has been variously defined as 'human flourishing in its fullest sense – in matters public and private, economic and social, and political and spiritual' (Alkire, 2002), and as 'a process of enlarging people's choices and freedom' (Sen, 2000). The UNDP has published a Human Development Index annually since 1990, using three indicators – education, longevity and income – as proxies for knowledge, a long and healthy life and standard of living. The human development situation in Vanuatu remains under-prioritised; in particular socio-economic inequality and the unique role played by the *kastom*[1] economy. Vanuatu has a high literacy rate and some positive health indicators, but inequality is very high and access to health services and education could be improved. In order to address such human development concerns, trade policies need to focus on increasing service-sector competitiveness; raising investment in human development; and improving and expanding service delivery in health and education. Such improvements have the potential to benefit women in particular. Research for the DTIS finds that, contrary to some assumptions, land productivity and scarcity may be among the main challenges for land reform rather than changing the form of ownership. While the money supply has grown quickly in recent years, a greater number of financial institutions in the outer islands should make credit more available. Again, women's groups stand to benefit from the increased availability of finance, in particular micro-finance. In turn this would increase the role of the private sector and raise the role of trade in human development.

The DTIS contains three chapters on specific industries and sectors: tourism; agriculture, livestock and forestry; and fisheries. Tourism is the most important for the

[1] A deep-rooted cultural concept which can be roughly translated as meaning 'customary' or 'traditional'.

cash economy as it has the most growth potential and forms the single largest part of GDP among the three industries and sectors. Several recommendations are put forward, most of which aim at increasing tourism yield. The suggested focus is on raising expenditure per visitor, ensuring that spending is better distributed throughout the nation and minimizing ‘leakage’ from the economy.

Although agriculture forms a slightly smaller part of the cash economy, it involves more people (through subsistence farming) than tourism and carries strong cultural implications. It also dominates goods exports. A number of institutional improvements can be made, chief among them the reform or dissolution of the Vanuatu Commodities Marketing Board. The Import of Goods (Control) Act has had a negative impact on agricultural exports. The DTIS proposes a number of positive measures, including the establishment of fair trade certification, assistance with achieving organic certification, and the promotion of certain products that can contribute to export growth in the years ahead, including beef, fruit and vegetables and high-value niche items.

Vanuatu’s fishing industry contributes only a minimal fraction of GDP, despite the existence of an exclusive economic zone covering an area roughly the size of mainland France. The benefits from commercial offshore fishing are USD1 million from license fees sold to a fleet of foreign vessels, barely 2% of the value of current exports. The desire to add value by developing onshore facilities rightly remains central to government policy, although the need to avoid environmental damage must be paramount. Pollution or despoliation would probably harm the tourism industry more than it would benefit the fishing industry.

SUMMARY OF RECOMMENDATIONS

This section sets out the priorities for the DTIS and provides a short explanation of the DTIS recommendations.

Prioritisation

In Vanuatu it is particularly important to prioritise economic sectors and activities. The prioritisation of ‘tourism, farming, forestry and fisheries’ is alone insufficient as it comprises almost the entire economy. Areas within these sectors need to be assessed relative to one another, particularly in light of the particular limitation on resources, while science, technology and innovation should be a strategic theme throughout. Some areas will receive a lower priority than others (as pointed out in the 2005 EU Trade Baseline Study). This prioritisation must involve adapting the policy framework to fit particular sectors rather than being a direct attempt by Government to intervene in specific activities. A similar lesson can be learnt from DTISs in other countries (Biggs 2007).

Cross-cutting, policy-related and institutional measures are likely to yield greater benefits than the promotion of individual economic activities. In such a small economy it is important to try to achieve as many objectives with as few policy measures as possible. This will also lead to greater donor and government policy co-ordination and coherence. Trying to second-guess the market by targeting micro economic projects is likely to fail. The recommendation for a shift in emphasis away from specific economic project-based support (as suggested in Bazeley and Mullen 2006) comes in light of the lessons learnt from the Producers’ Organisation Project (POPACA) and other specific sectoral projects.[2]

A number of cross-cutting issues can be tackled under a single initiative, such as the adoption of a trade policy which makes technology and innovation central; institutional strengthening of the Department of Trade; an e-business strategy; a program to improve data; and a program aimed at improving linkages and entrepreneurship. Each of these initiatives affects a number of productive sectors and government ministries.

Given the need to prioritise, issues which receive relatively less discussion in the initial matrix of DTIS priority recommendations include:

- *Infrastructure*. Although very important, detailed analysis, recommendations and funding are provided under the Millennium Challenge Account (MCA). This is not to suggest that work done under the MCA is alone sufficient[3], but at this stage, the IF should not target this area as a priority.
- *International transport costs*. Even if this is commonly cited as an obstacle to trade, the DTIS finds that international transport costs are little or no higher than in other Pacific island nations.
- *Exchange rate policy*. As suggested in the most recent IMF article IV report, no changes are required.

[2] However in light of existing projects and priorities in the agricultural sector, as well as its size and importance, specific projects are discussed and ranked in suggested order of benefit.
[3] And indeed there is still a need, for example, for better feeder roads to agricultural areas.

- *Significant reform of the financial sector.* However the option of a tax on the offshore sector based on use of domestic resources should be considered.
- *Significant land reform.* Efforts to deal with this well-known issue should be supported, but driven by the Ministry of Lands. Wholesale private land ownership will not work.
- *The promotion of major new crops.* Such activities detract from efforts in existing areas. However certain niche, high-value products have potential.
- *Forestry.* Although this is an important area, support for timber development is not considered an IF priority relative to agriculture, livestock and fisheries.
- *An Export Processing Zone.* This idea should be abandoned as it is not relevant to Vanuatu.
- *Intellectual Property Protection.* The issue of protecting domestic intellectual property continues to resurface in public debate, yet Vanuatu has passed comprehensive legislation in line with its potential WTO commitments. It is suggested that for the moment this issue remain secondary to other, more pressing priorities.
- The establishment of a dedicated Vanuatu retail outlet in a major city such as Sydney has been mooted. However this is not a priority because significant demand already exists overseas for Vanuatu products and services. The primary obstacle to export development lies with the supply-side.

Summary of DTIS recommendations

The following is a list of recommendations by chapter. The list is not intended to be undertaken simultaneously; rather it will be completed in stages. A fuller explanation of the policy issues at stake can be found in the relevant chapter. Overlap occurs in some areas – which generally indicates that the recommendations should receive a higher priority (although repetition has been avoided in the action matrix). Costings are included selectively to provide examples of the general degree of donor support. Further costing work will be required in collaboration with stakeholders and other donors. An attempt has been made to reduce reliance on short-term technical assistance, since considerable domestic technical capacity already exists in a number of areas.

SECTION I. CROSS-CUTTING ISSUES

1. MACROECONOMIC FRAMEWORK

1.1 Options need to be considered to increase the degree of engagement of the informal and subsistence sectors with the formal, including the financial, sector. Production in Vanuatu will remain volatile given its narrow base, vulnerability to environmental shocks, and limited capacity for counter-cyclical demand management. Increased engagement of the subsistence and formal sectors will provide the means for savings and borrowing and instruments for consumption smoothing in a climate of volatile supply. It is important that lessons be learnt from past experience in this area.

Action: Setting up of private business support activities in the rural areas (taking into account existing work by the Rural Economic Development

Initiative - REDI) – this would involve initially subsiding private business support services. This may be done in conjunction with 6.6, on entrepreneurship.

Cost: First trial 250,000 EU

Input: Review Chamber of Commerce (CCI) legislation, review CCI and Co-op functions, update training manuals, accreditation for manuals, set up service providers and train others

Action: Further research into the localised reasons for the decline in barter trade and analysis of measures required to improve the efficiency of barter trade and it transition into the formal economy,

Cost: Three province assessment – 300,000 EU

Input: Economic/historic research funded via academic institution

1.2 **The revenue base of the Government must be broadened** so as to reduce reliance on Value Added Tax (VAT) and import duties and to make the tax regime more equitable. Any move toward income tax would constitute a radical restructuring of the economic environment and thus requires strong country ownership. It cannot happen quickly and can thus not be recommended directly at this stage, although a feasibility study might be undertaken. Any future taxes must factor in the limited local capacity to enforce compliance. As part of the revenue-base widening exercise, consideration should be given to taxing the offshore services industry on a strictly user-pays basis for its use of domestic resources. Similarly the legislation governing the mining sector needs to be urgently updated and reviewed to make it more relevant to Vanuatu.

1.3 **The revenue base could also be strengthened** by providing audit training and support to Customs and other key revenue collection agencies such as Lands. The DTIS should support ongoing donor activities in this area. To effect this would also require key government systems such as VAT, ASYCUDA and Smartstream to exchange information and produce relevant reports. **The overall aim should be to achieve voluntary compliance.**

1.4 The level of arrears and exemptions are also considerable (in excess of 1 billion vatu each). **Removing the discretionary ability to grant exemptions** as part of the overall tariff reform would resolve this issue as would concrete actions and legal support to the Ministry of Finance in order to enable them to collect monies due to the Government. A number of options for the reform of the exemptions system are highlighted in the trade facilitation chapter with a view to improving economic efficiency.

Action: Support and training to Revenue Section

Cost: TA support for three years, 600,000 EU

Input: TA

1.5 The ratio of salary expenditure to overheads is too high to enable an effective Government. Following the recent increases in Government salaries **there is a need to rationalise the size and functionality of the civil service** by reducing the number of departments as well as personnel. By examining the actual functional capabilities of certain departments such as rural water supply and public works, environment unit and energy unit, the National REDI Unit and the Department of Economic and Social Planning (DESP) it is apparent that there are areas of overlap where organisational efficiencies could be found. This review should simultaneously attempt to refocus the institutional framework on trade.

Action: Functional review of public service

Cost: 120,000 EU – plus potential funding of redundancy program if required

Input: TA input to Human Resource Development Unit in Public Service Commission for six months

1.6 In the short term the discretionary budget and budget for overheads will be extremely limited therefore **there is a need to support existing donor training provided to key agencies like DESP** to improve their role in terms of monitoring and evaluation of government expenditure. There is a need for greater prioritisation of expenditure and for this work to feed in to the budget process. Therefore a review of the budget process is also needed, especially in terms of the relationship between planning, the budget and its implementation.

1.7 **All major Government contracts, especially for stevedoring (see 5.3 below) and the regulation of the gaming industry, should be reviewed** and re-tendered in line with the 2000 Contract and Tenders Act.

1.8 The full extent of Government liabilities is also not entirely clear and may present a major fiscal risk to the Government. **There is need for better quality financial data for the state-owned enterprises and to re-think the current policy of active management by Government as opposed to outright sale**.

Action: Strengthening of the Government Business Enterprise Unit (GBEU) in terms of its fiduciary responsibilities, development of financial database for storing financial data in a format consistent with the FMIS.

Cost: 400,000 EU

Input: TA input to GBEU for 2 years

1.9 **Fiscal and monetary policy should be better co-ordinated,** and a more pro-active and coordinated monetary policy pursued, aimed at dealing with the rapidly increasing money supply. However, fiscal policy will remains the key determinant of macroeconomic stability and therefore the Government should be encouraged to return to its former policy of surplus budgets.

1.10 **A study needs to be undertaken to examine the reasons behind the relatively large interest rate spread in Vanuatu** in order to make practical recommendations in terms of how it can be reduced.

1.11 **The Government's ability to co-ordinate and manage ODA should be strengthened** in order to mitigate the adverse macroeconomic impacts of a rapid increase in funds and also to try and ensure that funds are distributed in an equitable way, preferably into the more remote parts of the country. Targeting spending towards pro-poor initiatives in the provinces would be one way to achieve this.

1.12 **The quality and timeliness of data needs improvement** for allowing better basis for policy formulation. The National Statistics Office should be provided greater powers to collect information and more resources to produce timely analysis of issues of interest to the public. Use of outside expertise on specific assignments on a needs basis while building local expertise is one option worthy of further consideration.

2. BUSINESS ENVIRONMENT AND INVESTMENT POLICY

2.1 **Develop an e-business strategy and make it central to business development efforts.** Internet access is currently vastly overpriced and e-business only in its infancy. Given the ability for the Internet to render geographical distance less important, e-business has special relevance for Vanuatu. Given the country's tax-free status, considerably more investment could be attracted if the correct e-business regime were in place.

2.2 **Address the performance of the Land Titles Office** and address capacity constraints. The office is not adequately-resourced in terms of personnel and equipment to perform registration of land titles.

2.3 **Ensure that court orders can be better enforced**. Due to a shortage of sheriffs, court orders have not been executed in a timely manner, resulting in a backlog of court orders and a slowdown in business, especially for the banking and financial institutions.

2.4 **Reassess the two ni-Vanuatu micro-finance schemes** under the Ministry of Ni-Vanuatu Business. Loan recovery rates are very low. These schemes face financial and human resource constraints. Budgetary allocations are inadequate and there is a shortage of credit officers and trainers.

3. INSTITUTIONAL FRAMEWORK FOR MAINSTREAMING TRADE

3.1 **Establish a unit or person within the IF steering committee with responsibility for collating consultancy reports** and depositing them either in a separate library or in the National Library.

3.2 **Support an economic think tank and/or policy forum, bringing together Vanuatu's foremost economists.** Home-grown research is currently scarce, and there is over-reliance on donors, international consultancy reports and international publications. The domestic human resources exist for such a forum, which may publish periodic papers.[4] Similar efforts may be made to improve links with domestic lawyers, who may be able to contribute in the area of trade law.

3.3 **Revamp the National Trade Facilitation Committee** (NTFC) (see 6.1 and annex 2) and make the External Trade Division its secretariat (assuming that the trade Department will be moved to the Ministry of Foreign Affairs). It is envisaged that the NTFC would have a clear mandate and budget line, including the possibility of per diems for attendance at meetings, and may be formalised as a legal body. The revamped NTFC should meet at least quarterly, establishing various expert task groups as the need arises and to collaborate with other established committees in Government, private sector and civil society. It is important that it operate in an action-orientated manner, with quantitative benchmarks for the achievement of targets and accountability for execution of these targets.

Revamp National Trade Facilitation Committee

Mandate	Membership	Purpose
▪ To establish the enabling environment for dialogue with stakeholders on trade issues ▪ Consultations on trade issues at regular intervals ▪ Research and Analysis ▪ Workshops and Seminars.	▪ Minister for Trade (Chairman) ▪ Government Departments (Heads of Department Level) ▪ Chamber of Commerce ▪ Women's Affairs Department ▪ Civil Society ▪ Academia	▪ An inter-institutional forum where all interested parties in domestic and international trade work together to identify and resolve their respective trade facilitation problems.

4. TRADE POLICY

4.1 **Move the External Trade division of the Department of Trade to the Ministry of Foreign Affairs**. A similar move has been made in the Solomon Islands and Fiji. In Vanuatu, such a move would place the management and negotiation of international trade policy under one office. International trade policy is increasingly a matter of diplomacy, and international affairs increasingly involve trade, giving the External Trade division more synergy with the activities of the Ministry of Foreign Affairs. As a result, the existing Vanuatu Ministry of Trade would be able to concentrate more on domestic

[4] For example a suggested initial publication might be a paper based on the original unedited version of the Trade Facilitation chapter of the DTIS.

commercial activity. The possibility should be considered of amending the Foreign Affairs act to require the Minister of Finance to consult the Department of External Trade on tariff changes, which until now have been made largely for revenue-related rather than economic reasons.

4.2 **Adopt a national trade policy based on the DTIS**, under the leadership of the Department of Trade. The policy should concentrate on building export potential and developing the supply side, signalling a move away from the limited and unsuccessful import substitution industrialisation policy that has operated thus far. The policy would articulate the Government's vision and strategy to develop the country's export potential and address supply constraints, making science, technology and innovation central. It should also include agricultural SPS standards (see 5.1). The policy crucially needs to be owned and generated by all relevant national policymakers and politicians.

4.3 **Update current customs-related legislation,** in particular the outdated Import of Goods Control Act, to address gaps and bring it into line with modern trade practices.

4.4 **Vanuatu may wish to consider re-establishing its desire to accede to the WTO.** Many years have passed with Vanuatu's WTO accession in limbo. By staying outside the WTO Vanuatu carries all of the costs of WTO accession with few of the benefits, which for a small nation can be substantial. It is suggested that Vanuatu start to rebuild a national consensus on WTO accession, using the DTIS validation workshop as an initial platform. The UNDP, as lead agency for the Vanuatu IF, is willing to help facilitate the process. The National Trade Facilitation Committee, with the DTII playing a central role, should be tasked with building consensus on the WTO. Consideration should be given to hiring an appropriate technical assistant to move the process forward.

Action: The NTFC to be tasked with building consensus on the WTO, including consultations, briefing of politicians and awareness-building. If appropriate, institutional support to Ministry of Trade may be necessary, taking into account the existing ODI program and the development of trade policy outlined in 4.2.

4.5 **Continue to engage with the Economic Partnership Agreement (EPA) process, making fisheries development a priority.** It is now too late for a credible, detailed and negotiated agreement to be established by the proposed deadline of 31 December 2007.[5] Too many details remain to be worked out – and this is the same across all ACP regions. Yet it will remain important for Vanuatu to engage with the Pacific EPA negotiations. Meanwhile, Vanuatu as an LDC will continue to have preferential access to the EU market under the 'everything but arms' initiative. Policy space is important, meaning the maintenance of an acceptable import regime, including tariffs. Vanuatu must ensure that its productive interests are represented, particularly at a time when the Integrated Framework is urging a renewed effort to develop the productive sector. The newly-established diplomatic presence in Brussels will help

[5] 'Economic Partnership Agreements: What happens in 2008?', ODI Briefing Paper, June 2007

establish regular feedback from Europe. The recommendations to move the Department of Trade to Foreign Affairs and to increase resources for the National Trade Facilitation Committee will assist with these objectives.

4.6 **Promote increased trade with New Caledonia and move toward a formal trade agreement.** One of the notable features of Vanuatu's trade flows is that comparatively little commerce is conducted with its closest, and richest, neighbour. This is all the more unusual as the two have highly compatible comparative advantages. New Caledonia is primarily a nickel exporter and an agricultural importer. Vanuatu tends to import industrial, value-added and processed goods and export agricultural products. Easing down the high protective barriers in New Caledonia and building bilateral trade between the two territories would benefit both. The issue might even be brought up in EPA negotiations.

4.7 **Continue to monitor the potential costs and benefits of Pacific Agreement on Closer Economic Relations (PACER) membership**, ensuring that the maintenance of policy space remains paramount. As events progress the advantages of PACER will become clearer. Further analysis before completing the ratification process would help identify the costs and benefits and lead to a more informed decision.

4.8 **Conduct further study on the impact of possible graduation from LDC status,** ensuring continued preferential access for copra, beef, coffee, cocoa, kava and other potential exports. Proper preparation for potential graduation in 2013 will be vital. Donor help may be needed in providing international technical assistance, possibly including fact-finding missions to the Maldives and other potential graduates.

5. TRADE FACILITATION

Detailed recommendations relating to specific trade facilitation sectors have been provided at the end of the chapter, and should be referred to in the first instance. Nevertheless, in seeking to identify priority activities that could be incorporated into either a trade facilitation work program or a DTIS action plan, a ranking would be:

5.1 **Agricultural SPS and quality standards:** given the importance of the agricultural sector to the livelihoods of the majority of ni-Vanuatu, and especially the less well-off, improvements to agricultural standards will have a potentially major impact. Adherence to importing country standards is an increasingly significant factor in obtaining and maintaining market access for exports, vis-à-vis other traditional barriers to trade. It has already been identified by major bilateral and multilateral donors as a priority. It therefore makes sense to deliver a project or several projects through the IF aimed at creating systems for the development, promotion, monitoring and certification of a range of agricultural produce standards. This should include the Standards and Trade Development Facility (STDF) proposal on kava that is already in the pipeline, and should also extend to other sectors raised in the current NZAid/AusAID and EU/POPACA proposals on this.

5.2 **SPS architecture:** in order for investments and developments in the agricultural sector to be effective there is a need to clarify the responsibilities in SPS-related areas in the first instance. This can be done through developing an agricultural export policy covering comparative advantages, trade preferences and markets, the various roles of government agencies and the private sector, programs and levels of support for specific sectors, and overall objectives (see 4.2). In line with the recommendations of a number of previous studies, and as outlined in the agriculture chapter, this should include a reconsideration of the role of the VCMB (see 8.1).

5.3 **Stevedoring**: Vanuatu has the most expensive port and stevedoring costs of any Pacific Island Country. The Government – in its role as major shareholder – should review existing stevedoring contracts, to improve efficiency of existing operations and ultimately to reduce costs to consumers and exporters. There is currently insufficient space at the wharf and the existing Japanese project to enlarge the wharf is welcomed. The review should also cover the transportation and delivery of containers, to ensure competitiveness in this sector. Proper regulation of contract should be put in place, and also Vanuatu should consider making GATS-type commitments in stevedoring and port services where possible in the context of trade negotiations.

5.4 **Quarantine border control and protection:** Vanuatu Quarantine and Livestock Department (VQLD) should be assisted to improve its capacity to monitor import risks at the border, including investment in facilities (e.g. an office at the main wharf in Port Vila, fumigation and incineration facilities, x-ray equipment) and funding for emergency response plans. There is also need to improve capacity to monitor and control pests and animal diseases. This will require training, equipment (support for laboratory) and extra resources to update databases. Improvements on the dissemination of information to visitors would be beneficial, perhaps via a website.

5.5 **Border Automation and Information Sharing**: Subject to a full assessment by DCIR of the costs and benefits, the introduction of the ASYCUDA World automation upgrade. There is a need for better information sharing between DCIR and VQLD in particular, which may be achieved through updating the ASYCUDA system. A website – possibly combined with Trade and DCIR – would also be useful in helping to deal with front-line public enquiries on quarantine more efficiently, and thereby freeing up officers time to concentrate on more pressing needs.

5.6 **Coordination of Trade Facilitation Efforts:** Vanuatu should consider using the DTIS recommendations as the basis for a work program on trade facilitation, coordinated by the NTFC. Consideration should be given to bringing the aforementioned other committees under the umbrella of the NTFC if it helps to focus their work (see 6.1). Another point to consider is that the Department of Trade, Industry and Investment (DTII) is not currently geared towards pursuing a program of trade facilitation, and might consider reviewing existing responsibilities of its staff, or creating new officers directly responsible for trade facilitation issues. As suggested in the chapter on trade policy, this may include the relocation of the DTII to the Ministry of Foreign Affairs.

5.7 **Technical Standards (e.g. Metrology, Standards and Conformance):** There is currently no work within the DTII on some traditional trade facilitation areas such as standards and conformance issues, nor on regulation of commerce and competition or consumer protection.

6. TRADE, POVERTY AND HUMAN DEVELOPMENT

6.1 Trade, poverty and human development policy: The policy discourse in Vanuatu lacks mainstreaming of trade and trade-related issues, especially with regards to human development. Mainstreaming trade within the broader framework of Millennium Development Goals (MDGs)[6] requires allocating resources – external and domestic – for setting up a policy forum that promotes mainstreaming of trade. This can be achieved by reforming and encouraging the existing National Trade Facilitation Committee (see 3.3).

6.2 Land Productivity: Efforts are already in place by NZAID and the Chamber of Commerce to increase household land productivity. The Department of Agriculture and Rural Development (DARD) also has field extension programs with motivated staff but lacks resources. These bodies are already attempting to address many of the supply-side issues. Rather than duplicating programs, there needs to be assistance for: (1) coordinating all interventions aimed at increasing productivity (supply-side issues); (2) building links to general trade policy (demand-side issues).

6.3 Financial Services in the outer islands: Research for the DTIS finds that an overall lack of credit is not the primary obstacle to business development (broad money is growing fast and there is currently excess liquidity). Rather, the problem is a lack of access for ni-Vanuatu people to financial institutions. A lack of access to financial services has not only curtailed production but has also thwarted moves from subsistence to a market economy. Hence there is a need to increase access to financial services (savings and credit) for people in rural areas. The National Bank of Vanuatu has branches in some of the outer islands, but its outreach is still limited. The Bank should be assisted in expanding its operations in the outer islands.

6.4 Labour: Labour out-migration can have both positive and negative impacts at the household and the national levels. A more definitive cost-benefit calculus of labour out-migration in Vanuatu is currently missing, as is a comprehensive understanding of the implications on labour out-migration for the household and the nation. Studies need to address these gaps and provide recommendations for policy. The current attention to labour mobility should focus on updating the legislation to ensure that Department of Labour has effective powers to regulate seasonal worker employment agencies. In the medium term, the focus for trade

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[6] The MDGs are: (1) Eradicate extreme poverty; (2) Achieve universal primary education; (3) Promote gender equality and empower women; (4) Reduce child mortality; (5) Improve maternal health; (6) Combat HIV/AIDS; (7) Ensure environmental sustainability; (8) Develop a global partnership for development.

and education authorities should be on finding ways of mutual recognition of qualifications to facilitate greater levels of semi-skilled labour mobility.

6.5 **Subsistence:** The majority of people in Vanuatu depend on subsistence for their daily livelihoods. Subsistence also influences household decisions over allocation of resources for agricultural production. Despite this, there is very little research being done on the subsistence economy and the 'subsistence effect' on cash crop production in Vanuatu.

6.6 **Entrepreneurship:** The case of Tanna Coffee reveals the importance of entrepreneurs for boosting export and achieving 'private sector led growth'. At present, there is a paucity of entrepreneurs. Interventions are needed to promote, encourage, and develop entrepreneurship. The Ministry of Ni-Vanuatu Business was set up for this purpose but its task has been hampered by political intervention. In order to boost trade and foster economic growth in rural areas, development interventions need to be aimed at promoting entrepreneurship. The Vanuatu Chamber of Commerce and Industries, because of its relative focus toward the private sector, may be a more prudent organisational choice for such interventions in the future. Its legislation, however, may need to be reviewed to make it more accountable to the private sector (see 1.1).

6.7 **Export-oriented policies:** At present, Vanuatu's trade policy largely promotes inefficient manufacturing industries which conduct import substitution. These industries have no backward linkages to resources available in rural areas, generate minimal employment, and add little to consumer welfare. These industries also divert vital resources away from the rural areas, and survive on subsidies such as import duty exemptions. A fundamental policy shift is needed from industry-orientated import substitution to export-oriented growth (including tourism) to bolster trade linkages to the rural areas.

6.8 **Dissemination of Information:** Asymmetry in information has contributed to market failures. A lack of information has particularly constrained potential suppliers from entering urban markets for agricultural products. While demand for agricultural products often exists in urban areas, suppliers in rural areas are unaware of them. Hence, there is a need to disseminate market-related information to both producers and buyers. A proactive trade and market information system should be developed and funded adequately (see 8.9).

6.9 **Linking Trade Negotiation and Human Development:** Policies aimed at linking all trade negotiations to human development must be promoted. The following, amongst others, must be protected and accounted for when negotiating trade agreements:

- Promote development policy space to provide targeted subsidies on export performance (Wagle 2007).
- Encourage incoming foreign direct investors to take human development into account (Wagle 2007).
- Ensure commitment on tariff reduction is contingent on means for compensation of lost revenue arising from trade liberalization.

SECTION II. SECTORAL ISSUES

7. TOURISM

7.1 Building tourism yield

There should be an effort to enhance the yield of *all* industry segments and to realize that there is no real point in 're-branding' Vanuatu. In the modern era of internet marketing and information dissemination Vanuatu can be many things to many people – and this approach will provide the basis for sustainable growth plus improvement in yield. In simple terms, yield and sustainability should be enhanced across *all* sectors of the tourism industry.

7.2 SME Development and Networking

There is clearly a need to look to new ways to develop SMEs in Vanuatu, especially those owned and operated by ni-Vanuatu. Funding, training and networking are critical themes that should be explored through future donor assistance. This objective can be achieved in conjunction with the proposals considered under chapters 1, 2 and 3 of the DTIS.

Tasks:

- A study needs to be undertaken by an SME/tourism specialist and local tourism sector expert, concentrating particularly on reasons for the limited success of past initiatives and the potential to overcome these.

- Assistance is required to tourism enterprises to design appropriate accommodation and other tourism services and products for target clients.

- Assist outer islands tourism enterprises to directly and collaboratively market their products to potential clients, including linkages to and co-marketing with Vila-based tourism enterprises. In particular web-based net-working strategies should be pursued and strengthened where feasible.

- To identify strategies to utilize the Vanuatu Tourism Education and Training (VATET) Project and other resources – including the SPTO tourism toolkit (www.spto.org) to maximize opportunities for both staff and owner training and development.

- To review current success in the tourism sector in gaining access to micro-finance funds and to provide suggestions for the optimal route forward. The NTDO has, for example, applied for funds to establish and run a micro-financing tool through its office. Such a review could evaluate the benefits and potential costs involved in taking such an approach.

- To utilize the South Pacific Tourism Investment Marketplace and other tools to maximise opportunities for local operators to link up with overseas, perhaps small, 'angel' investors/expertise that can help to build businesses. The www.sptim.org site represents a useful tool to achieve this.

7.3 Linkage Creation and Development

One area of tourism linkage that has perhaps the greatest opportunity to create economic spin-offs around the nation is with the agriculture sector. With over 80 % of the population residing in rural areas, agriculture remains the mainstay of the economy. Further linkages may also be created with the fisheries sector. As shown in the chapter on fisheries, the sport-boat industry already contributes to tourism. Further benefits to the tourism industry may accrue from supply to hotels and restaurants from the offloading of fish at onshore facilities or from domestic processing.

An important dimension to many linkages is that they actively involve female participation. Women's links to tourism are as employees and also owner/operators.

Tasks

- Analyse linkage structures between tourism and surrounding sectors
- Identify successful models of linkage development from the region and worldwide
- Identify core mismatches between tourism and local industry and where progress could be made
- Create innovative approaches to sustaining and developing linkages – i.e. competitions for the preparation of local food in ways that meet tourist demands

7.4 Community Awareness and Participation

If governments want to incorporate community culture, heritage and local environs into a more diversified tourism product, then community must be an active rather than passive participant in the development process. Yield enhancement depends not only on improving visitor experience, but also the experience of tourism for the host communities.

Tasks

- Conduct a review of awareness building activities – with a focus on enhanced coordination of activities and more sustainable outcomes.
- Develop awareness in sectors that link to tourism and where levels of awareness appear to be quite low.
- Analyse current methods designed to encourage community participation in tourism planning and identify gaps and problems. Identify tools, approaches and examples that can facilitate community involvement in planning and land-based issues.
- To develop indicators of tourism success that are defined and can at some point be evaluated by the community.

7.5 Human Resource Development

An increase in the number of trained staff to support the expanding tourism industry is currently a priority (EC 2006; AVL 2007). Vanuatu is also lacking the middle management skills among ni-Vanuatu, to supervise operational skills, either learned at the Hospitality Tourism and Leisure Training Centre (HTLTC) or on-the-job.

The implementation phase of VATET is now commencing and will have a duration of at least three years. There is a need for a range of other skills, including life skills for people who come into contact with tourists (e.g. retailers, taxi drivers) and entrepreneurial skills (e.g. small tour operators) (AVL 2007).

Tasks

- Build on the earlier needs assessments of VATET (2005) and SPTO (2005) to identify needs and to optimize training opportunities provided by a number of organisations. It will be critical to identify existing and new resources such as the SPTO Tourism Toolkit and how they can be utilized rather than reinventing the wheel.
- An evaluation of the role of labour in creating the visitor experience. How is labour educated and trained as part of the tourism experience? How is labour rewarded? Can approaches be adopted to enhance labour 'buy-in' to the tourism development process? How many business websites or brochures feature their staff, how many staff actually know the vision or goal of the company they work for?

7.6 Internal Transportation

Domestic access is a major issue as it is probably more supply-constrained than international (AVL 2007). This means work is potentially needed in the policy area to review ways of removing the constraint.

If numbers of tourists to the outer islands are to grow it will be important to develop some form of sea-based transport. In addition the ongoing importance of the cruise sector requires further analysis if benefits are to be generated for host communities and regions. Likewise the internal land-based sector requires further development and review (taxis, buses etc.).

Tasks

- Review and benchmark existing domestic transport offerings for tourism and propose ways to move things forward.
- Review the potential for water-based transport options – with a focus on Luganville and Port Vila as hubs.
- Evaluate and benchmark cruise ship and yacht preparedness among communities and regions.
- Develop a clear strategy to maximise benefits from the MCA-funded infrastructure developments to the local tourism industry and the communities that depend on it.

7.7 Research And Decision Support

Good data on visitor characteristics, tourist spend, industry linkage structures and outer island travel must lie at the heart of any future development of the tourism industry. Interviews reveal that the problem of limited statistics is most keenly felt in the outer islands. Lack of data on visitors constrains lobbying but more importantly makes it hard to make informed business decisions – both for ni-Vanuatu and overseas investors.

The MCA statistics work to be conducted in the second half of 2007 will provide a useful base to work from – in conjunction with some of the more reliable data from the 2004 visitor survey.

Tasks

- Clear understanding and definition of research needs.
- Development of cost-effective tools to gather data and the creation of an ongoing barometer of visitor satisfaction, spend and industry performance.
- An evaluation of how information is disseminated to those that need it – and how this can be improved.

7.8 Marketing - Information Technologies

Strategy and discussion documents often emphasize re-branding or re-positioning Vanuatu. Bazeley and Mullins (2006) also argue that:

> "a cohort of recent entrants into the tourism sector, with considerable experience in development of niche markets, may be the catalyst needed to address past marketing inadequacies and forge more productive and creative private-public sector partnerships".

In real terms this may not be what is required to move Vanuatu tourism forward. A lot of the current 'mass' marketing for Vanuatu already features attractions and experiences that lie outside Port Vila and Efate. The outer island experience is pushed quite strongly on the portal websites that represent Vanuatu. As mentioned in the chapter a focus purely on these niche markets would also not enable the visitor numbers predicted to be obtained – or sustained.

In effect the Vanuatu tourism industry needs to focus its attention on where it can make the most targeted impact with the least cost. The need to balance the mix of 'mass' and 'niche' tourism is vital to the industry's survival. It is also important to note that some visitors may look for a combination of traditional resort *and* more unique island experiences.

The Internet is the tool that offers the greatest opportunity to tap into both niche and mass markets and is a vital supplement to traditional distribution channels. The emphasis on the internet also brings into focus the relationship between the tourism industry and the telecommunications sector. The World Bank is supporting the Government's initiatives to reform the telecoms sector and improve the coverage and quality of services in the country through the provision of assistance in the preparation of a sector reform road map. It will include detailed goals to improve the telecoms market (structure and its evolution) and a subsequent implementation plan (IMF 2007).

The following critical issues were raised by interviewees:

- Many bungalows don't have telephones or computer access
- Infrastructure and reliability of telecommunications is an issue – especially in the outer islands
- The monopoly status at the moment leads to relatively high costs (ITU 2006) for example $NZ 200 per month for 'broadband' access in Luganville.

Tasks

- Conduct a 'web-audit' of current on-line resources for the industry, with a focus on basic content and usability but also on network and linkage formation.
- Strengthen understanding between the telecommunications and the tourism sector and explore key bottlenecks – perhaps through the organisation of a knowledge-sharing workshop
- Develop an effective strategy for internet-focused marketing of the sector.
- Review and benchmark current activities against marketing efforts in key Australian and New Zealand markets. For example what does the NZ tourism industry's focus on the 'interactive' traveller mean for future positioning of Vanuatu's marketing activities?

7.9 Global Climate Change And Sustainability

Any attempts to develop sustainable yield must be based on an understanding of the environmental impacts on, and performance of, the tourism industry.

One critical issue for the industry is its own environmental performance. Tourist awareness of environmental issues is often heightened by policies in their home country – for example recycling programs, emissions regulations and reductions in plastic bag use. Poor environmental performance on the part of the tourism industry has a negative impact on visitor satisfaction and also on the broader environment.

Of more significance in the long term, the issue of climate change and resultant changes in sea levels and storm activity. A SOPAC integrated coastal management program has been initiated in Vanuatu and it is vital that the tourism industry link into this, and other future work, as much as possible. It is also important that the industry become more aware of both vulnerability and adaptive dimensions.

Tasks

- Technical assistance to assess vulnerability and enhance preparedness and adaptation to climate change. What percentage of tourism product is vulnerable to events? How can this be analysed and understood this from an economic and social perspective?

- Development of improved awareness of environmental issues by the tourism sector.
- Integrate global change issues into tourism planning and development legislation and policy frameworks.
- Awareness building in the area of business environmental performance, reviewing existing resources in this area and refining resources to enhance tourism business environmental performance

7.10 Institutional Structures and Industry Vision

There needs to be better coordination of the various organisations and agencies that are charged with developing and promoting tourism. There was some discussion of re-convening a tourism task force or some other coordinating body. The AVL document (2007) argues that such an organisation would:

- Act as an effective and efficient strategic decision-making forum.
- Be a trusted agency for receipt and control of Government, private sector and donor tourism-focused funding.
- Harness the energies (and supplementary funding) of Government and the private sector to carry out tourism development.

There is a clear sense that a summit of some form is necessary to 'kick-start' the process of taskforce formation. The feeling was that such a summit should occur within the next six months.

Tasks

- A review and, where appropriate, update of all plans, strategies, legislation, and regulations to align them with a common set of objectives;

- Identify areas where there is need for change or enhancement because the framework either inhibits tourism development, or leads to inappropriate development that is not consistent with the above objectives, or is insufficiently proactive;

- Develop a comprehensive tourism policy and regulatory reform program, and have this nurtured through Government processes until completion - a Tourism Development Act?

- The starting point for the process is a Tourism Task Force summit that will require an effective facilitator and technical assistance.

8. <u>AGRICULTURE, LIVESTOCK AND FORESTRY</u>

The recommendations are prioritized, sequenced and justified and are linked to existing and new initiatives being undertaken by donors and stakeholders in the ALF sector. It is envisaged that proposals relating in particular to programs of up to two years duration, will be funded in collaboration with other interested donors.[7]

8.1 VCMB reform

Acknowledging the ongoing contribution of AusAID in this area, it is recommended as a matter of urgency that the following options be considered:

- Repeal of the VCMB Act and outright abolition of the VCMB, with transfer of its residual activities/assets to other Government Departments and/or the private sector.
  - It may be that the private sector could undertake certain functions more efficiently or whether other functions should be transferred to an appropriate Government department or organisation, for example, the VCMB database to National Statistics Office; licensing to the DTI, or CCI; all inspection and grading responsibility to the VQIS.

- Privatization of the VCMB
  - Privatisation options must be reviewed in the light of financial accounts and reports relative to VCMB's assets– the oil mill and soap plant, cocoa grading equipment, land and buildings, vehicles etc. could form the basis of one commercial centre of VCMB.
- "Downsizing " the VCMB operation to vastly reduce costs.

COST: USD 34,400

8.2 Smallholder cattle production, purchase and trade program

(***i) Support to the Vanuatu Abattoir Ltd (VAL***)'s new initiative to purchase beef cattle from smallholder/custom landowners in the outer islands, initially Malakula and Epi, and ship them to Efate for pasturing/fattening, slaughter and eventual export as frozen/chilled cuts. It was indicated by VAL during the study trip that smallholder cattle purchased from the islands may be particularly suitable for the developing markets of the Solomon Islands and PNG. The proposal entails a two year program with the IF, together with other donors, supporting an initial subsidy of transaction costs, infrastructure and capacity building. This business should be developed based on loans, through a revolving credit fund which is eventually phased out. The programme should become economically viable and sustainable within two years.

The program concept involves the following activities:

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[7] International and local consultancy fees have been calculated at USD500 and USD200 per working day respectively, on the basis of 20 working days per calendar month; per diems have been calculated at USD300 per day; and international airfares at USD 2,500 per return trip.

- Location, and inspection identification of smallholder cattle suitable, in terms of size and condition, for purchase and transportation to the VAL abattoir Port Vila – in this task the program should be assisted by existing activities of the VQIS and VCCI;
- Internal island transportation of cattle to holding points (stockyards) to await shipment;
- Shipment and offloading at Efate;
- Fattening for up to 6-9 months, for a fee, by Efate commercial ranchers;
- Delivery to the VAL abattoir, slaughter and export.

COST; To be advised – as an indication one shipment of 100 head of cattle to Efate from Malakula is estimated at US$ 6,500; say ten shipments p.a. for two years = USD 130,000.

8.3 Organic beef market research study

ToR and cost to be advised by VAL/VQIS.

8.4 Fair trade certification

(i) Fair Trade Feasibility Study and Certification Program: Support to the identification of Vanuatu agricultural and other export products suitable for certification by the Fair Trade Labelling Organisation (FLO), and assistance with ongoing certification programs. The following outline ToR is recommended:

(a) Two-month Feasibility Study covering:
- Literature review of fair trade regulations and criteria for certification acceptance;
- Identification of suitable Vanuatu agricultural and other products for fair trade certification; these could include; cocoa, coffee, spices, beef (from smallholders), essential oils and health products, handicrafts;
- Identification of actual and potential appropriate organisations for certification;
- Costs and action plan.

(b) Two-year program covering:
- Certification procedure;
- Market research;
- Quality and standard compliance;
- Sustainability of ongoing audit and internal control.

It is envisaged that this program will be undertaken in collaboration with the ACP-EU CDE

COST: Full costs to be advised/Feasibility study USD47,300

8.5 Cocoa quality, grades and standards program

(i) Cocoa Quality and Standardization of Grades Program: Support to the establishment of definitive Vanuatu cocoa grades acceptable to the international market and particularly fair trade buyers, and the maintenance of consistent quality and standards. This two year program would link with fair trade certification study and program (see 5 above). The program concept involves the following activities:

(a) Quality-band Standards Review:

- Review by an internationally recognised cocoa quality expert of all Vanuatu smallholder cocoa processing units meeting criteria for fair trade certification;
- Recommendation of standards and grades and action plan for ongoing monitoring of quality, and long term sustainability of the system.

(b) Monitoring:

- Regular monitoring of processing units by a local cocoa quality expert.

It is envisaged that this Program will be undertaken in collaboration with the EU/DARD – POP2

Cost: Full costs to be advised/Feasibility study USD47,300

8.6 Fruit and vegetable export program

(i) Fruit and Vegetable Export to regional Markets: Support to the initial start up costs required to achieve sustainability in the export of fruit and vegetables to regional markets under a two-year program, The Program concept is initial subsidy to transaction costs, infrastructure (cold stores/transport/packaging) and capacity building. It is not proposed that a fruit and vegetable export business is developed based on permanent subsidies, and that subsidies are gradually replaced by loans, through a revolving credit fund, and eventually phased out completely over a two year period. The rationale behind the proposal is that, currently, Vanuatu exporters do not have the economies of scale to compete in the export market, and are restricted to transport their products by air. If sufficient volume is built up then a move to containerized sea transport can take place.

Detailed ToR/Action Plan to be advised.

8.7 Essential oils /health products - market research study

(i) High Value Product Market Research: Support to a marketing study on the quality, standards, packaging, costs, and promotion required to gain access to high value essential oils and health product markets. The study should cover Nangae, Navele and Natapoa nuts; Tamanu, Frangipani, Virgin coconut, and Sandalwood oils.

It is envisaged that this Program will be undertaken in collaboration with the ACP-EU CDE.

ToR and costs to be advised.

8.8 Organic certification program

(i) Organic Certification: Support to the feasibility of organic certification of coffee and ongoing financial support to the costs of international audit and internal control of maintaining organic status of the spice sub sector.

It is envisaged that this Program will be undertaken in collaboration with the EU/DARD – POP2 and be implemented by the Farmers Support Association (FSA).

ToR and costs to be advised.

8.9 Feasibility study on the establishment of a proactive trade and market information system (PTMIS)

In line with the suggestion under 1.8 above, the following outline ToR is recommended:

(i) Literature/document review;
(ii) Review and analysis of current situation regarding trade and marketing information availability; and base line surveys/studies;
(iii) Diagnose, assess and identify all potential marketable and exportable products in Vanuatu;
(iv) Develop market product profile (ID Cards) for each potential marketable and exportable product describing the characteristics, traceability, product composition, product variety and name product level by product line, by sector and geographic area, etc.;
(v) Propose an appropriate infrastructure and technical specification for the PTMIS implementation, including the network system and draft a detailed ToR for the design, development and installation of the PTMIS to be accessed by interested stakeholders and featuring:

- Market and trade dissemination methodologies;
- Potential exploitable resources in Vanuatu and opportunity for investment and trade;
- Potential product profiles for export;
- Targeted markets by sector and product lines;
- Matchmaking buyers and sellers of Vanuatu products to close the information gap;
- Available technologies by sector including training;
- Marketing product design, development and/or adaptation, packaging and labelling, etc.

(vi) Propose training and institutional capacity building program in trade and marketing;
(vii) Propose a role for the Pacific Islands Trade and Investment Commission (PITIC) and other marketing support mechanisms;
(vii) Establish a plan of PTMIS establishment and operation including implementation strategy, equipment, human resources and management;
(viii) Hold a stakeholders workshop to discuss proposals and agree a course of action;
(ix) Stakeholder workshop to discuss and confirm feasibility study and implementation proposals.

Cost: USD47,300

9. FISHERIES

9.1 Formulate comprehensive fisheries sectors policies including clear guidelines on how to engage the provinces and private sector in the development and management of fisheries. Included in this should be a list of national fisheries policies that provides detailed objectives, strategies and activities for each fisheries sub-sector forming a clear roadmap for the department, provinces and private sector. Innovation and technological upgrading should remain central to these policies. This should be done through consultations with private and public sector stakeholders (cost estimate VT10 million).

9.2 Create resource development and management plans for each fisheries sub-sector that support the sub-sector policies and development in consultation with private and public stakeholders. Immediate priorities should be with:

i) Finalizing the revision and the implementation of the Tuna Management Plan incorporating the Ecological Approach to Fisheries Management and the establishment of a national observer program to monitor fishing activities for FFVs and Vanuatu Flagged Vessels (cost estimate VT20 million).

ii) The completion and implementation of an Aquarium Trade Management Plan through consultation with all stakeholders in order to effectively regulate and manage this trade, ensure its sustainability and reduce conflicts with communities and the tourism sector (cost estimate VT4.5 million)

iii) Development and management plans for all commercial, artisanal and nearshore fisheries in Vanuatu. This should include for nearshore commercial resources such as trochus and sea cucumbers, FAD deployment, distribution of ice plants, marketing strategies and export quality standards, value adding to products and training for extension personnel (cost estimate VT 10 million).

iv) Development and management plans for all aquaculture activities that provides a regulatory framework including for private sector involvement and includes research for investigating the viability of utilizing local species in aquaculture to avoid the further introduction of exotic species that may negatively impact local species and the environment (cost estimate VT 15 million).

v) Require a stock assessment of the deepwater demersal fisheries resource and an updated estimation of the Maximum Sustainable Yield (MSY) by island to determine the status and economic potential of this fishery (cost estimate VT15 million).

9.3 **Support the rational and transparent development of an onshore tuna facility/landing base** that generates employment and value-added benefits to Vanuatu from its EEZ, improves resource management while contributing to the sustainable development of marine resources and human development in Vanuatu (cost estimate VT15 million).

9.4 **Strengthen the management of marine resources** by developing and refining the collection, analysis and reporting of fisheries data for offshore tuna, deepwater demersal fishery, nearshore fisheries as well as market outlets. This should include capacity building for Fisher's Associations and Extension Officers to collect fisheries data and implement management strategies (cost estimate VT8 million).

9.5 **Restructure the department, including the recruitment of additional qualified staff to sustainably develop and manage the fisheries of Vanuatu.** Current human and financial resources within the DoF as the country's regulating Government agency responsible for the development and management of Vanuatu's inshore and offshore fisheries resources are insufficient. Additional recurrent funds need be allocated to support the structure and necessary programming as developed in policy statement and management plans or alternatively, a portion of the revenue collected (through resource rentals) be allocated directly to DoF for these purposes (cost estimate VT0.5 million).

9.6 **Build on the success the DoF has had in supporting and strengthening traditional management of nearshore resources.** This involves building and mobilizing community capacity to manage resources under their tenure including through cooperative management strategies (cost estimate VT10 million).

9.7 **Train Extension Officers and provincial authorities in the new Fisheries Act** and regulations and fund them to promote awareness to the public throughout all provinces (cost estimate VT4 million).

9.8 **Revise Fishers Associations objectives and strategies** and establish a new Action Plan for implementation by the DoF (cost estimate VT1 million).

9.9 **Improve communication and collaboration between the DoF and other national government agencies, provincial governments, NGOs and other stakeholders** including communities/resource custodians and the private sector to further the sustainable development and management of marine resources and enhance the human development of ni-Vanuatu. Forming a Fisheries Advisory Council that holds regular meetings to promote fisheries policies and information sharing amongst stakeholders and use of mass media could help with this goal (cost estimate VT1 million).

DRAFT DTIS ACTION MATRIX[8]

Action no.	Action recommended	Requirements: Implement existing policy	Requirements: Change policy/ legislation/Reform Institutions	Requirements: Technical assistance/ investments	Agencies involved	Likely time frame
SECTION I. CROSS-CUTTING ISSUES						
1. Macroeconomic framework						
1.1	Conduct further research into the localised reasons for the decline in barter trade with a view to increasing the degree of engagement of the informal and subsistence sectors with the formal. Set up private business support activities in the rural areas.	X		X	MAQFF, MTIT, CCI	Medium term
1.2	**Broaden the government revenue base so as to reduce reliance on VAT and import duties and to make the tax regime more equitable.**		X	X	MFEM	Medium to Long term
1.3	Support ongoing attempts to strengthen the revenue base by providing audit training to Customs and other key revenue collection agencies such as Lands. Support the provision of technical assistance for legislative drafting, training and strengthening of tax administration.	X		X	MFEM, MOLNR and others.	Medium term
1.4	**Remove the discretionary ability to grant exemptions as part of overall tariff reform. Revise subsidies and tariffs so that they promote agriculture, fisheries and tourism. Provide support and training to the Revenue section of MFEM.**		X	X	MFEM, MTIT, MAQFF	Medium term

[8] Immediate priorities highlighted

Action no.	Action recommended	Requirements: Implement existing policy	Requirements: Change policy/ legislation/Reform Institutions	Requirements: Technical assistance/ investments	Agencies involved	Likely time frame
1.5	Review the size and functionality of the public sector with a view to reducing the ratio of wages to expenditure.		X	X	MFEM, other departments and agencies	Medium term
1.6	Support the provision of training to key agencies, including DESP, to improve their role in monitoring and evaluating government expenditure. Conduct a review of budget processes and provide training to sector analysts	X	X	X	MFEM	Short to medium term
1.7	**Review major government contracts with a value of more than VT20 million, especially for stevedoring (see 5.3) and the regulation of the gaming industry.**	X	X	X	MFEM	Short term
1.8	Strengthen the Government Business Enterprise Unit in terms of its fiduciary responsibilities, development of financial database for storing financial data in a format consistent with the FMIS.	X	X	X	MFEM	Short term
1.9	Strengthen co-ordination between fiscal and monetary policy.			X	RBV	Short term
1.10	Undertake a study on the reasons behind the relatively large interest rate spread in order to make practical recommendations on how it can be reduced.			X	MFEM, RBV	Short to medium term
1.11	Strengthen the ability of the Government to co-ordinate and manage ODA. Support the Aid Management Unit to detail Vanuatu's donor harmonisation road map.	X		X	MOFA, MFEM	Medium term
1.12	Support continuing attempts to improve the quality and timeliness of data via long-term institutional strengthening of the National Statistics Office..		X	X	MFEM	Long term

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
2. Business environment and investment policy						
2.1	**Develop an e-business strategy and make it central to business development efforts.** Ensure that technological upgrading remains central to efforts to develop the business environment. Improve presence of VIPA on the Internet.		X	X	CCI, VIPA, DTII	Short to medium term
2.2	Support existing efforts to address the performance of the Land Titles Office and address capacity constraints. The office is not adequately resourced in terms of personnel and equipment to perform registration of land titles.	X	X	X	MOLNR	Short to medium term
2.3	Ensure that court orders can be better enforced. Support efforts to tackle the shortage in the number of sheriffs.	X	X	X	SLO	Short to medium term
2.4	**Reassess the two ni-Vanuatu micro-finance schemes under the Ministry of Ni-Vanuatu Business with a view at least to improving loan recovery rates. Support attempts by the Department of Co-operatives to increase the availability of credit in the rural areas.**	X	X	X	MTII, DCBD	Short to Medium term
2.5	Develop a one-stop-shop for incoming foreign investors by 31 December 2008.	X		X	VIPA	
3. Institutional framework for mainstreaming trade						

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
3.1	**Establish a unit or person within the IF steering committee with responsibility for drawing up trade-related ToRs, collating consultancy reports and depositing them on the intranet and either in a separate library or in the national library.**		X		DTII, other institutions.	Short to medium term
3.2	**Maintain financial support for the Trade and Development Unit established to facilitate the IF process.**					
3.3	**Support an economic think tank and/or policy forum, bringing together Vanuatu's foremost economists.**		X	X	DTII, MTIT, RBV, MFEM	Short term
3.4	**Make the National Trade Facilitation Committee the national implementation unit of the enhanced Integrated Framework, driven by the External Trade division of the DTII.**		X	X	NTFC, DTII	Short term
3.5	**Incorporate the DTIS with the PAA.**					
	4. Trade policy					
4.1	**Move the External Trade division of the Department of Trade to the Ministry of Foreign Affairs. Consider amending the Foreign Affairs Act to require involvement of the External Trade division over tariff changes. In the long term, adopt a Trade Act incorporating consumer rights, intellectual property and trade-related tax legislation.**		X		DTII, MOFA, MFEM	Short to medium term
4.2	**Adopt a national trade policy based on the DTIS, ensuring that science, technology and innovation remain central.**		X	X	DTII, NTFC	Medium term

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
4.3	**Update current customs-related legislation, in particular the outdated Import of Goods Control Act, to address gaps and bring it into line with modern trade practices.**		X	X	MTIT, DTII, DCIR	Medium term
4.4	Re-start the process of accession to the World Trade Organisation.	X			DTII	Short term
4.5	Continue to engage with the Economic Partnership Agreement (EPA) process, making fisheries development a priority. Establish regular consultations in Brussels using the newly-established diplomatic presence.	X			DTII, MOFA, MOF	Short to medium term
4.6	**Promote increased trade with New Caledonia via an FTA, and in the long-term, regional trade integration.**		X		DTII, MOFA	Medium to long term
4.7	Continue to monitor the potential costs and benefits of PACER membership, ensuring that the maintenance of policy space remains paramount.	X			DTII, MOFA	Short term
4.8	Conduct further study on the impact of possible graduation from LDC status, ensuring continued preferential EU market access for copra, beef, coffee, cocoa and other potential exports.		X	X	DTII	Short to medium term
5. Trade Facilitation						
5.1	Deliver a project or several projects aimed at creating systems for the development, promotion, monitoring and certification of a range of agricultural produce standards.	X		X	MAQFF	Medium term
5.2	**Ensure that the trade policy developed under 4.2 makes SPS architecture central.**	X	X		MAQFF, DTII	Short term

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
5.3	**Review existing stevedoring contracts. Consider making GATS-type commitments in stevedoring and port services where possible in the context of trade negotiations. Tackle congestion and space limitations at the wharf in Port Vila.**		X		DCIR, MFEM, DTII	Medium term
5.4	**Assist the Vanuatu Quarantine and Livestock Department (VQLD) to improve its capacity to monitor import risks at the border, including investment in facilities and funding for emergency response plans. Improve capacity to monitor and control pests and animal diseases. Assist efforts by VQIS to ensure export quality.**	X		X	VQLD	Short to medium term
5.5	**Update current customs-related legislation, in particular the outdated Import of Goods Control Act.**		X		MFEM, DTII, MTIT	Short to Medium term
5.6	**Co-ordinate trade facilitation efforts under the NTFC (see 6.1 and 3.3)**	X			NTFC	Short to medium term
5.7	**Initiate work on traditional trade facilitation areas such as standards and conformance issues, regulation of commerce and competition and consumer protection.**	X	X	X	NTFC	Short term
6. Trade, poverty and human development						

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
6.1	**Allocate external and domestic resources to enable the National Trade Facilitation Committee to promote the mainstreaming of trade.**		X	X	NTFC, DTII, MOFA, MFEM, CCI, MAQFF, VANGO, VIPA	Short to medium term
6.2	Increase household land productivity by: (1) coordinating all interventions aimed at increasing productivity; (2) building links to general trade policy.		X	X	CCI, MAQFF, MTIT	Medium to long term
6.3	**Improve access for ni-Vanuatu to financial services in the outer islands.**	X	X	X	NBV, MFEM, RBV	Medium to long term
6.4	Initiate a study into labour outmigration, paying particular attention to areas in which Vanuatu stands to lose skills. Ensure that the Department of Labour has effective powers to regulate seasonal worker employment agencies. In the medium term focus on mutual recognition of qualifications to facilitate greater levels of semi-skilled labour mobility.			X	MOL	Short term
6.5	Conduct further research into the subsistence economy, including fieldwork on existing entrepreneurship among women.			X	DTII, DWA	Short term
6.6	**Look at measures to promote indigenous entrepreneurship in all areas of the economy, but particularly tourism. Any training programs in this area should take account of earlier experiences.**	X	X	X	CCI, DCNB	Medium Term
6.7	Undertake a poverty and human development impact assessment before ratifying any new trade agreement.		X		DTII, MFEM, MOFA	Medium to long term
SECTION II. SECTORAL ISSUES						
7. Tourism						

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
7.1	**Create a clear yield and data-driven vision for Vanuatu tourism including running a summit to develop a Tourism Taskforce.**		X	X	NTDO, VTO	Short to medium term
7.2	**Look at new ways to develop tourism SMEs.**		X	X	NTDO, VTO	Short term
7.3	**Create and develop linkages with the agriculture and fisheries sectors.**		X	X	NTDO, VTO	Medium to long term
7.4	Improve community awareness and participation.	X		X	NTDO, VTO	Medium to long term
7.5	Continue to improve tourism human resources, including training tourism managers in the outer islands.	X		X	NTDO, VTO	Long term
7.6	Improve internal transportation for tourism, including reviewing existing arrangements and developing a strategy to ensure that the MCA caters to tourism.	X		X	NTDO, VTO	Short to medium term
7.7	Improve research and decision support for tourism		X	X	NTDO, VTO	Medium term
7.8	Develop a marketing and information technology program for tourism.		X	X	NTDO, VTO	Medium term
7.9	Assess and monitor the impact of global climate change and sustainability	X	X	X	NTDO, VTO	Long term
8. Agriculture, livestock and forestry						
8.1	**Support the ongoing feasibility study on reform of the VCMB including the possibility of its outright abolition.**		X	X	MAQFF, MTIT, DTII, VCMB	Short term

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
8.2	Strengthen smallholder cattle production, purchase and trade.		X	X	MTIT, MAQFF	Medium term
8.3	Launch an organic beef market research study.		X	X	MAQFF	Short term
8.4	**Establish fair trade certification.**		X	X	MAQFF, DTII	Medium term
8.5	Initiate a cocoa quality, grades and standards program		X	X	MAQFF	Medium term
8.6	Establish a fruit and vegetable export program and consider setting up intermediary organisations to on-sell products to the tourism industry.		X	X	CCI, MAQFF	Medium term
8.7	Conduct a market research study on high value products and consider the possibility of public-private partnerships in this area.		X	X	MAQFF	Short term
8.8	**Achieve organic certification.**		X	X	MAQFF	Medium to long term
8.9	**Establish a proactive trade and market information system, including the wider dissemination of trade information in the provinces.**		X	X	MAQFF, DTII	Short to medium term
8.10	Support the establishment of a carbon credits export program.		X	X		
8.11	Continue to recognise the importance of forestry for the economy.					
9. Fisheries						

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
9.1	**Formulate comprehensive fisheries sectors policies including clear guidelines on how to engage the provinces and private sector in the development and management of fisheries.**		X	X	DOF	Short to medium term
9.2	Create resource development and management plans for each fisheries sub-sector.		X	X	DOF	Short term
9.3	**Support the rational development of an onshore tuna facility/landing base. Make an environmental impact assessment a condition of the establishment of onshore facilities.**	X	X	X	DOF	Medium to long term
9.4	**Strengthen the management of marine resources by developing and refining the collection, analysis and reporting of fisheries data for offshore tuna, deepwater demersal fishery, nearshore fisheries, aquaculture as well as market outlets.**	X	X	X	DOF	Short to medium term
9.5	Restructure the department, including the recruitment of additional qualified staff.		X	X	DOF	Medium term
9.6	Build on the success the DoF has had in supporting and strengthening traditional management of nearshore resources. This involves building and mobilizing community capacity to manage resources under their tenure including through cooperative management strategies.	X		X	DOF	Medium term
9.7	Train Extension Officers and provincial authorities in the new Fisheries Act			X	DOF	Short to medium term

Action no.	Action recommended	Requirements			Agencies involved	Likely time frame
		Implement existing policy	Change policy/ legislation/Reform Institutions	Technical assistance/ investments		
9.8	Revise Fishers Associations establishment objectives and strategies and establish a new Action Plan for implementation by the DoF		X	X	DOF	Short term
9.9	Improve communication and collaboration between the DoF and other national government agencies, provincial governments, NGOs and other stakeholders. Form a Fisheries Advisory Council.		X	X	DOF	Short to medium term

SECTION I. CROSS-CUTTING ISSUES

1. MACROECONOMIC ENVIRONMENT

1.1 Introduction

Vanuatu's economy is recovering from several years of macroeconomic underperformance following the initiation of the Comprehensive Reform Program (CRP) in 1997. The economy is now one of the fastest growing in the Pacific region, setting Vanuatu on a path to graduate from LDC status in coming years. This chapter outlines the context of the current period of economic growth before outlining the composition of the economy, fiscal policy, inflation and monetary policy. It concludes with a look at some of the risks resulting from the current increase in the public sector wage bill and incoming foreign aid.

1.2 Background

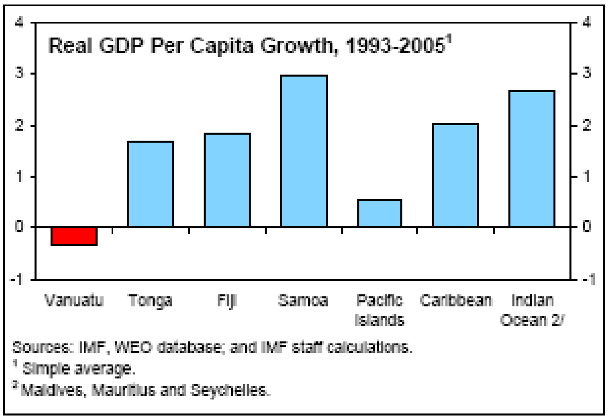
The first half of Vanuatu's post-independence period was marked by relative macroeconomic stability. Until 1988 the Government ran a prudent fiscal policy, minimising debt and usually running budget surpluses, which were used to build up national reserves. In 1988 the ruling VP party split. Three years later the late Fr. Walter Lini, was removed as Prime Minister, a position he had held since independence,.

The early nineties saw the start of budget deficits. Despite the efforts of the CRP, a donor-assisted economic reform program initiated in 1997, the Government's financial position and the overall economy continued to worsen.

The currency came under intermittent pressure after the financial crisis of the mid-nineties due to a loss of confidence in the domestic financial sector combined with poor responsive actions from the Reserve Bank of Vanuatu (RBV). A decision of 27 March 1998 to devalue the currency by 20 percent was revoked by the Minister three days later. A sharp loss of reserves followed, with the RBV bringing in capital controls to stem capital flight.

The following table shows that from 1993-2005 economic growth was lower than in comparable countries. Vanuatu was the only country in the sample to suffer a real economic contraction during the period.

Table1.1 Real GDP growth in selected countries and regions



Historical GDP growth has proven particularly volatile, partly due to the large contribution of agriculture, changing international commodity prices, lack of diversification and vulnerability. Foreign-currency donor loans during the late 1990s exacerbated GDP volatility. In terms of instability of merchandise exports over the 1970 to 1995 period, ADB estimates give Vanuatu a rank of 17th most unstable out of a sample of 103 developing countries (the Trade Policy chapter of the DTIS provides a fuller discussion of the trade situation and the balance of payments). The potential for counter-cyclical demand management is limited by the narrow revenue base and occasional liquidity problems.

1.3 Composition of the economy

The services sector comprises by far the majority of GDP, at 72 percent. Wholesale and retail trade and transport and communication contribute more than half of the total services share. Tourism represents around 18 percent of GDP and is concentrated around the two main urban centres. This activity is expected to gain in importance, as shown in the chapter on tourism.

Other significant service industries are the Government and the offshore sector, which involves the provision of offshore financial and administrative services and has been estimated to contribute around 5 percent of GDP. The Government contribution to GDP is estimated to be just under 13 percent.

According to the official figures agriculture and tourism constitute the bulk of production. Commercial agriculture and forestry account for 8 percent of GDP, whilst traditional agriculture (including subsistence) accounts for a further 10 percent. As suggested above, this is likely to be an underestimate.

Industrial production is 10 percent of GDP, including the national power and utility monopolies. The major source of growth in this area in recent years has been construction associated with land speculation. Manufacturing has been in decline for a decade and comprises only 3 percent of GDP. Sole proprietorships dominate this sub-sector, which comprises bakeries, manufacturers of concrete blocks, kava grinders, sawmills and other businesses.

Table 1.2 Composition of GDP, VT million

	2000	2001	2002	2003	2004	2005	2006
Custom/traditional agriculture	**3,102**	**3,237**	**3,340**	**3,419**	**3,552**	**3,676**	**4,364**
Garden and food crops	1,701	1,786	1,839	1,892	1,948	1,991	2,144
Kava	813	831	858	877	913	1,000	1,519
Fishing	259	277	286	292	301	305	313
Livestock	89	94	97	111	115	119	126
Coconut	98	100	111	100	107	93	89
Poultry	15	15	16	16	17	17	20
Firewood	127	134	134	131	151	151	155
Export agriculture	**1,995**	**1,750**	**1,560**	**1,667**	**1,915**	**1,826**	**2,180**
Copra	716	663	624	619	832	413	342
Kava	436	440	262	263	418	456	673
Beef	409	410	429	471	456	591	856
Forestry and logging	295	169	165	172	128	297	197
Cocoa	138	68	78	140	79	67	107
Coffee	1	2	2	2	1	3	5
Other commercial agriculture	**148**	**144**	**130**	**127**	**121**	**166**	**188**
Fishing	68	56	43	43	38	53	70
Poultry and dairy	62	69	67	60	64	92	96
Fruits and vegetables	17	19	20	23	20	22	22
Total agriculture	**5,245**	**5,132**	**5,030**	**5,213**	**5,588**	**5,668**	**6,732**
Manufacturing	1486	1328	1167	1244	1341	1438	1477
Electricity	598	685	701	683	675	810	917
Construction	1064	1092	1094	1075	1164	1317	1559
Total industry	**3,130**	**3,105**	**2,962**	**3,002**	**3,180**	**3,565**	**3,953**
Wholesale and retail trade	10,679	10,705	9,219	10,523	11,122	12,611	14,436
Hotels and rest..	2,741	2,603	2,372	2,163	2,461	2,633	2,940
Transport and communication	4,082	4,166	3,785	4,115	4,704	5,368	5,892

Finance and insurance	2,160	2,724	2,664	2,991	3,225	3,908	4,310
Real estate and business services	1,970	2,053	1,961	2,189	2,547	2,794	3,118
Government services	4,521	4,663	4,825	4,995	4,973	5,147	6,195
Personal services	358	372	383	391	403	422	450
Domestic services	385	408	429	459	485	509	535
less bank charges	1,622	1,806	1,673	1,816	1,825	2,238	2,660
Total services	**25,274**	**25,888**	**23,965**	**25,970**	**28,094**	**31,154**	**35,216**
Total GDP	**33,649**	**34,125**	**31,957**	**34,185**	**36,863**	**40,387**	**45,901**

Source: National Accounts of Vanuatu 2007, NSO

1.4 Recent economic growth

Following the disappointment of the CRP, further internal attempts at reform began in 2002. A focus on fiscal stability and budgetary control, a housing boom and a pick-up in commodity prices helped improve macroeconomic stability and growth. According to the IMF, "growth reached 7 percent in 2005 and an estimated 5½ percent in 2006, well above the average for Pacific island countries".[9] The following table shows that GDP growth is forecast to remain high in the short- to medium-term.

Table 1.3 Selected macroeconomic data

Indicators	**Years**				
	2004	**2005**	**Est. 2006**	**2007**	**2008**
National accounts					
Real GDP (annual growth rate)	5.5	6.5	7.2	5.0	5.2
Prices					
Consumer Price Index (annual growth rate)	1.4%	1.2%	2.0%	2.5%	2.5%
Money and Monetary Policy					
91 day RBV note interest rate	3.9%	3.7%	5.2%	4.5%	3.9%
External Sector and Policy					
External current account balance (incl. grants) (%	-7.3%	-10.0 %	-8.0%	-13..2%	-4.3%

[9] IMF Article IV PIN 2007.

GDP)					
Exchange rate vatu/USD	112.9	109.0	110.0	112.0	115.0
External debt (% of GDP)	21.7%	18.9%	15.9%	14.0%	12.2%
International Reserves (number of months imports)	6.0	5.6	7.2	7.1	5.7
Fiscal policy					
Government deficit (excl grants) (% GDP)	-1.4%	0.2%	-1.4%	-6.2%	-5.6%
Government deficit (incl. grants) (% GDP)	0.9%	0.0%	0.5%	0.0%	0.6%
Domestic revenue (% GDP)	19.9%	19.7%	20.7%	21.7%	20.9%
Recurrent Expenditure (%GDP)	21.4%	19.7%	19.6%	27.9%	26.5%
Shares of social sectors in the overall budget (% GDP)	7.98%	6.85%	6.66%	9.30%	9.22%
Annual external debt service payments (% of fiscal revenues)	3.7%	7.1%	2.1%	3.4%	3.3%
Debt/GDP ratio	30.2%	26.5%	22.4%	19.9%	17.6%

Source: MFEM, RBV, IMF AIV 2007.

Improved fiscal controls have meant that in the past two years Vanuatu has achieved a virtuous circle of economic growth combined with budget surpluses, a reduced stock of debt (both domestic and external), large increases in Central Bank reserves and net foreign assets, declining interest rates and low levels of inflation. This has meant that the Government has been able to maintain relatively high levels of social spending, as shown in the chapter on human development.

Whilst the immediate prospects for growth and the macroeconomic environment appear strong, some risks remain, including the potential relaxation of fiscal discipline in the coming years.[10]

Macroeconomic performance has perhaps been jeopardised by a recent pay rise of around 25% for most civil servants, together with other spending. Combined with the relatively large potential increase in aid flows and the rapid increase in foreign direct investment, there remains a risk of the economy overheating. The social impact is of considerable concern. The recent civil service pay rise means that the urban elite will be cushioned from inflationary pressures. But real incomes in the informal or subsistence sectors

[10] Note on data:

Most of the common poverty related data surveys, including household income and expenditure and the composition of the informal sector, remain inadequate due to the high costs entailed. The agricultural census in 2007 was the first in over a decade.

2006 saw a renewed attempt at obtaining data – especially rural – with the initiation of a new household income and expenditure survey. These studies suggest that subsistence agriculture production or the "*kastom*" economy has been consistently and significantly understated. If this is true, then it would imply that more attention needs to be paid to the drivers and constraints of internal trade than in the past.

(where the majority of ni-Vanuatu people work) are likely to decline sharply unless the extra Government income is spent more equitably. Moreover the civil service is male-dominated, particularly at the senior levels, meaning that the impact of wage rises is likely to benefit males more than females.

Growth in the money supply offers supporting evidence. Narrow money grew nearly 50% over the past five years, a trend which is likely to continue in the short term. Whilst some of this is driven by private sector investment, especially in real estate, much is also driven by aid flows and the recent expansionary fiscal policy. How this increase in the money supply is managed, including its eventual slowdown, will significantly determine Vanuatu's macroeconomic performance over the next five years.

The potential negative impact of political disturbances in the rest of Melanesia (Fiji, Papua New Guinea, and the Solomon Islands) remains of concern. The risk premium on investment in Vanuatu is likely to remain high, while the tourism industry will remain vulnerable. Vanuatu does not suffer political unrest of the order experienced in the rest of the region, but its reputation tends to suffer by association.

1.5 Fiscal Policy

1.5.1 Income

Government revenues come mostly from tariffs and consumption taxes, although the fiscal structure has changed over time. The CRP was essentially a product of the "fiscal fashion" sweeping through the Pacific in the mid-1990s and led mainly by the large multilateral institutions. Unusually, Vanuatu underwent structural adjustment without experiencing a balance of payments crisis.

During these fiscal reforms Vanuatu dropped average tariffs to under 20% by 2000. Turnover tax was replaced with a 12.5% value added tax in 1998, although difficulties with collection have destabilised Government revenue.

Considerable opposition to VAT came from the small retailers and consumers who previously did not incur such costs. The larger businesses were supportive of the proposed increase in the number of business licenses but opposed to the flat rate applied to all businesses; this was changed in 2003 so that business license fees are progressive depending on turnover. In the short to medium term, improved enforcement has the potential to deliver significant additional revenues to Government.

These changes required administrative and legislative reforms including the expansion of the Customs department. However, despite these changes total recurrent revenue as a percent of GDP declined from 21.6% in 1998 to 19.8% by 2005. It could be argued, however, that the reforms broadened the tax base slightly and enabled Vanuatu to accommodate the decrease in its revenues from tariffs. VAT is now the largest individual revenue earner for the Government, closely followed by import duties – but it is noteworthy that the average duty rate is higher than VAT. This may suggest that the advent of VAT has adversely affected other revenue collections.

It should also be noted that after 1999 revenue from the corporatised bodies such as the airport and the post office no longer shows up as Government recurrent revenue. Furthermore, revenue from quasi-fiscal entities and other sub-national levels of Government such as schools and provinces are not shown – if they were, the figure of revenue as a percentage of GDP would increase by up to 2%. This means that despite having no income tax the overall level of taxation in Vanuatu would be about 25% of GDP, similar to the median level for all developing countries over the last decade.

More recently there has been an acknowledgement that Vanuatu requires some form of tax on income since after the CRP the tax base was focused excessively on consumption taxes. In 2007 businesses that previously paid no VAT were to be subject to a turnover tax. This is ironic since the turnover tax was removed in 1998 on the advice of many of the same proponents of a return to income tax.

The following issues remain outstanding:

- The Government still loses considerable sums through discretionary exceptions provisions (MFEM estimates for 2005 are in excess of VT 1 billion (USD10 million)). Businesses have a direct and strong incentive to lobby the Government in order to pay less tax. This incentive was made stronger in 2006/2007 by the decision to allow the Minister of Finance to have the power of appeal over decisions by the Director of Customs to give exemptions. In the absence of competition, most taxation is applied directly to the consumer.

- Large-scale fiscal changes tend to be administratively burdensome and perhaps more costly in terms of lower compliance. In addition the relatively low skills base (there are two professionally qualified indigenous ni-Vanuatu accountants) means that minor administrative fixes can often have a similar impact to significant fiscal changes. As mentioned above, the successful implementation of VAT may have weakened collection of other taxes, as limited skills and resources were transferred.

- In the future, external pressures to further reduce import duties will continue, meaning that excise will play a greater role. In effect the fiscal changes will have done little other than increase administrative costs and absorb Government and donor funds.

- Bilateral donors are likely to play an increasing role in tax reform. There is a risk, however, that if they focus on opening up the domestic market rather than helping it develop, then the Government may become more insular and overtly political – a trend which is already evident in recent policy, including the continued use of bans, tariffs, exemptions and other discretionary measures.

- There has been little analysis of the potential to further investigate more efficient methods of taxing the large and growing service industry. The deregulation and opening up of the telecommunications market as well as the roll-out of these services to the outer islands mean that the potential for increased revenue from services is quite high, although information will need to improve. Despite an increase in the provision of offshore services, the Government has not yet tabled an e-business act. Minor taxes on the gaming industry are the only tax in this area.

- Large efficiency gains could be made through institutional support to the main revenue collecting agencies. Weak audit and compliance capacity is compounded by inadequate information exchange.

- The final overlooked element of the fiscal regime is in the area of mining and extraction. The recent increase in mineral prices may mean some new extraction operations open. The current fiscal regime for mining is unclear and poorly administered. There is a clear need to develop a fiscal regime for this industry that is fair and equitable.

Table 1.4 Government revenue

	Actual 2003	Actual 2004	Prelim 2005	Budget 2006	Projection 2007	Projection 2008	Projection 2009
Tax Revenue	**6,021.5**	**6,621.7**	**7,095.0**	**7,261.3**	**9,393.9**	**9,910.0**	**10,406.3**
A1 - Taxes on income and profits	-	-	-	-	-	-	-
A4 - Taxes on property	74.8	106.5	154.5	110.0	560.0	592.4	623.6
A5 - Taxes on the use of goods	3,663.4	3,995.5	4,526.0	4,613.8	5,447.9	5,759.7	6,059.9
VAT	2,358.6	2,475.4	2,780.3	2,832.2	3,286.0	3,476.1	3,659.2
Business Licenses	124.7	150.1	185.3	222.1	258.3	273.3	287.6
Turnover Tax	98.1	122.8	146.5	167.9	326.4	345.3	363.4
Internet Casino	6.6	4.1	0.2	4.0	28.6	30.2	31.8
Debits Tax	17.4	37.7	4.9	-	-	-	-
Service Taxes	85.3	99.2	103.3	105.3	125.0	128.9	132.6
Beer Duty / Excise	322.7	392.0	444.3	400.0	545.7	577.3	607.7
Other	650.1	714.3	861.3	882.3	877.8	928.6	977.5
A6 - Taxes on international trade	2,283.3	2,519.7	2,414.6	2,537.5	3,386.0	3,557.9	3,722.8
Export duty	0.1	-	-	-	-	-	-
Import duty	2,283.3	2,519.7	2,414.6	2,537.5	3,386.0	3,557.9	3,722.8
Import duty breakdown							
beer & wine	*122.8*	*226.5*	*128.2*	*140.0*	*269.7*	*285.2*	*300.3*
tobacco	*288.3*	*349.2*	*231.3*	*380.0*	*366.5*	*377.9*	*388.7*
vehicles	*86.5*	*109.2*	*144.7*	*97.5*	*303.9*	*321.5*	*338.4*
motor spirits	*726.2*	*769.3*	*337.7*	*500.0*	*534.7*	*551.4*	*567.2*
other	*1,059.5*	*1,065.5*	*1,572.7*	*1,420.0*	*1,911.2*	*2,021.8*	*2,128.2*
Non-Tax Revenue (incl grants)	**1,034.4**	**1,619.7**	**2,098.3**	**1,407.0**	**4,183.9**	**4,519.9**	**2,035.3**
A8 - Entrepreneurial & Property Income	235.9	270.4	267.6	430.1	440.9	466.4	490.9
Dividends	101.3	133.2	168.1	205.0	195.0	206.3	217.1
Property Income	68.0	73.4	74.4	140.0	218.8	231.4	243.6
Other	66.6	63.9	25.1	85.1	27.1	28.7	30.2
A9 - Administrative fees and charges	380.2	468.1	565.9	467.7	668.4	707.1	744.3
Households	75.0	81.7	159.9	195.7	191.5	202.6	213.2
Other	305.2	386.4	406.0	272.0	476.9	504.5	531.0
A10 - Other non-tax revenue	20.8	19.8	25.9	31.5	24.5	25.9	27.3
Total Recurrent Revenue	**6,658.4**	**7,380.1**	**7,954.5**	**8,190.6**	**10,527.7**	**11,109.3**	**11,668.8**
as % of GDP			19.7%	18.5%	21.6%	21.0%	20.4%
A13 - Sales of fixed capital assets	16.0	9.9	49.5	0.6	10.5	15.0	15.0
Grants From Abroad	381.5	851.5	1,189.3	477.1	3,039.7	3,305.5	757.8
Project Grants	381.5	615.3	384.5	450.0	2,915.2	3,305.5	757.8
Budget Support	-	236.2	804.8	27.1	124.5	-	
TOTAL REVENUE AND GRANTS	**7,055.9**	**8,241.4**	**9,193.3**	**8,668.3**	**13,577.8**	**14,429.9**	**12,441.6**
as % of GDP			22.8%	19.6%	27.9%	27.3%	21.7%
Gross borrowing	1,536.1	476.1	320.0	1,326.1	620.0	1,715.0	2,303.0
Domestic	1,536.1	476.1	320.0	1,061.1	620.0	1,715.0	2,303.0
External	-	-	-	265.0	-	-	
Sale of financial assets	123.8	-	-	-	-	-	
Principal receipts from lending							
TOTAL RECEIPTS	**8,715.9**	**8,717.5**	**9,513.3**	**9,994.4**	**14,197.8**	**16,144.9**	**14,744.6**
as % of GDP	24.9%	24.5%	23.6%	22.6%	29.2%	30.5%	25.8%

Source: MFEM

1.5.2 OECD Financial Action Task Force (FATF)

The recommendations of the FATF on Vanuatu's offshore financial centre since 2001 have had a relatively minor fiscal impact, but have resulted in the decline of one of Vanuatu's few truly viable value-adding industries.

Vanuatu is one of the only countries in the world to have passed legislation effecting all 42 FATF requirements. Despite this and the absence of blacklisting by the OECD there continues to be unprecedented pressure on the Vanuatu authorities to do more. Initially the Vanuatu Government was told that by having a more robust regulatory regime the country would attract more and better-quality clients. However this has not eventuated and there is a feeling that the real driver behind these changes is a misplaced view in Australia and New Zealand that Vanuatu is a conduit for tax evasion.

Vanuatu is a relatively small tax haven even by Pacific standards, with Samoa and Cook Islands both having a larger client and service base. However Vanuatu seems to be associated with the lower quality elements of the industry. In part this is a misperception – for example many local banks find it hard to clear funds in the US not because of any blacklisting but because it is not in the financial interests of the US banks to undertake the costly due diligence exercises now required post 9/11. In part there is a view that this is part of an overall strategy by the tax authorities in Australia and New Zealand to force the closure of the local industry and impose an income tax regime. Past political misdemeanours on Vanuatu's part have not helped.

Whilst Vanuatu officials were initially willing to address this issue (hence the passing of legislation that even the most ardent external observers regard as excessive) there is a clear risk of a loss of momentum. Australia and New Zealand, key donor partners, seem unwilling to assist in this image-change, leading some civil servants to question the benefits of this strategy.

1.5.3 Expenditure

The coverage of the budget is strong in that it covers all central government operations and also links the recurrent and capital budgets. However, it does not as yet cover quasi-fiscal entities such as state owned enterprises.

By and large budget allocations are consistent with national policies, which is partly a result of the revising of the budget timetable. Historically budget support has been a relatively minor part of the budget. However, much of the capital budget is funded by indirect donor assistance.

The main Government strategy is prudent, being based around a balanced budget and maintaining overall macroeconomic stability. Debt limits have been set at 40 percent of GDP and inflation targeted at around 2.5 to 3 percent.

Having achieved overall fiscal and macroeconomic control, the Government has shifted emphasis towards improved efficiency and value for money, which explains the renewed focus on internal auditing. The development of an internally consistent medium-term development strategy is also a key element of this process. Whilst budget credibility is high because of strong central control, government policy should be further linked to the budget so that money may be directed more effectively towards the efficient delivery of services.

In conjunction with this there is a need to improve the overall planning and implementation of the budget in order to maximise the use of the limited discretionary budget. It could be argued that the recent increase in salaries has essentially removed the available discretionary financing that would otherwise have been available to government as a result of the increase in economic growth. This suggests that the need for better 'quality' expenditure through better analysis of spending and management of fiscal risk will be an increasing priority in the future.

According to the recent Public Expenditure and Financial Accountability (PEFA) assessment[11] funded by the EU the main weaknesses in public financial management relate to: i) the lack of up-to-date information on state enterprises (ii) the tenuous links between the budget and policy; iii) lack of effective external scrutiny and audit and availability of information for public scrutiny; and iv) inadequate information on the totality of donor resources.

Limited scrutiny by external audit, the legislature and public can impact adversely on both strategic resource allocation and efficient service delivery. In particular, a lack of scrutiny may result in a situation where the Government is not held accountable for the allocation and execution of the budget in line with its stated policy. Improved access to financial information, particularly at the community level can assist in improved financial management, particularly in more remote areas, where centralised controls are inappropriate.

Donor support to the Government is significant. Regular meetings between donors and Government, and between donors should further improve resource allocation and efficient service delivery.

By far the main use of Government funds is to pay the salaries of civil servants. In 1998 the salary and wage bill was 49% of recurrent expenditure; by 2009 this is forecast to be 61%. This is high by any standards, although as shown in the chapter on human development it partly reflects Vanuatu's geographical fragmentation and transport difficulties.

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[11]Vanuatu Public Expenditure and Financial Accountability Report, EC, 2006

Table 1.5 Government expenditure by function, 1998-2003

Description	**Expenditure by percentage of total**					
	1998	**1999**	**2000**	**2001**	**2002**	**2003 (preliminary)**
General Public Service	26.14	25.58	26.56	27.35	25.15	24.56
Defence	0.00	0.02	0.01	0.06	0.01	0.03
Public Order and Safety	10.01	9.01	9.36	8.96	10.66	9.99
Economic Affairs	26.96	25.46	22.60	20.48	20.15	21.24
General Economic, Commercial and Labour Affairs	*4.03*	*6.32*	*4.53*	*4.69*	*5.73*	*5.25*
Agriculture, Forestry, Fishing and Hunting	*4.37*	*4.09*	*3.65*	*3.69*	*3.67*	*3.82*
Fuel And Energy	*0.11*	*0.07*	*0.07*	*0.07*	*0.07*	*0.07*
Mining, Manufacturing and Construction	*6.96*	*6.26*	*6.06*	*4.11*	*3.13*	*3.95*
Transport	*9.50*	*7.36*	*6.64*	*6.44*	*6.00*	*6.68*
Communication	*0.95*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Other Industries	*0.11*	*0.26*	*0.30*	*0.32*	*0.39*	*0.36*
R and D Economic Affairs	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Other Economic Affairs	*0.92*	*1.09*	*1.33*	*1.15*	*1.15*	*1.12*
Environmental Protection	0.09	0.39	0.32	0.27	0.28	0.37
Housing And Community Amenities	1.16	1.28	1.25	1.68	1.32	1.21
Health	**11.89**	**12.01**	**12.56**	**12.62**	**12.81**	**12.87**
Recreation, Culture and Religion	0.86	1.64	1.50	1.51	0.91	0.95
Education	**22.39**	**24.45**	**25.68**	**26.83**	**28.56**	**28.84**
Social Protection	0.50	0.17	0.16	0.23	0.15	0.18

Source: DoF

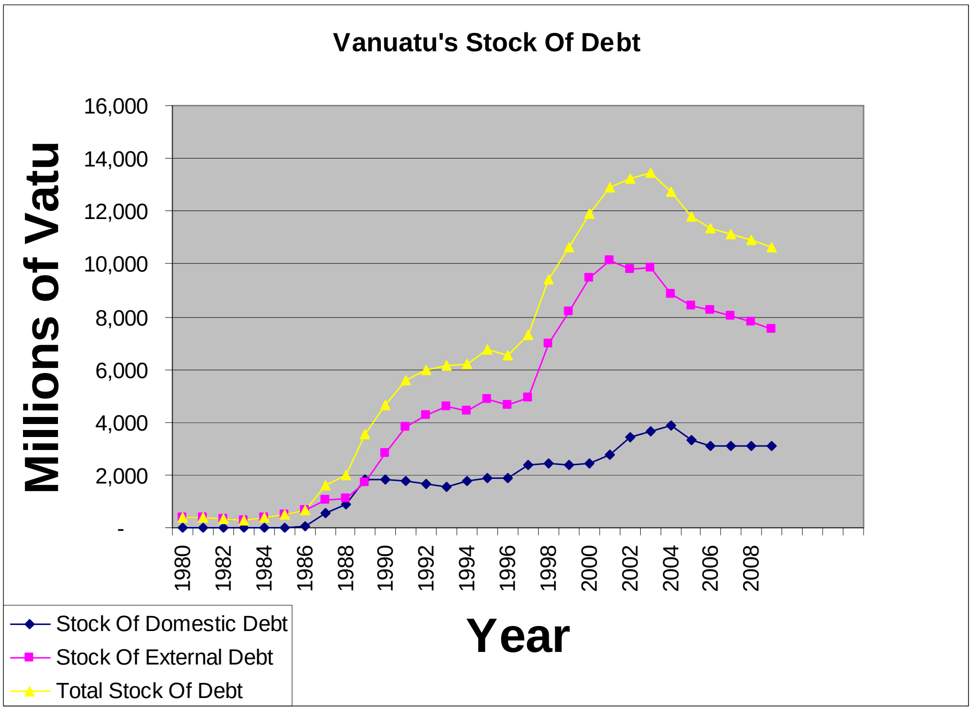
It should be noted that leakage from the budget is small. The distribution of the budget is good and the management of funds according to the recent PEFA[12] assessment is one to which all developing countries might aspire. However, the quality of spending and bias toward the urban and political elite mean that much of the population is neglected. Greater spending in the rural areas without corresponding reductions in Vila may mean that the budget may become tighter after the election in 2008, a situation which will have political and social repercussions.

[12] Vanuatu PEFA July 2006 Ecorys

1.5.4 Debt

External debt increased from 27 percent of GDP in 1997 to approximately 40 percent by 2001; current commitments imply that the debt to GDP ratio is likely to remain at manageable levels for the foreseeable future. Total debt service, comprising repayments of principal and interest, has risen. However, debt levels both as a proportion of GDP and debt service as a share of revenues of the public sector are comfortable to date. Much of the recent rise in external debt, particularly since 1997, comprises concessionary loans from the ADB, the World Bank, and bilateral donors. The large external debt that is denominated in either SDR or USD exposes the Government to exchange rate risks in the longer term, particularly from a devaluation of the Vatu. Whilst Vanuatu does not face a stock of debt constraint, the flow of debt payments will cause slight problems in the medium term due to the increase in external payments combined with the lumpy maturity schedule of domestic liabilities.

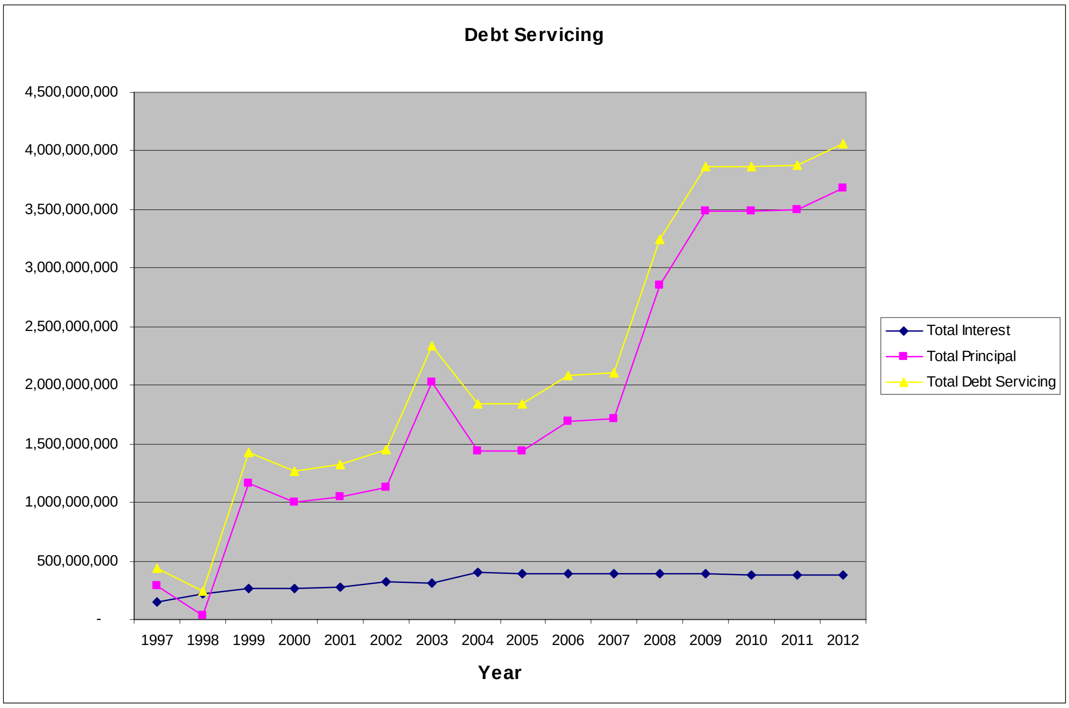
Figure 1.1 Vanuatu's Stock of Debt, 1980-2008



Source: DoF

Debt servicing comprises a larger part of expenditure than has historically been the case, having risen from 2.5% of all payments in 1998 to 14.2% in 2005. Whilst some of this debt is paid by issuing more debt, some has to be retired due to the inefficiencies of the domestic credit market and the fact that external debt from multilateral donors cannot be re-issued. Debt retirement can only come from surplus funds and therefore post-CRP this was the major driver behind the reduction in the budget. The continuing maturing of CRP and other bonds will remain a potentially difficult issue for future governments. However, the data would suggest that the worst of the crisis has potentially passed with the majority of the forthcoming domestic maturities being held by institutions that are likely to want to renew them.

Figure 1.2 Debt Servicing, 1997-2012



Source: DoF
*Note this assumes all maturities converted into one year bonds.

1.6 Monetary Policy

The Reserve Bank of Vanuatu uses an indirect or market-based monetary management approach, fine-tuning the level of balances within the financial system. In so doing the Bank indirectly influences short-term market interest rates and thus regulates monetary conditions.

The main objectives of monetary policy are:

1. Maintaining price stability or keeping a low and sustainable level of inflation;
2. Maintaining a healthy and viable balance of payment position..

The policy instruments used to achieve these dual objectives include use of open market operations, setting and enforcement of reserve requirements for financial institutions, operation of the discount window by the central bank, and setting of interest rates. Given an open capital account and a fixed exchange rate regime[13], the domestic monetary authorities have limited scope for influencing either the domestic money supply or interest rates. The large offshore financial centre and the options for holding foreign currency deposits within domestic banks further reduces the flexibility to use active monetary policy for demand management.

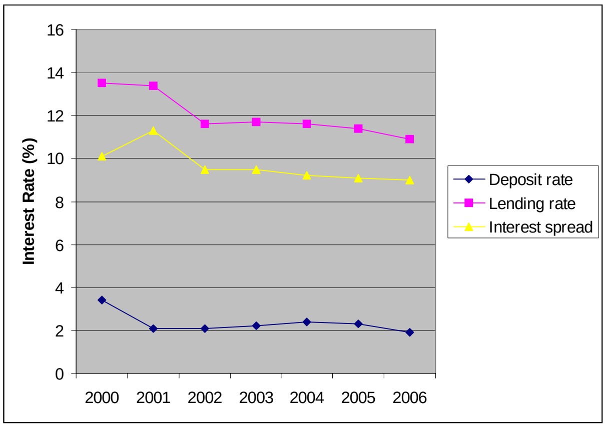
While total liquidity has grown, currency and demand deposits have grown even faster. Quasi-money comprising Vatu and foreign currency denominated time deposits have grown by 28 and 68 percent, respectively. The large increase in M1 is somewhat inconsistent with the low inflation and low growth pre-2003 since it suggests large hoarding of cash. The last is implausible given the sharp rise in foreign currency denominated deposits in the face of slower-growing Vatu time deposits.

Despite excess liquidity with zero-interest rate deposits held by commercial banks at the RBV, interest rates remain high. Access to credit remains a significant constraint to the growth of business. Commercial rates of interest range between 10 and 18 percent. Additional barriers to credit in terms of requirements to hold cash deposits of between 50 and 75 percent of the amount borrowed, and at prevailing interest rates on deposits, raises effective cost of funds in the range of 32 to 60 percent. These high rates of interest together with the presence of excess liquidity in the banking system appear counter-intuitive.

Not only are interest rates reasonably high, but high interest-rate spreads have been a persistent feature of the Vanuatu economy. The spread between the lending interest rate and the deposit rate was 9 percent on average between 2000 and 2006, suggesting that financial institutions perceive the economy as being high risk (this may reflect international banks' assessment of the region, rather than the individual country). It also implies that financial intermediation is not deep. This is borne out by the fact that the cash economy constitutes only about a fifth of GDP.

[13] The Vatu has been pegged since 1988 to an undisclosed transaction-weighted (trade and tourism receipts) basket of currencies of Vanuatu's major trading partners.

Figure1.3 Interest rates, Vatu deposits and loans



Source: IMF

The high interest-rate spreads are a result of a combination of four factors: first, market power of financial institutions; second, presence of country-specific risks as those associated with being unable to repatriate capital abroad; third, exchange rate risks from possible devaluation of the Vatu; and fourth, debtor-specific risks that would be dependent on enforceability of property rights on collateral. Credit provision is costly and debt contracts difficult to enforce. Regulatory controls increase the cost of funds. These require an interest-free statutory reserve deposit (SRD) of 10 percent of total deposits and, for domestically registered banks, a minimum of another 12 percent of total deposits held in RBV notes and/or government securities (as prescribed by the Liquid Asset Ratio or LAR). A detailed analysis of the above risks in the Vanuatu context is long overdue.

The magnitude of exchange rate risk can be gauged by the difference in rates of interest paid by commercial banks to deposits on foreign versus domestic currency; here the Australian dollar is used to proxy the former. Commercial banks have consistently paid higher rates on AUD deposits as compared to Vatu deposits. The difference in these rates has fluctuated from 0.65 to 2.28 percentage points, suggesting a significant premium to holding Vatu deposits. Confirmation can be found in the fact that some retail outlets in Port Vila offer a higher rate on foreign exchange than banks.

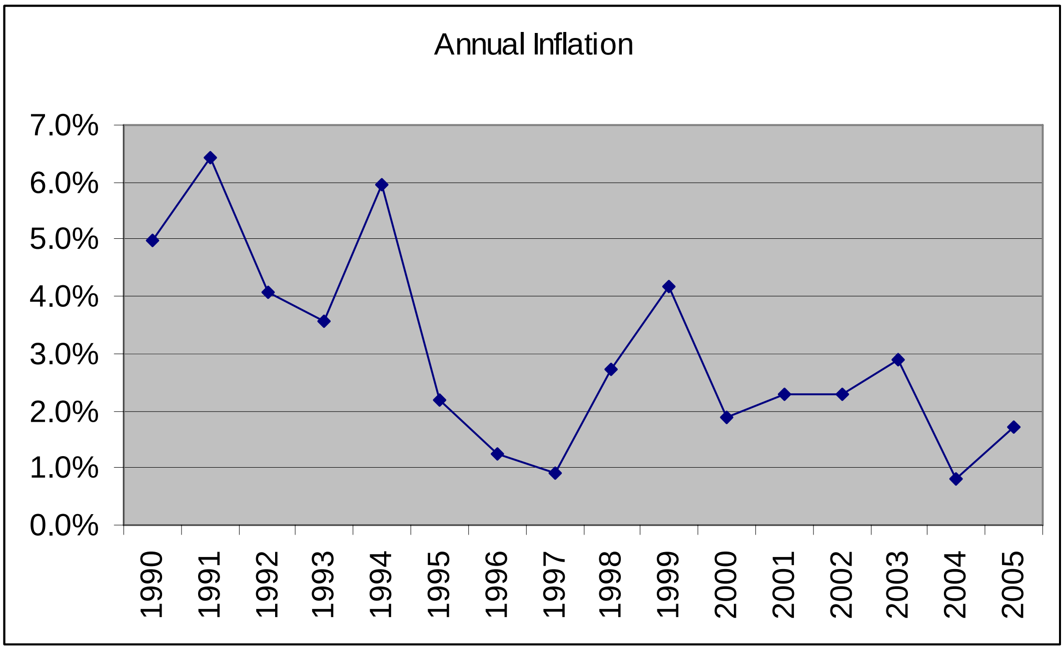
Foreign exchange guidelines were reintroduced on 23 February 2000 to protect the falling foreign reserves that had reached a low of five months of import cover. This initiative has clearly been successful given the return to healthy foreign reserve position. Since 2004 these guidelines were changed as the overall level of foreign currency increased throughout the market.

1.7 Inflation

Vanuatu maintained price stability for much of the 1990s and into the next decade. The real exchange rate has been stable and wages have mostly remained steady, until now.

Inflationary pressures now appear to be picking up. CPI data may be unreliable, and does not entirely correspond with other data such as the implicit GDP price deflator, the nominal money supply or the exchange rate. It is important to note that the CPI basket is based on import weights of urban residents, and hence may not provide a true reflection of the aggregate economy.

Figure 1.4 Annual Inflation, `1990-2005



Source: MFEM

Supply shocks such as those arising from adverse weather conditions, leading to sharp movements in food prices, have had the largest impact on inflation. For example two cyclones, Paula and Sose, hit most of the country in February and April 2001 and disrupted food supplies, causing an increase in food prices that showed up in higher inflation for the year.

Prices for labour are regulated with a legislated minimum wage of VT20,000 per month. This rate is significantly above the rates that prevail in the informal sectors with reports of wage rates offered half the legislated minimum. Employers run the risk of being prosecuted for violating the minimum wage legislation; in such a situation, the legislated wage above the equilibrium level reduces employment. The large number of entrants to the workforce implies that downward pressure on wages will continue for the foreseeable future. The larger businesses and the public sector will continue to abide by the minimum wage legislation, but in the process draw on the better-qualified and skilled labour. The remaining workers will either find employment with lower, albeit, below legislated minimum or be faced without a job. The only means of raising wages and employment simultaneously is by raising productivity of the workers in a market open to international trade. For the former, training is necessary while the latter requires minimal border distortions and adequate transport infrastructure.

Municipal authorities in the Port Vila market set price floors for produce sold there. These controls have hampered quick sales, particularly in periods of excess supply of garden produce. In some cases vendors have gone from house to house in the late hours of the afternoon to sell leftover produce from the day. This negative impact is the direct result of these price controls.

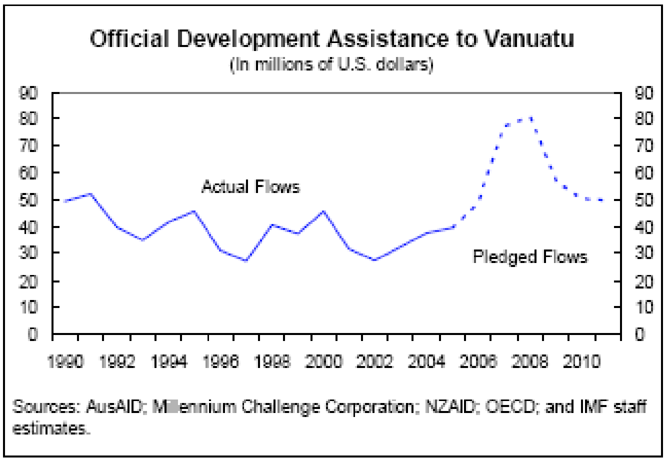
1.8 Impact of Aid

Vanuatu is the sixth-highest recipient of per capita official development assistance among the Least Developed Countries[14]. Aid directly accounts for over 5% of GDP before factoring in multiplier effects. A considerable proportion of aid comes in the form of technical assistance, although it would be desirable to reduce reliance on short-term external technical assistance in a number of particular areas, as in many cases the domestic skills can already be found.

Australia is the largest bilateral donor, accounting for 30 percent of total aid flows since 1990, and up to 50 percent in the last five years. France, New Zealand and Japan are also important, together comprising 40 percent of aid flows[15]. The European Union remains a major donor. More recently China and the United States have recently increased their prominence in Vanuatu, with the Millennium Challenge Account expected to contribute up to $66 million over the next five years for infrastructure projects and the Chinese expected to provide a range of support from budget support to telecommunications infrastructure.

The size of ODA to Vanuatu is forecast to increase rapidly in the near term, as shown by the following figure.

Figure 1.5 Official Development Assistance to Vanuatu 1990-2010



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14 Source: OECD, data downloaded 25/9/2007
15 IMF Article IV Report, 2007

The focus of ODA will have to shift in order to make sure funds directly reach the rural communities (a policy which fits with the findings of the DTIS chapter on human development) or are used to in a manner that minimise the impact on the BOP. This would mean external debt amortisation, direct budget support into rural projects or to pay for other external transactions and also funds being handled by the Central Bank. These efforts will minimise the impact on the exchange rate and inflation – but it is still highly likely that in the medium term prices will rise directly as a consequence of the extra ODA.

Whether or not this has a longer-term impact on underlying structural growth prospects will depend on the effectiveness of the use of the aid as well as government and donor co-ordination.

1.9 Conclusions

The current economic upturn is an opportune time in which to enact measures aimed at improving the macroeconomic environment. Vanuatu's volatile economic history suggests that current high levels of economic growth are unlikely to last, and that prudence now will reap long-term rewards. Finding ways of integrating the informal and subsistence sectors with the formal economy would serve the dual ends of poverty reduction and consumption smoothing. Recommendations on this and the following points are made at the start of the DTIS.

At a time when aid and the wages bill are increasing, a number of improvements to fiscal management are appropriate in order to help maintain macroeconomic stability. Broadening and strengthening the revenue base as well as removing the ability to grant discretionary tariff exemptions would help stabilise government revenues. Government management of ODA could improve. The ratio of salary to overheads is particularly high, a situation which requires review. In addition it would be worth reviewing the full extent of the Government's liabilities and reassessing its position on the state-owned enterprises.

Finally, it would be desirable to pursue a more proactive and coordinated monetary policy, which linked better with fiscal policy. A study on interest-rate spreads could help establish ways of reducing the cost of credit to domestic entrepreneurs and small business people. Improving the quality of data, and training Government officials and others in how to use it would have further benefits for the macroeconomic environment.

2. THE BUSINESS ENVIRONMENT AND INVESTMENT POLICY

2.1 Introduction

Vanuatu's business environment is ranked higher than most LDCs and is one of the most liberal in the Pacific region. Yet a number of improvements are possible. They can perhaps best be achieved not by confronting the most obvious binding constraints, such as geographical isolation and size, but by addressing some less apparent shortcomings which have the potential to complement one another and existing reform efforts. This chapter tries to move the debate forward by outlining the major features of the business environment before discussing improvements to investment policy, services and utilities.

2.2 Overview of policy

The Government is already undertaking a number of steps to revitalise policy towards the business environment.

The Medium Term Strategic Framework (MTSF) is being developed with the assistance of the ADB[16] and support from international donors, particularly AusAID, the EU and NZAID.[17] The DTIS has been designed to fit into this framework. The MTSF will create a basis for setting priorities of sector development plans, corporate plans, departmental budgets and project proposals, involving the following actions:

- Sector development plans will be formulated as medium term development programs, included in revised ministry corporate plans;
- Ministry corporate plans will be revised and expanded to include medium term development plans;
- Departmental budgets, as components of ministerial budgets will be substantially strengthened through the medium term expenditure framework;
- Project proposals will be included within medium term development programs.

The key components of the MTSF include the following:

- The Priorities and Action Agenda (PAA)
- The Comprehensive Reform Program (CRP) Matrix
- The Government Investment Program (GIP)
- The polices and strategic plans of Government ministries and agencies
- Program proposals from ministries/agencies for the GIP presented in revised corporate plans
- Rural Economic Development Initiative (REDI)
- The Business Forum Matrix

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[16] TA No 4362 – VAN; Development of a Medium Term Strategic Framework

[17] AusAID; Governance for Growth Program, and donor support of Vanuatu Education Sector Strategy (VESS) under a Sector Wide Approach (SWAp).

- Aid management and coordination through the Development Cooperation Division (DCD) of the Ministry of Foreign Affairs
- Medium Term Expenditure Framework (MTEF)
- Program implementation, monitoring and implementation

The PAA is an integration and prioritization of the action agendas contained in accepted and ongoing national and provincial programs including the CRP, Business Forum outcomes, and the REDI. The overall objective of the PAA is to link policy and planning with resources and to ensure that the most urgent and important outcomes are achieved in the medium term.[18] The national vision, as stated in the PAA is for "an educated, healthy and wealthy Vanuatu." The challenge is to translate the priority development goals of the PAA into action through implementation which will be achieved through the MTSF process. A selection of relevant development priorities listed in the PAA are as follows:

- Private sector development and employment creation;
- Macroeconomic development and equitable growth;
- Good governance and public sector reform;
- Primary sector development;
- Provision of better basic services, especially in rural areas;
- Education and human resource development;
- Infrastructure and support services.

The Government has identified measures to reduce the costs of doing business in order to create a business environment that is more efficient, competitive and with affordable business support services, including infrastructure and utilities:[19]

1. Ensure the provision of competitively priced, quality infrastructure, utilities and services, either through public enterprises or through private sector partnerships and competition;
2. Encourage the development of competitive private sector involvement in utilities and services;
3. Minimise subsidies for public utilities;
4. Ensure economic infrastructure and support services are available to other sectors.

2.3 The business environment

Vanuatu has a liberal business environment with very few restrictions on investment. As an offshore financial centre, it has no income tax, withholding tax or inheritance tax and no exchange controls. A number of investment incentives and duty exemptions also exist.[20] However several challenges to doing business are commonly identified:

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[18] Draft PAA, Forward, May 2006

[19] TA No 4362 – VAN; Development of a Medium Term Strategic Framework, Figure 2.8, p. 11

[20] A study by the World Economic Processing Zones Association concluded that Vanuatu already possesses all of the advantages that an Export Processing Zone (EPZ) is designed to create. Although

1. Vanuatu's small size and geographical dispersion limit the possibility for economies of scale. Most manufacturing or processing enterprises are very small, inefficient and find it difficult to compete internationally. The agriculture sector is dominated by smallholder operations following the dismantling of plantations toward the end of the colonial period.
2. A lack of competition contributes to costs. The retail sector is dominated by a handful of companies. A similar situation exists in electricity, water and telecoms. Telecoms, until now, have been amongst the most expensive in the world.
3. Vanuatu is a more expensive place to do business than several other countries in the Pacific region. The minimum wage is the highest in Melanesia. Other particular costs are associated with starting a business, delays in registering property, poor access to credit and the cost of enforcing contracts due to court delays.[21]
4. Overall trade policy, particularly SPS standards, is insufficiently co-ordinated or private-sector orientated.
5. Exports remain undiversified. Dependence on commodities like copra and kava renders the economy vulnerable to international price fluctuations. This volatility is exacerbated by the country's vulnerability to natural disasters.
6. A lack of access to credit contributes to the difficulties faced by small-scale indigenous enterprises. The privately-run domestic retail banks are reluctant to lend to local people, who rarely possess useable collateral or a credit history. Interest rates are, for many, prohibitively high.
7. Infrastructure is generally weak. The main tar-sealed road extends only several miles either side of the capital, Port Vila. Wharves are insufficient in number and often inadequate. Access roads to agricultural areas could be improved.
8. The problem of competing claims among custom owners creates difficulties with land tenure for both foreign investors and local businesses.
9. Domestic inter-island trade is limited and boats service some islands only twice a year, due largely to geographical dispersion and high transport costs. The long-term decline of the copra industry has further reduced the incentive for small inter-island traders to visit some of the more remote islands.
10. Geographical isolation and the consequent distance from major markets hampers international trade. International shipping is often said to be limited and unreliable.

Discussions of the business environment and investment policy often take several of these difficulties for granted. But as will be shown later, certain assumptions are unwarranted or require further specification. Smallness in itself may not be an

further measures must clearly be taken to improve the business environment, the argument that an EPZ is inappropriate has now been accepted by many people in government and the business community.

[21] IMF Country Report No. 07/93, March 2007, p. 4.

insurmountable problem.[22] The resulting lack of competition and economies of scale can be tackled through measures such as competition legislation, improving access to land, and diversification into industries like tourism which rely less on production volume.

Point 6, the availability of credit, can be addressed through improving the performance of micro-finance, creating facilities for recording credit history and establishing more financial institutions on the islands.

Infrastructure, point 7, has been comparatively under-resourced, partly because it fell out of favour among donors over the past two decades. Infrastructural improvements, to be addressed under the US-funded Millennium Challenge Account (MCA), have a significant potential impact.[23] But they are not alone sufficient and require accompanying changes, particularly to trade facilitation at the border.

Land ownership is often cited as a major barrier to doing business, but the key issue is not that land must be leased rather than bought freehold. Rather, competing claims among landowners cause some of the biggest problems and must be tackled internally and institutionally. Land is so central to culture and livelihoods that a radical alteration in the form of ownership would cause social and political instability. Further, as shown in the chapter on human development, productivity and scarcity may matter more than form of ownership.

Business people and civil servants often complain about the cost of doing business. But costs are not uniformly high, and a few targeted interventions, such as lowering stevedoring costs, have the potential to reap significant rewards. The World Bank ranks Vanuatu as the 58th easiest place to do business out of 175 countries, which is higher than most LDCs and well ahead of the neighbouring Solomon islands.

Lastly, points 9 and 10 above are perhaps over-emphasised. Vanuatu does not experience substantially higher international transport costs than other Pacific island countries. Unless domestic policy is better co-ordinated and more targeted at private-sector development (point 4 above), there would be little advantage in being closer to major markets. Trade facilitation, particularly SPS measures, is more nebulous and less quantifiable than other more apparently immediate issues. Its current under-prioritisation means it has the potential to achieve some of the highest returns.

It is worth looking at four particular issues – scale, distance, land and ease of doing business – in more depth, since these are the apparent ‘binding constraints’ that receive the most attention.

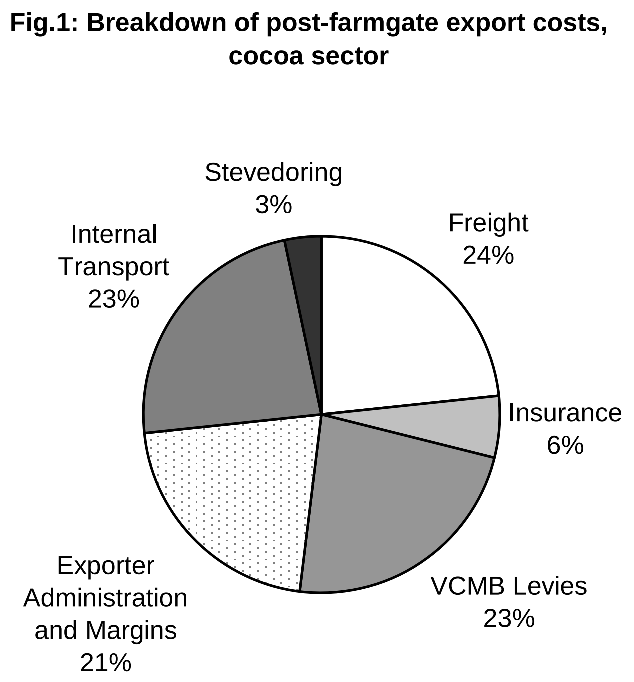
2.3.1 Lack of Scale

[22] Nearly half of the world’s countries have a population of less than 5 million. Over 60 countries are smaller than 1.5 million.

[23] The MCA agreement will provide some USD65M over five years to upgrade selected roads, airstrips, jetties and storage facilities on Efate and other islands. Some 83 percent of total funds will be allocated towards engineering and construction, 9 percent to institutional strengthening for sustainability and maintenance, 6 percent for program administration and audits, and 2 percent for monitoring and evaluation.

Scale is obviously important in large-scale manufacturing industries where unit costs fall rapidly with plant size and output. Yet smallness may matter less for agricultural commodities such as cocoa and copra, where some unit costs – for example the cost of internal transportation and labour costs – vary rather less between large and small countries at a similar level of development. This is not to discount the importance of economies of scale completely, since any export industry requires a sufficient base in order to guarantee markets and be profitable, and agri-processing industries such as coconut oil production depend upon access a large, regular and reliable supply of raw inputs. Nevertheless, it may be that the *relative* importance attributed to lack of scale as a major constraint to export growth is misleading. As the breakdown of the post-farm gate price of cocoa shows in the figure below suggests, some areas influenced by smallness are clearly important, such as domestic and international transport. Other factors – for example charges levied for inspection and assurance of quality standards, or the cost of trade support services such as stevedoring and freight forwarding – that are unrelated to smallness may be just as much an impediment to exports, and may in fact matter more.

Figure 2.1 Breakdown of post-farmgate export costs, cocoa sector

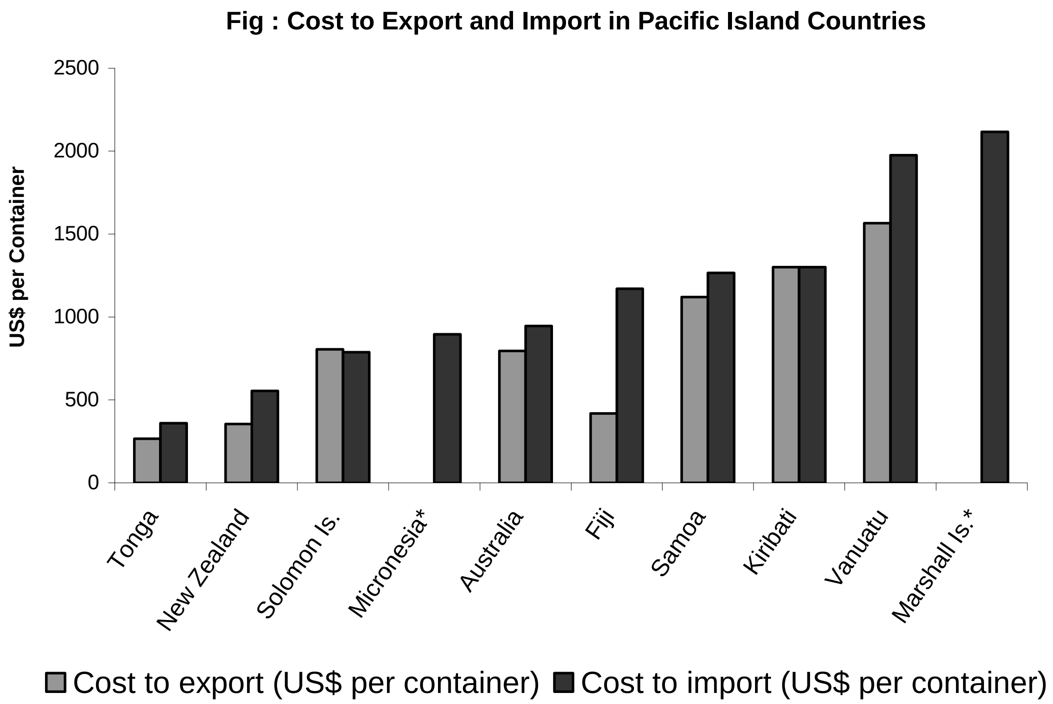


Source: Based on EU/POPACA 2006, p.154

2.3.2 Distance from major markets

The same reasoning can also apply to the idea that Vanuatu is severely constrained by its distance from major markets. Here, while again it is true that the high cost of international transport acts as a significant barrier to trade, freight rates may not vary too greatly between countries competing in the same industry . It may not even matter in terms of transport costs where the export is sent to: according to shipping agents, it does not cost much more to ship from Vanuatu to Rotterdam or Hamburg than it does to ship to Brisbane. Furthermore, indicators from across the Pacific region show that compared to countries that are perhaps even more isolated and distant from markets, such as Kiribati and The Federated States of Micronesia, Vanuatu has noticeably higher overall costs to import and export (see Figure 2.2). This suggests that the actual distance may not be the over-riding factor here, and that again other factors influencing the overall cost may be playing their part, such as port charges and stevedoring.

Figure 2.2 Cost to Export and Import in Pacific Island Countries



Source: World Bank Doing Business Indicators 2006
* Export costs not available

2.3.3 Land

While land disputes are often cited as a particularly difficult issue for businesses, it is only through strong domestic leadership that useful change can occur. This may be time-consuming and at times frustrating for business, but the advantages of fostering national leadership over land policy outweigh the social problems that might occur through rapid, externally-imposed changes to the form of land ownership.

The Ministry of Lands and Natural Resources (MoLNR) has developed a first draft of a "*Review of National Land Registration*". One of the first actions to result will be working with the communities to zone the country, including surveying and mapping. This project will be extensive and costly, yet the Director General of Lands believes that the long-term benefits would far outweigh the initial costs. Land boundaries will be clearly marked with identified customary land owners and with properly registered land titles to minimise the possibility of future land disputes. Further, under the new policy, there will be a nationwide review of how to protect the rights of custom owners and land for development, creating an environment of fairness for both the ni-Vanuatu and the foreign investor.

In addition, MoLNR is currently undertaking an audit of the existing systems and procedures of land registration. The purpose of the audit is to identify the terms and conditions under which leases were transferred. The idea behind this exercise is to ascertain correctly the level of corruption in the registration and approval process.

Challenges

1. Under the existing management system, recording and registration of land is done manually. The Department of Lands still uses manual typewriters and its records have not been computerised, although this situation is changing.

2. The Government is currently in a land dispute on the island of Efate with a community which claims ownership of land occupied by Government for offices and schools. Thus ownership disputes are not just between businesses and landowners, or between *kastom* landowners, but involve the Government, which aims to register and arbitrate between disputes. The MoLNR is also considering compulsorily acquiring the provincial headquarters for each of the six provinces.

3. The Government is keen to streamline the lengthy registration and approval processes involved in land acquisition. This is part of the goal of removing barriers to investment, such as access to land.

2.3.4 Ease of doing business

International comparisons are given in the World Bank's annual *Doing Business* indicators, a survey of 175 economies in ten broad categories. While the data are not without their problems – for example they are based solely on questionnaires submitted by private sector stakeholders and contain certain assumptions about the average business – they do serve as an indicative guide for comparison across countries and across the different categories.

Table 2.1 Vanuatu Doing Business Economy Rankings, 2006

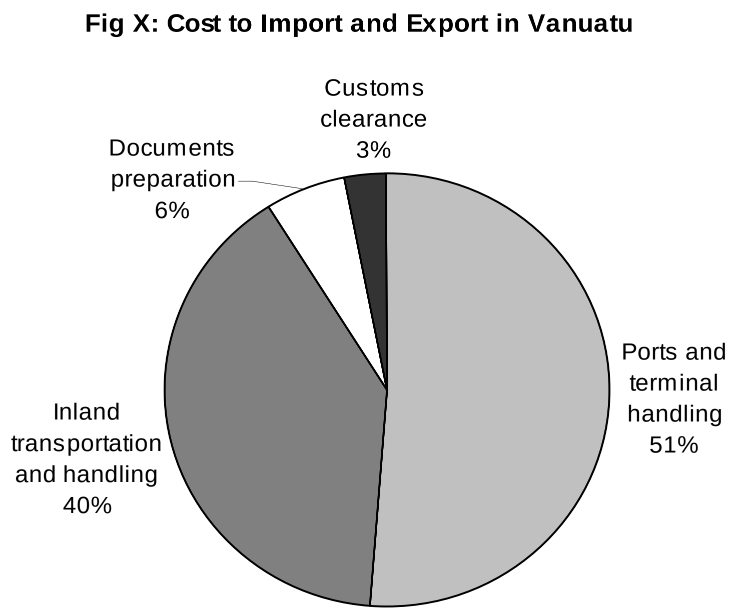
Ease of…	*2006 Rank**

Paying Taxes	19
Dealing with Licenses	33
Closing a Business	45
Protecting Investors	60
Starting a Business	65
Enforcing Contracts	88
Registering Property	91
Employing Workers	96
Getting Credit	117
Trading Across Borders	120
Overall	*58*

Source: World Bank Doing Business Indicators 2006
*Rank out of 175.

The immediately striking thing is that for an LDC Vanuatu scores highly on 'Paying Taxes' at 19th place in the world. But while Vanuatu has a generally good standing as the world's 58th easiest place to do business, it scores badly on 'Getting Credit', a finding which is backed up by the research for the DTIS chapter on human development. The single worst performing area is 'Trading Across Borders', which provides comparative measures of the time, cost, and number of documents needed for import and export. Breaking down the Trading Across Borders heading into its component parts, it becomes clear that the two major reasons for Vanuatu's poor performance overall are high port handling charges and the cost of inter-island shipping.

Figure 2.3 Cost to Import and Export in Vanuatu



Source: World Bank Doing Business Indicators 2006

It is important to note that the above indicators focus solely on costs at the border and do not take into account the whole range of activities that go into facilitating trade, for example in supporting business to reach sanitary and phyto-sanitary standards. In many such areas of trade facilitation objective statistics with which compare countries are limited or do not exist. It is quite possible that Vanuatu would score lower in these areas, and the DTIS chapter on trade facilitation discusses such issues at length.

Nevertheless, the data suggest that targeted interventions in a number of specific areas have the potential to yield substantial gains, which could make a major difference to the ease of doing business. As suggested in the introduction to the DTIS, policy prioritisation is thus the key, rather than a blanket approach. Overall, it is possible to focus too much on the 'binding constraints' that are perceived to characterise Vanuatu's business environment, and in the process to overlook areas of policy change that can achieve major benefits.

2.4 Investment trends and policy

2.4.1 Trends and flows

The level of inward foreign direct investment (FDI) in the past five years has remained very low, peaking in 2004 at USD22 million. The distribution of projects has not been fully consistent with the key investment sectors. While the majority of investments went into favoured activities such as information technology services and tourism, a significant proportion were in low priority areas such as wholesale/retail services and restaurant/takeaway establishments. Very few were in agriculture and export, fisheries, forestry or manufacturing.

The level of inward FDI from 2002 to the third quarter of 2006 averaged USD13.9 million per year, considerably lower than Vanuatu's larger neighbours (as shown in the following table). Investment in Vanuatu picked up after 2002, peaking in 2004 and then declining. Outward investment for Vanuatu over the same period was negligible, averaging around USD1 million a year.

Between 1999 and 2005 an average of only 50 percent of approved projects were implemented.

Table 2.2 Investment Trends, 2002–2006 (in millions of US Dollars)

Country	2002	2003	2004	2005	2006
Vanuatu					
Inward	7	15	22	15	10.3

Outward	1	1	1	1	
Fiji					
Inward	21	26	94	-4	
Outward	1	4	3	10	
Papua New Guinea					
Inward	18	101	26	32	
Outward	-1	-3		6	
Source: UNCTAD, World Investment Report 2006 for 2002-2005; IMF for 2006.					

The primary sources of investment by country of origin in terms of value were Australia, China, New Zealand, France, United Kingdom, other OECD countries and joint ventures.

2.4.2 Investment Policy

The Vanuatu Investment Promotion Authority (VIPA) was established during the Comprehensive Reform Program by the Vanuatu Foreign Investment Promotion Act No. 15 of 1998 to "expeditiously facilitate, promote and foster foreign investment in Vanuatu".

In 2005, the World Bank assisted VIPA in drafting a National Investment Policy statement.[24] Draft policy statements are also being prepared for the provinces. Additionally, a World Bank mission from the Foreign Investment Advisory Service visited in February 2007 to review and benchmark Vanuatu's investment environment, documenting administrative barriers and other obstacles to investment.

No representative of the private sector is required to sit on the board, although occasionally the private sector is invited when external expertise is required. The functions of the board are to receive and appraise investment proposals in accordance with the Act and issue approval certificates to foreign investors. The board meets at least once a month.

The application process is as follows:
1. Completion of application form by applicant and payment of the appropriate fee.
2. Assessment of the application by VIPA staff (criteria are: jobs to be created, reserve list, training plan, police clearance, credit checks, and signed statutory declaration [no prior convictions for serious offences, tax evasion, not declared bankrupt]). VIPA

[24] Government of Vanuatu (March 2005). *National Investment Policy.*

management then recommends the project proposal for approval by the board. Duration can range from one day to four weeks.[25]
3. Board approval or rejection of the application.
4. Certificate of approval is issued.

The selection criteria for investment proposals are governed by the following guidelines:

- Economic activities that are consistent with the priority sectors[26] identified in the Government's investment policy;
- Prohibited investments (Box 3.1);
- Investments reserved for nationals.

Box 3.1. Prohibited Investments

This is a list of banned activities:
- Manufacture of nuclear weapons
- Manufacture of chemical weapons
- Arms manufacture
- Dumping or storage of nuclear waste
- Dumping or storage of toxic chemicals

Source: Vanuatu Investment Promotion Act, No. 15 of 1998.

The certificate of approval entitles the foreign investor to residence permits, work permits, a business licence and a land lease, whichever may apply for the purposes of the project. The board has 14 days to make a decision to approve an investment proposal and advise the investor within seven days after reaching a decision. Foreign investors are encouraged to enter into joint ventures, partnerships and other forms of association with local citizens, although this is not a requirement.

Application fees are between VT15,000 and VT50,000 depending on the size of the investment. In addition to application fees, foreign investors are required to apply for work permits and residence permits for their expatriate staff. The cost of a work permit is VT200,000 annually and a residence permit is VT60,000 per year. Whilst the investment approval process is generally faster-moving and better co-ordinated than in many other LDCs, the reasons behind investment approval or rejection are not always sufficiently transparent or consistent. Vanuatu is concerned to avoid the unsavoury or 'fly-by-night' investors that are often attracted to such a minimally-regulated tax haven. For this reason VIPA does not have an automatic investment approval process. Yet it will remain important that the VIPA board does not use purely discretionary criteria, that it always makes its decisions publicly available and that it accords national treatment to foreign investors.

The VIPA Act offers a range of fiscal and other incentives to attract foreign investors, including

[25] Delays can be caused by Vanuatu Financial Services Commission (VFSC), the registrar of company names, police clearance, signatures of statutory declarations, passport information, negotiation of land, opening a bank account, due diligence tests to ensure against money laundering.
[26] The priority economic sectors are (1) tourism: accommodation, recreational services, inter-island cruises, game fishing and scuba diving, ecotourism; (2) agriculture: plantation/estate agriculture, export crop diversification and expansion, ranching, forestry; (3) fisheries: aquaculture, fish farming, a variety of sea foods; (4) manufacturing: coconut fuel, soft drinks, bread, furniture, clothing. See http://www.investinvanuatu.com.

- No requirement on capital size, but a minimum VT5 million bank balance in a domestic bank;
- Exemptions on import duty for equipment and raw materials;
- No income or company tax[27];
- No exchange controls;
- No tax on capital gains;
- No inheritance tax;
- Tax holiday for three years for investments of VT1 billion or more;
- Work permits for 15 employees; the investor or owner is excluded from this requirement.

The minimum wage is VT20,000 per month. The National Provident Fund contribution is 8 percent of the wage or salary (4 percent by the employer, 4 percent by employee). There is mandatory paid leave of 21 days per year and maternity leave of 12 weeks.

Industrial relations in Vanuatu are generally harmonious. Anti-strike legislation was introduced against picketing and demonstrations following the major strikes of the mid-1990s. The Vanuatu Council of Trade Unions is an umbrella organisation representing five trade unions, mostly public service workers.

For the protection of investments against losses arising from non-commercial risks and fair treatment, Vanuatu has signed Investment Protection and Promotion Agreements (IPPA) with China and the United Kingdom, the latter pending ratification. Bilateral agreements with other countries that are still under consideration include France, Italy, Japan, Australia, New Zealand, New Caledonia, Malaysia and Thailand. It is also a signatory to the International Centre for Settlement of Investment Disputes (ICSID) Convention.

Table 2.3 Investments reserved for ni-Vanuatu nationals

TOURISM
Local tour agent if the annual turnover is less than VT 20 million (USD200,000)
Local tour operator if the investment is less than VT 50 million (USD 500,000)
Commercial cultural feasts (Melanesian, Polynesian, etc.)
Guest houses if the number of beds is less than 50 or less than 10 rooms or annual turnover is less than VT 20 million (USD 200,000)
Bungalows if the annual turnover is less than VT 30 million (USD 300,000)
Hotels and motels if the total value of the investment is less than VT 10 million (USD 100,000) or the annual turnover is less than VT 20 million (USD 200,000)
TRADE
Export of sandalwood in stick and chips form
Local trading of sandalwood
Export of seeds and other minor forest products
Second hand clothing shops

[27] Because of the absence of income tax, Vanuatu has not signed double taxation treaties.

Export of kava in root, chips and stick form
MANUFACTURING
Manufacture of handicrafts and artefacts
SERVICES
Kava bars
Open air vendors
Mobile shops
Door to door sales
Road transport operators – public taxi and bus services
Private security services including security guards
Category F of Business Licence Act No. 19 of 1998 of less than VT 5 million (USD 50,000) turnover per year
Retail shops including general merchandise trading shops where the annual turnover is less than VT 30 million (USD 300,000), excluding specialty shops
Coastal shipping of less than 80 tonnes, excluding vessels used for tourism purposes
Electricians and electro-technicians meeting prescribed standards
Residential building and construction meeting prescribed standards
FISHING
Fishing within archipelagic waters within the meaning of the Maritime Zones Act [CAP 138] and the first six nautical miles of the territorial sea within the meaning of that Act.

Source: Vanuatu Investment Promotion Act, No. 15 of 1998.

The Government's investment policy imposes certain performance requirements on foreign investors. For example, investors are required to employ nationals and to submit a training plan indicating the skills they will transfer to local employees. This localisation policy is overseen by the Labour Department. It is not clear how successful this policy has been, as data do not show what type and level of skills have been acquired, or the length of employment.

The list of reserved investments setting aside for nationals is not assessed frequently enough. One good example is coastal inter-island shipping, where uptake has been marginal because of the high upfront costs involved and lack of credit available. If workable solutions cannot be found, then some of these activities should be opened up so that essential services, especially shipping, could be provided by interested investors.

VIPA is improving its services in a number of areas, including enhancing promotion in key sectors and adopting a more aggressive, targeted marketing approach.

- Funds have been made available to open a provincial office in Santo.
- VIPA has requested a specialist from the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) to develop an investment marketing strategy.
- VIPA has sent proposals to the State Law Office to set up offices and/or place agents in key markets. Work plans for Pacific Islands Trade and Investment Commission (PITIC) offices in Auckland and Sydney have also been developed.

- It has requested extra funds to realise fully the idea of a one-stop-shop.

2.5 Financial Services

Three domestic banks, the National Bank of Vanuatu, ANZ and Westpac, serve the domestic retail market. European Bank serves the offshore sector. Other financial institutions include 12 insurance companies; the Vanuatu National Provident Fund (the Government pension scheme) and a number of micro-credit schemes. Vanuatu also has an offshore financial centre, established in 1971, that provides services in shipping, banking, insurance, trusts and managed funds. The industry is represented by the Vanuatu Financial Centre Association, a private-sector organisation. The Reserve Bank of Vanuatu has authority to license domestic banks, and recently began licensing and regulating the offshore sector.

The financial industry is regulated by the Vanuatu Financial Services Commission (VFSC), the Reserve Bank and the Financial Intelligence Unit (FIU), which monitors irregular financial practices. An overlap of functions means that VFSC and VIPA both engage in regulation and promotion. Separation could be achieved by revising the Companies Act and Bankruptcy Bill and possibly the VIPA Act.

Company registration forms the bulk of the activities of the offshore sector. At the end of 2004 there were 4,464 international companies registered. The shipping register, operated by Vanuatu Maritime Services, had 590 vessels on its books, with annual revenues of around VT150 million. After the Reserve Bank began to regulate the sector the number of offshore banks fell from around 100 in the early 1990s, to 34 banks in 2002, to seven by the end of 2006.[28] There were an estimated 150 trusts and 26 offshore insurers in 2004.

2.5.1 National Bank of Vanuatu

Of the three domestic banks, National Bank of Vanuatu (NBV), a fully Government-owned statutory organisation, has a mandate to cater to ni-Vanuatu clients. The bank was restructured and recapitalised during the Comprehensive Reform Program to operate strictly on commercial terms. The bank is overseen by an independent board of directors and has 21 branches in Malakula, Santo, Tanna, Ambae, Efate, Pentecost and Ambrym. The bank issues micro-finance, loans for small and medium-sized enterprises (SMEs) and standard commercial loans.

The Micro-Finance Product involves loans of up to VT50,000 (USD500) for agricultural and retail purposes for individuals from the remote islands. The rate of interest is 27 percent per year. The collateral used is a pledge from the borrower and a guarantee from the village chief to repay the loan on the terms agreed. If a borrower defaults, then NBV writes off the loss and the entire village is disqualified from receiving loans in the future. The level of arrears for these loans is low and the recovery rate is good, according to the bank. Seven micro-finance officers travel on motorbikes to market and administer this product.

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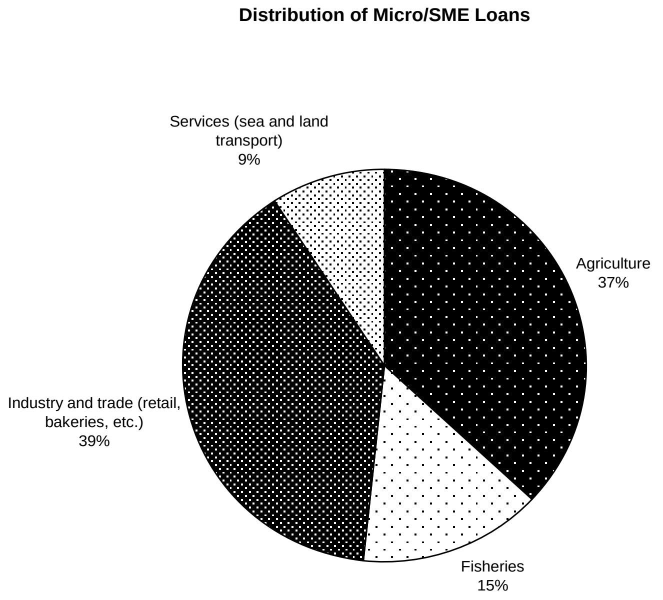
[28] IMF Country Report No. 07/93. March 2007.

SMEs with a turnover of more than VT 30 million make up four-fifths of the bank's SME clients. Accounts are not required for loans to SMEs with a lower turnover, making risk-assessment difficult. Loan recovery has proven problematic. There may be a role for the increased provision of credit to women's groups, since female participation in micro-finance tends to be more successful.

Since the start of micro-finance lending in 2004, 1,060 micro-finance and SME clients have received VT251.6 million in loans. As of December 2006, there were 445 active loans with a value of VT85 million. The distribution of these loans by activity is shown in the following figure, with the majority of micro-finance loans going into industry, retail trade and bakeries, followed by agriculture, fisheries and sea and land transport.

Figure 2.4 Distribution of Micro/SME Loans



Source: National Bank of Vanuatu

NBV's future plans may include privatisation with Government retaining a 49 percent share. The advantages of a merger with a larger foreign multinational bank include access to better credit facilities, IT systems, marketing resources, staff training, correspondent banking and international branches.

To facilitate access to credit for ni-Vanuatu people, the Government is drafting a Secured Transactions Bill. The Bill would allow banks to treat movable assets – such as traditional woven mats, vehicles, machinery and other property – as collateral for the purpose of securing loans. The Asian Development Bank has shown interest in providing technical assistance in this area.

2.5.2 Ni-Vanuatu Small Business Development Fund

The objective is to promote ni-Vanuatu individually owned businesses. The fund was set up in 2001 with a Chinese grant of VT110 million for the revolving fund.[29] The loans are for working capital and equipment in forestry, tourism, agriculture and retail. The loans are either secured or unsecured, depending on the character of the borrower, although preference is given to the employed. Training is provided free of charge to clients, who number approximately 1000.

- Range of loan size: 30,000 to 500,000 vatu
- Duration: 6 to 24 months
- Interest rate: 10 percent per year, fixed

A challenge in this area is that entrepreneurs provide services or goods to family members and friends on credit with the expectation of repayment. However, these debts are often not repaid, putting these businesses at risk of bankruptcy. The recovery rate has been very poor. Again, there may be room for directing a greater proportion of credit towards women or women's groups, where recovery rates tend to be higher.

2.5.3 Cooperative Development Fund

This fund was started in 2001 to promote the development of cooperatives for the ni-Vanuatu. Borrowers have to form a cooperative with a minimum of seven members. For a cooperative to qualify for a loan, it must to be registered under the Cooperative Societies Act and have by-laws and a business plan. The scheme provides free technical assistance and training to help cooperatives meet these requirements.

- Loan size: 250,000 vatu to two million vatu
- Duration: one month to 60 months
- Interest rate: 12 percent per year, fixed

The fund has assisted 56 cooperatives with a total of 23,738 members. The size of individual cooperatives ranges from 20 to over 300. Members subscribe to the cooperative and receive a share for which they earn a dividend at the end of the year. Members are mainly from the rural areas, including subsistence farmers. Management and bookkeeping skills training are offered by nine training officers. Training provided to the rural communities is in Bislama, the local language.

2.5.4 Vanuatu Agriculture Development Bank

There is a proposal to establish an agriculture development bank. According to the Vanuatu Agriculture Development Bank Act No. 20 of 2006, the purpose of the bank is

[29] Out of the VT110 million, VT5 million was given to the Vanuatu Women in Development scheme, a micro-finance scheme set up originally by UNDP, but now under the Chairmanship of the Department of Women's Affairs.

to promote the development of national resources in the agriculture, forestry, fisheries, livestock, manufacturing and tourism sectors. An earlier Vanuatu Development Bank (VDB) failed in 1998 because of politically appointed boards of directors, fraudulent use of funds and mismanagement.[30] To avoid repeating the same mistakes, the new bank should be independent and come under the supervision of the Reserve Bank. Policy inconsistency is evident here in the proposed privatisation of the National Bank alongside the simultaneous launch of a new, state-owned bank. The new bank's purpose is consistent with the priority productive sectors. However, it does not mention transport, and shipping in particular, as being the kinds of activities it will support. Overall, it is not suggested that this area be a priority for support under the DTIS.

2.6 Utilities

2.6.1 Competition Policy

Under the CRP most corporatised and privatised entities moved out of Government jurisdiction, and in effect public monopolies became private monopolies. Limited technical capacity and scant government resources – particularly at a time of budget cuts – meant that effective regulation was always unlikely. The absence of antitrust legislation or meaningful competition has meant that prices for many crucial services, such as water, electricity, telecommunications and transport, remain high. One exception is perhaps the post office, which is now run by New Zealand Post.

The Government is rightly considering the establishment of a regulatory framework together with a statutory agency responsible for enforcement of competition legislation for the utilities sector. The Ministry of Infrastructure and Public Utilities has been working closely with the World Bank to draft a law that will establish a Utility Regulatory Authority (URA). The intention of establishing the URA is to regulate the pricing of electricity, water and telecommunications, and to remove the existing monopoly arrangement with UNELCO and Telecom Vanuatu Limited (TVL). There is a very strong possibility that the Government will liberalise the telecommunications market as several telecommunications service providers are interested in setting up operations in Vanuatu.

However existing concessionary arrangements with utility providers would have to be renegotiated before the market could be opened up to new entrants. Although a fully-fledged competition council to protect consumer interests may be too demanding on existing resources, one option would be to create a smaller body that oversees and enforces competition legislation by drawing on overseas expertise on a case-by-case basis.

Its functions could complement the role of the, Vanuatu Financial Services Commission (VFSC) and the proposed Utility Regulatory Authority (URA), scheduled to start operations soon. It could perform the following functions:

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[30] IMF Country Report No. 07/93. March 2007.

- Promote competition by ensuring that there is free market entry and exit for firms and individuals and prevent monopolies from being formed through mergers and acquisitions, whether openly or clandestinely. Natural monopolies would be exempted from being broken up, for example, post office, railway line, fixed line telephone service for local calls, hydroelectric dams.

- As a legal entity, it could sue and be sued. With this legal authority, it should also prosecute firms that abuse their market dominance or collude with others to unfairly take advantage of the public by setting prices too high, artificially controlling supply (withdrawing a good or service from the market) to create a shortage and influence prices.

- Administer the Price Control Act Cap. 86 to monitor and inspect prices.

- Gather and publish market information on a basket of essential consumer goods and services on a dedicated website to promote information sharing and transparency.

- Receive complaints, investigate and prosecute individuals or firms, both private and public, involved in collusion, price fixing, abuse of market dominance or the sale of expired goods and other dangerous products in violation of consumer protection laws.

- Ensure that Government contracting processes, awards and bids are transparent.

- Report unregistered/unlicensed non-citizen vendors found violating VIPA regulations with respect to reserved investments.

- Form a committee with URA, and VFSC to coordinate and exchange information regarding anti-competitive behaviour and unfair business practices. The committee could also review best practices in an effort to improve its services and use benchmarks to measure success, for example, increased competition, lower prices, improved quality of goods and services, removal of barriers to business activities.

2.6.2 Telecommunications

The Government's policy is to promote user and investor confidence in the sector and create an environment favourable for fair competition at all levels of society. The policy statement makes it possible for the Government to discuss with the current service providers how to introduce competition into the market. The statement also makes allowances for the Government to set up a special fund to be used by the newly established URA. The URA will be able to use this pool of resources to go towards funding telecommunications in rural or neglected areas that are currently not serviced.

TVL owns the infrastructure, including the number of lines, hosts the domain name "*gov.vu*" on behalf of the state, and attends on behalf of the Government all telecommunications conferences at its own cost. It also pays the VT1 million annual subscription fee to the International Telecommunications Union (ITU) on behalf of the Government. In addition, TVL pays the Government an annual dividend. Over the past seven years, the Government received an average dividend of VT48.9 million (USD500,000) per year. The highest dividend that was paid out to the Government was over VT103 million in 2006. It would appear that, given moves to open up the sector, TVL is trying to compensate for the years during which it did not pay a full dividend. This latest payment is well above the Government's annual budget forecast for a TVL dividend of VT65 million per annum.

Table 2.4 Dividend Paid to the Government of Vanuatu in Vatu, 2000 - 2006

Year	Budget Forecast	Actual Dividend Paid
2000	65,000,000	44,687,966
2001	65,000,000	75,333,335
2002	65,000,000	54,122,675
2003	65,000,000	15,341,607
2004	65,000,000	16,325,754
2005	65,000,000	32,754,003
2006	65,000,000	103,397,926
Average over 7 years	**65,000,000**	**48,851,895**
Sources: Government of Vanuatu, TVL		

The telecommunications contract between TVL and the Government is governed by a franchise agreement which will cease in 2012. There is cross-subsidisation of tariffs in Port Vila and Luganville, Santo. TVL is also required to subsidise the costs of telecommunication installation in the rural areas.

Major Challenges to telecoms development

1. The major challenges are infrastructure-related, and include the installation of solar power and network equipment, deployment costs, chartering of helicopters and airlifting/shifting equipment.

2. Land disputes prevent rapid development. TVL takes out 75-year leases to install infrastructure to provide telecommunications services. This adds to costs. TVL also faces difficulties in gaining access to most remote areas. For example, the trip to Hiu Island in the Banks and Torres Group for repair and maintenance work takes about two weeks due to the lack of flights as well as flooding and closure of airstrips.

Figure 2.5 TVL Mobile Phone Coverage Zone

Coverage areas are shaded in pink

3. Aside from weather conditions, transportation in rural areas is unreliable and very costly. TVL also faces the problem of vandalism and theft of its property.

Services

The teledensity of Vanuatu is 10 percent. Fiji, in comparison, has a teledensity of 20 percent.

TVL also offers WiMAX and a wireless service, both of which are prohibitively expensive for most users. TVL provides free dial-up internet services for schools. Broadband, however, incurs 70 percent of the full cost.

International Calls

International calls are very expensive, as shown by the following table.

Table 2.5 Telephone costs per minute, VAT inclusive

	Peak-time	Off-peak
Neighbourhood zone	119	97
Rest of the world	149	117

	00-00	6AM 8PM	00-00
Monday to Saturday	off-peak	**peak time**	Off-peak
Sunday and Public Holidays	Off Peak		

International calls made from a mobile phone are charged with a VT20 - VT40 per minute surcharge, although TVL are reported to be cutting prices.

E-commerce

The Government is in the process of placing much of its routine business on the Internet. This initiative will bypass TVL, using a Government intranet and a PABX system that will link up Government offices in all six provinces.

This e-government initiative will create a gateway for the dissemination of other internet-based services. E-commerce has an immensely positive potential, as it can tackle some of Vanuatu's major disadvantages, such as physical distance from major markets and a fragmented domestic marketplace.

A users' association, the Vanuatu IT Users' Society (VITUS), is working with a number of Government departments to create an information, communication and technology (ICT) policy. The policy, among other things, will have to look at creating an enabling environment for e-commerce, such as fiscal incentives (lower import tariffs on hardware and software), infrastructure (electricity, telephone services, computers, high speed/broadband internet access), computer literacy, human resources (ICT training, retention of IT professionals), and the legal framework (dispute resolution mechanisms, validity of electronic signatures, computer crime and security, privacy issues, intellectual property).[31]

The table below shows the types of infrastructure that TVL has to facilitate e-commerce transactions.

Table 2.6. TVL's capability to support e-commerce

Utilisation of existing satellite infrastructure	Internet technology	Data hosting location	Fibre optic ring within the central business district area	Service Level Agreements
Full back-up redundancy facilities in place 45Mbps capability on bandwidth with ability for extension on request up to 200 Mbps	Latest internet protocol (IP) routing Technology readily available	State-of-the-art at Independence Park	N/A	N/A

Source: TVL

Banks and financial institutions can use these services, although they are not utilised to their full potential. Pacific Data Solutions, a local IT company, is trying to provide this service at a cheaper rate than TVL.

Medium-to-Long Term Plans

TVL is preparing for eventual competition in 2012[32], partly by expanding its services to the rural areas. It is planning to issue 80,000 mobile phones and 7,000 solar panel phone chargers to be distributed to the rural areas through the branches of National Bank of Vanuatu and VANWODS.

Digicell, an Irish multinational telephone company which has operations in the Caribbean, Samoa and PNG, aims to set up operations in Vanuatu. In anticipation of this move, TVL aimed to reduce the cost of SIM cards to VT1,000. The company is also looking at ways to provide alternative power sources to subscribers, that is, solar panels for recharging mobile phones in areas where there is no electricity.

[31] UNCTAD (May 2002). Electronic Commerce Strategies for Development: The Basic Elements of an Enabling Environment for E-Commerce.

[32] The standard telecommunications appendix is included in Vanuatu's GATS schedule of commitments, although the TVL monopoly is guaranteed if Vanuatu accedes before 2012.

Information Technology
Eight companies offer information technology sales and service provision. VITUS delivers services to grassroots users and promotes improvement of IT practices in the IT community. VITUS has been engaging the Government on developing an ICT strategy through an inter-departmental committee and is promoting several other initiatives, such as:

- Lowering tariffs on computer components and spare parts as an incentive to promote local assembly and dissemination of computers. However this is a misguided idea as Vanuatu is unlike ever to compete with low-cost destinations in the assembly of electronics. If anything, promotion of computer usage should be attempted by reducing final tariffs on computers.
- Providing community access to low-cost computers.
- Ensuring that the Utility Regulatory Authority promotes fair business practices in the marketplace and that providers charge uniform prices for their services and do not discriminate against emerging SMEs that want to resell internet-based services.

The Ministry of Education is embarking on a program for implementing the “Vanuatu Education Information Management System (VEIMS)”, funded by the European Union and NZAID, which will be linking all educational institutions across Vanuatu. The vision of VITUS is to work closely with the Ministry of Education to implement the “One Laptop Per Child” policy which is aimed at enhancing the status of children across the globe through the use of internet services. In addition, the Government is setting up its own telephone system and intranet as a way of improving its internal communications and reducing costs.

2.6.3 Water and electricity

Under the existing concession agreement between UNELCO and the Government, UNELCO is responsible for the management of power supply in the municipalities of Port Vila and Luganville under two separate concession agreements. The concession agreement for the supply of electricity for Luganville will end in 2010 and for Port Vila in 2031. In anticipation the Government is proposing to: (a) tender the management out to another management company; (b) renew the existing arrangement with UNELCO; or (c) take over UNELCO and set up an energy corporation. There are plans to use wind power, solar power and a mixture of diesel and bio-fuel.

In an effort to develop infrastructure in the rural areas and the outer islands, the Government has produced a Rural Electrification Master Plan. Donors, including the EU, have contributed substantial funds for rural electrification.

In August 2007, MoLNR was to embark on a large mapping exercise of all the water catchments in Vanuatu in order to ascertain the quality and also identify water sources. The reasoning is that once the country’s water sources are identified, then MoLNR will be able to set policies in place to protect Vanuatu's water resources. UNELCO's water concession expires in 2034.

2.7 Conclusions

Vanuatu is in many ways already a good place to do business, despite oft-expressed frustrations about administrative delays and the slow pace of everyday life. Taxes are low and reasonably simple. The Government appears to be committed to improving the business environment and investment policy. A number of promising initiatives are underway, such as the long-overdue move toward greater competition in telecommunications and utilities as well as other areas of the economy. Land issues remain difficult, but the Government is again tackling the problem. Overall the economic environment is already liberal and further liberalisation may achieve little. Yet problems with excessive bureaucracy remain, and these must be tackled through institutional reform and improved policy coordination.

Domestic complaints about the business environment are often a product of unrealistic comparisons. Reasonable comparators are Papua New Guinea, the Solomon Islands, Fiji or other LDCs – not Australia and New Zealand, countries which are incomparably larger, have a longer independent history and are far more developed. The many small incoming foreign investors may simply have to adjust their perceptions to life in a tiny, isolated and relatively newly-independent LDC, rather than expecting a similar level of efficiency as they would find back home.

A certain amount of fatalism also afflicts discussion, including the argument that the country is too small or far from major markets for substantial development to be possible, or that Government policy is simply too unresponsive ever to be sufficiently orientated toward the private sector.

Yet targeted interventions can achieve significant gains. These include lowering the cost of stevedoring and port charges (a subject which is addressed in more detail in the trade facilitation chapter); addressing the performance of the land titles office; reducing the backlog of court orders; and reassessing the performance of the micro-finance schemes. Access to credit remains particularly problematic for ni-Vanuatu business people. Revamping the National Trade Facilitation Committee should help improve policy co-ordination. Diversification, particularly including further improvements in tourism, will help reduce macroeconomic volatility. General improvements in trade and sectoral policies, the macroeconomic framework and trade facilitation will all benefit the business environment.

3. INSTITUTIONAL FRAMEWORK FOR MAINSTREAMING TRADE

3.1 Introduction

This chapter examines the aspects of the institutional framework for trade mainstreaming that have not been covered in other chapters. Trade mainstreaming refers to the systematic promotion of mutually reinforcing policy actions across government and civil society with a view to supporting agreed development goals. It can occur at the level of policy, institutions and government/donors. The chapter has a particular emphasis on gender, civil society and academia.

3.2 Mainstreaming trade in Vanuatu

One concern in Vanuatu is that trade policy is dispersed among several public sector agencies. Responsibilities often overlap and co-ordination is at times insufficient. Policy can be initiated at the Ministry level mainly through the Department of Trade, Industry and Investment (DTII) but it may include other line ministries such as the Ministry of Agriculture, Forestry and Fisheries and the Reserve Bank of Vanuatu. Other ministries or departments often make policy with major trade-related implications but with minimal input from the DTII and without taking trade policy concerns into account. For example the Ministry of Finance and Economic Management (MFEM) sets import tariff levels without the need to consult the DTII.

The DTII operates only on an advisory level. No other department, or indeed the Minister, is obliged to follow its recommendations. In order to strengthen the current advisory role the Ministry of Trade, it would be worthwhile considering legislative and institutional measures that would further empower the Department. The trade policy chapter of the DTIS suggests amending the Foreign Affairs Act to give the DTII the ability to influence decisions on import tariffs. Revamping and increasing funding for the National Trade Facilitation Committee (NTFC) will further help co-ordinate and mainstream trade policy.

3.2.1 Human resources for policymaking

In such a small country, institutional memory is often short. The departure of key officers to other positions will leave significant gaps in negotiating skills and knowledge. Such is the size of the civil service that a select few individuals can have a considerable impact. The former Director-General of Trade, Mr Georges Maniuri, and the former Director of Trade, Mr Roy Mickey Joy, both stand out as key players in the administration and conduct of domestic and international trade in recent years. The two have over 20 years of experience between them, yet both have recently moved to other positions.

Maniuri was Director-General since the inception of the post in 1997. He is now the Director-General for Foreign Affairs and Commerce. Joy was appointed in 1998 and is one of Vanuatu’s most seasoned diplomats, spending lengthy periods on assignment in Geneva and having been appointed Vanuatu’s Ambassador to the European Commission in May 2007. Joy also led the WTO accession process. He has been particularly successful in obtaining technical assistance and external funding and is responsible for the participation of Vanuatu in the IF.

Moreover, out of Vanuatu's original five-member WTO negotiating team three have now taken up new positions. This means trade negotiating capacity is little better than at the start of accession in 1995. This situation throws doubt on whether such a small and changing administration will ever be able to negotiate effectively with larger countries or regions. It makes all the more sense for Vanuatu to negotiate as a bloc through the MSG and the PIFS. Onus is also placed on in-house training for professional staff, and targeted technical assistance can reap rewards.

3.2.2 External Trade Relations

Some of the functions and responsibilities of the Ministry of Trade and the Ministry of Foreign Affairs overlap, creating difficulties in the coordination and management of trade policy. The Department of Trade is the focal point for the WTO, while the Ministry of Foreign Affairs is the official point of contact for the European Commission, the African, Caribbean and Pacific group of States (ACP), the Melanesian Spearhead Group (MSG), and the Pacific Islands Forum (PIF). On several occasions important notifications have been missed, while the two agencies have not passed information between them. Both departments agree that the international trade component of the Department of Trade should be with the Ministry of Foreign Affairs. Revamping the National Trade Facilitation Committee (NTFC), as suggested in the trade facilitation chapter, will help improve inter-departmental coordination.

The budget allocation for the DTII remains a challenge. The Department's annual budget of VT22 million per annum (approximately USD220,000) has remained almost unchanged in the last five years. As discussed later in the chapter, the budget is lower than either the Department of Women's Affairs or the Chamber of Commerce. Given the increasing importance of the DTII and its impact on all sectors of the economy, serious consideration should be given to increasing its budget.

A staff of 10 manages the trade and industry portfolio. Like in some other departments, the budget goes largely on overheads and salaries, with minimal funds left over for activities. Trade officials tend to devote considerable resources to preparing project proposals for external funding to ensure some of their planned activities are completed.

Since 2002 the department has benefited from the initiative of the Commonwealth Secretariat capacity building program in collaboration with the Overseas Development Institute (ODI) of the United Kingdom, the Pacific Islands Forum, the WTO, United Nations Conference on Trade and Development (UNCTAD), International Trade Centre (ITC), and the World Intellectual Property Organisation (WIPO.

As suggested in the trade policy chapter of the DTIS, it might be worth considering the recruitment of a trade specialist well-versed in multilateral trade negotiations to assist the

Department cope with accession to the WTO. This specialist, or another consultant, might also work on the multilateral trade negotiations taking place with the European Union in the context of the Economic Partnership Agreement (EPA) and the Melanesian Spearhead Group (MSG).

3.3 Gender

The Department of Women's Affairs (DWA) is the Government office that provides advice on gender and women-specific policy advice on issues such as health, child care, nutrition and domestic violence..

Consultation of the DWA in trade policy has occurred, but has been irregular. An officer in the Department of Trade was assigned to incorporate gender issues in the decision making process but this officer was, at the time of writing, on study leave. The issue of women in trade has been given some attention through training programs for women in business and through a small loans facility but in an ad hoc manner.

The budget of the DWA is VT25 million a year, which goes almost exclusively to salaries and operating costs (note that this is slightly higher than the budget for the DTII). Out of this amount VT11.5 million is grant funding. The office has six staff of which one is an administrative officer[33]. From 2004-2006 there was an in-house advisor funded by New Zealand to assist the Department in formulating its work program and to generally assist the Director with discharging their functions.

It is left to the DWA to be proactive in obtaining external funding for capacity building or strengthening its resource base. In the last couple of years the DWA has been involved in establishing an organisational structure, policy statements and work programs on the Convention on the Elimination of all forms of Discrimination Against Women (CEDAW) and the MDG. It has been noted that there has been collaboration with the DTII on business development for women and some training on multilateral trade issues.

In 2004, a taskforce was established known as Women in Political Decision-Making. The taskforce comprised senior women in government, private sector and civil society. It was intended to be a platform where women can channel their various issues and concerns. To date its activities are somewhat unclear. It may be worthwhile to examine whether it can deal with trade issues.

There has been an active drive by the DWA to participate in trade discussions with the trade-related ministries. Equally, representation at trade related committees has been noticed with a representation in the Chamber of Commerce. However, given the lack of resources and the dependence on external funding for its activities, there is a lack of understanding in the department of how the various trade arrangements can be used to benefit women in business whether in the informal or formal sector. The present situation

[33] The number of staff at the DWA is dependent on whether there is an advisor or expert attached to the office.

is ad hoc and reactive. There is a need to strengthen the DWA through its various activities to ensure the greater participation of women in the economy.

The DWA actively supports womens' groups charged with encouraging the participation of women in small and micro businesses as a strategy to address poverty reduction at the village level. The interview with VANWODS provided an insight as how a group which primarily represents disadvantaged women has been able to grow in strength through strong partnerships with the Government umbrella department.

The Vanuatu National Council of Women (VNCW) has a five-year strategic plan which aims, amongst other things, to improve living standards for women. The VNCW is very clear about its role in trade mainstreaming. It seeks greater participation in the discussions of regional and international trade agreements. The VNCW expressed some disappointments with the Trade Department for not fully engaging them in trade discussions but it is generally accepted that this line of communication between them and the Government departments needs to strengthened. The level of understanding of trade issues is rudimentary and therefore some form of basic training of selected trade issues for women in business would be beneficial.

3.4 Local government

Shefa Provincial Council provides an example of the role of local government in mainstreaming trade. Trade has long been a core business of the Council, which under its corporate plan implements national policies and priorities as noted in the PAA and Business Forum. The province implements the Rural Economic Development Initiative (REDI) and follows the set guidelines. Lately the Council developed the Shefa Business Forum Matrix as the overall guideline for its work in all sectors of trade and development. These include tourism, which is the priority, agriculture and fisheries.

There is, however, a need to strengthen linkages with government agencies, NGOs and private sector. Cooperation with the CCI has been good, with business license holders benefiting from the services offered. Some government agencies, however, find it difficult to attend meetings. In the absence of improved cooperation with the Government the Council has mooted employing its own tourism, agriculture, fisheries, land and statisticians.

The Council faces financial and resource constraints which have hindered it from implementing various programs, particularly the community-based initiatives relating to small business development. The Council identified that one major challenge is recruiting a permanent Secretary-General who can provide the political and administrative strength required to effectively converse with high-level central government officials.

The Council has been vocal in informing the Government through various forums that there is a need to strengthen the credit schemes available to rural areas, to establish a fish market in Port Vila and to tackle land management and titles. The Council has also been resourceful in strengthening its own capacity. Already it has entered into various agreements with government agencies to pool resources, establishing dedicated teams on specific issues, such as the Provincial Kava Authority. Most recently the Council entered into a cooperation agreement with New Caledonia to export certain agricultural products to the territory.

3.5 The private sector

In recent years the Government has made more of an effort to consult the private sector, NGOs and civil society as part of its decision-making process. The process of consultation on trade has been driven primarily through annual and biannual summits and conferences. Yet for trade policies to be more effective the private sector, NGOs and civil society need to be more fully engaged on a continuing basis. It must be remembered that none of the three groups is homogeneous, and that each faces their own difficulties. Consultation must therefore occur on a private, individual, face-to-face basis as well as in regular forums. Responsibility also rests with private firms and NGOs to make their views known to Government in a constructive and coherent manner.

3.5.1 The Chamber of Commerce and Industry (CCI)

The CCI in Vanuatu is the focal point for private sector representation. The membership is drawn from the local business community. The office is led by the Managing Director with a team of seven staff charged with monitoring sectors including manufacturing, the services sector, agriculture, retail and hospitality. The functions of the Chamber include research and analysis, skills training for its members, representation on various Government committees, and meetings and workshops. In recent years the Chamber has been vocal on trade policies.

The structure of the Chamber is unique in that members do not pay a fee as is traditionally the case. Rather, the Chamber is fully funded by the Government, receiving 10 percent of business license fees. This situation has created its own set of difficulties because the CCI is therefore accountable to the Trade Minister.

The authority of the CCI comes from the Act of Parliament (The Chamber of Commerce and Industry Act No.4 of 1995, amended 2003). Under the terms of the Act as amended, the Chamber's annual subscription income was to be a percentage of the business license fees received by the Government during the previous fiscal year. Under the Public Finance and Economic Management Act No.6 of 1998, the Government is required to obtain a Parliamentary approval under an appropriation Act before discharging any expense on behalf of the state.[34] As recorded in the annual Chamber of Commerce Annual Report and Financial Statements 2005, the Government allocated VT30 million to the Chamber for 2005[35]. Yet over a number of years the Government has not obtained the requisite parliamentary approval to discharge these funds. The dispute over funding remains outstanding.

[34] 10th Port Vila Chamber of Commerce & Industry Annual Report December 2005 p.20
[35] 10th Port Vila Chamber of Commerce & Industry Annual Report December 2005, p.3

Over the years the Chamber has come to assume some of the functions of the DTII. The duplication of roles can be attributed to a lack of resources in the DTII, but it is also a product of the energies and ambition of the Chamber. At times this has caused some tension between the two agencies.

The funding arrangement of the Chamber with the Government has led to some problems for the Chamber as they are ultimately answerable to the Trade Minister yet at the same time they must represent the interests of private firms. When the Trade Minister placed an import restriction on Fijian biscuits in 2005, the Chamber represented its members, several of whom imported cheaper and better quality biscuits. This created hostility between the Chamber and the office of the Minister.

In order to mainstream trade effectively, it is therefore recommended that the Chamber explore alternative funding arrangements that would reduce political interventions in its operations, as the current precarious position the Chamber finds itself in could hinder its role.

3.6 Civil society

In recent years civil society groups have begun to participate more effectively in the decision-making process, supported by donors. One of the reasons for the withdrawal of Vanuatu accession to the WTO in 2001 at Doha was related to civil society not being involved in the consultation process. There was a clear lack of awareness about the WTO and how Vanuatu was to benefit from membership. The Department set up to administer the Comprehensive Reform Program (CRP) has been instrumental in the inclusion of civil society in the consultative process.

There is no formal or structured framework in place to ensure that civil society is heard. The other side of the coin is the question of each civil society group themselves: who are they representing, what is their mandate and what field do they specialize in? The inclusion of these groups needs to be accorded the value that they can bring to the table. Some of the groups have come together haphazardly and therefore lack a formal organisational structure and a resource base to ensure their sustainability.

3.6.1 Vanuatu Association of Non Government Organisations (VANGO)

VANGO is the national umbrella body for NGOs. VANGO currently has 80 members, including community-based organisations, the Council of Chiefs, international NGOs, religious organisations, rural training centres, schools, small business associations, sports associations, unions and volunteer organisations. VANGO is a non-profit association that aims to strengthen the capacity of its members, to support them in their activities for the benefit of the most disadvantaged people of Vanuatu, to support their growth directly through specific activities or indirectly through collaboration with Government and other international organisations[36].

[36] CICUS World Alliance for Citizenship Participation, Survey of National Association of NGO's/NPO's in Vanuatu, 2006

Services to members are provided through the following focus areas: capacity-building (various training programs); information and communications (resource centre and information system connecting members, and a database of locally skilled consultants); relationship building (facilitate consultations between members, communities, donor agencies, and Government); strengthening of VANGO itself (engaging professional staff, having in place organisation's constitution, policies and procedures, and updated Strategic Plan).

3.7 Academia

Links between national academic institutions and Government are still in their early stages. Vanuatu benefits from two Agricultural Colleges; the Vanuatu Institute of Technology; and the University of the South Pacific's law faculty. These institutions may be capable of generating reports, studies and analysis of trade issues to support and supplement the Government's own resources. However the present situation needs an institutional mechanism to facilitate trade dialogue with academia. Further funding may also be necessary.

Two agricultural colleges play an important role: the Vanuatu Agricultural Research and Training Centre and the recently established Vanuatu Agricultural College.

3.7.1 The Vanuatu Agricultural Research and Training Centre

The Centre was established in 2003 under the Vanuatu Agricultural Research and Technical Centre Act 2002 with the primary function of technical research. The function of the Centre is to:
(i) assist the agricultural, livestock, forestry and fisheries industries;
(ii) further the interests of the Vanuatu agricultural and rural community;
(iii) contribute to the achievement of Vanuatu national objectives;
(iv) any other purpose determined by the Minister.

3.7.2 The Vanuatu Agricultural College

The College was established in 2006 under the Vanuatu Agricultural College Act 2005, although at the time of writing it was not functioning. The purpose of the College is "to be the Centre for the training of farmers and acquisition of farming technologies and skills for enhancing agriculture production and in so doing contributing to the economic and social development of Vanuatu"[37]. Funded by the Chinese Government, the main aim of the college is to show farmers and agriculturalist how to add value to food products. The College is under the direction of Mr Peter Napwatt, a former member of the CCI, who has private sector experience and a history of trade policy work. The College will be expected to work closely with the Department of Agriculture as well as the DTII. The Agricultural College has been funded with one disbursement, unlike other training institutes such as the tourism college, which has received a three-year commitment.

3.7.3 The Vanuatu Institute of Technology (VIT)

[37] Vanuatu Agricultural College Act 2005

The Institute of Technology was established 2002 under the Institute of Technology Act 2001. Under Article three, the purpose of the Institute is to be "the national centre of excellence for technical, vocational and continuing education in Vanuatu, and in so doing to contribute to the economic and social development of Vanuatu". One of the strengths of the Institute is the tourism and hospitality course. Given that Vanuatu's tourism sector is the most vibrant in the services sector, the collaboration with VIT in relation to the needs of the industry is critical to the development of the industry. This function is discussed in more detail in the tourism chapter.

3.7.4 The University of the South Pacific Law School

At present there is very little collaboration between Government and the law school on trade issues. In other countries academic institutions such as law faculties have played an important role in providing Government with technical support in terms of generating reports, research and analysis. In light of the number of trade agreements Vanuatu has signed up to, it is worth considering strengthening the link between the law school and the MTIT and MoFA.

The Law School also produces the Journal of South Pacific Law in which articles relating to economic, social and political issues are published. A review of the articles in the journal reveal little on regional trade agreements or multilateral trade agreements, although this is an area to be encouraged and developed. The Law School could play a more prominent role in trade policy analysis both for Vanuatu and for other countries in the region. Technical support may be appropriate, but any decision on funding or training would have to made in consultation with the Law School.

3.8 Conclusions

The various mechanisms which exist in Vanuatu to mainstream trade are constrained by resources and manpower, not unexpected in a country which has been undergoing structural changes to its economy and various institutions since the implementation of the Comprehensive Reform Program (CRP). The lack of technical expertise to fulfil some of the responsibilities associated with management and administration of international trade is also evident. Where there is a robust system in place, it is often undermined by policy decisions taken unilaterally for political expediency.

The private sector enjoys a well-managed and robust structure in the Chamber of Commerce, although it is not immune to a lack of funding and human resources. Political influence over the operations of the Chamber also exists and there is a need to identify a system whereby external pressures are eliminated. A closer partnership between Government and the private sector in trade mainstreaming can only result in a focused and dedicated commitment to take advantage of the benefits provided by the global trading system.

Civil society groups have been well supported by the Government and donors. The establishment of VANGO as the umbrella organisation to represent civil society organisation means that civil society groups have a well structured system in place to co-ordinate their activities. In terms of their role to mainstream trade, VANGO stands out for their close associations with the rural communities, women's groups, religious affiliated groups and cultural groups. VANGO will serve as the focal point in the dissemination of information as well as to co-ordinate small scale business projects. Civil society groups will continue to be dogged by funding and lack of technical expertise but evidence suggest that donor countries are keen to support a variety of interesting projects from civil society groups.

The academic institutions in Vanuatu have emerged as a strong supportive partner to Government and to the private sector particularly the agricultural colleges. It is envisaged that some exciting programs in processing of agricultural products is planned and this will continue to strengthen and develop in the coming years. The Vanuatu Institute of Technology and the University of the South Pacific's Law School have not yet begun to provide Government with back-up technical support as yet. This is a new area in which the two institutions might consider coming together for their mutual benefit. In particular the Law School can make a contribution in terms of research and analysis on various trade agreements.

4. TRADE POLICY

4.1 Introduction

As in several other LDCs, trade and trade policy have long been seen as peripheral to development. In Vanuatu this is largely because of a post-independence political emphasis on national autonomy. First Prime Minister Walter Lini's 'Melanesian Socialism', drawing on other colonial liberation movements, urged economic independence from former colonial powers. A focus on import substitution industrialisation meant that export development was a secondary goal.

This chapter outlines trade performance and the composition of trade, before discussing the institutional environment for trade policymaking, the trade regime, trade agreements and some implications of Vanuatu's possible graduation from LDC status in 2013. Throughout, the focus is on how to make trade policy more central to overall development policy and therefore to raise the contribution of trade to development.

4.2 Trade performance

Partly as a result of the marginalisation of trade policy, goods exports now comprise an average of 10 percent of GDP, lower than most Melanesian economies and very low for an island economy. Annual goods exports typically outweigh imports by a ratio of three or four to one. Vanuatu has run a visible trade deficit every year since independence in 1980.

4.2.1 Balance of Payments

The persistent goods trade deficit is financed by foreign aid, tourism receipts and foreign direct investment. Indeed, given that FDI inflows and tourism are relatively high and increasing, the persistently low foreign-exchange earnings from goods exports can be considered an important explanation for the country's reliance on foreign aid. One of the main objectives of national economic policy is to achieve 'economic self-determination', and a reduction in dependence on aid is considered desirable. This suggests that an improvement in the export of goods and services is a high priority. In other words, export development can help achieve the country move toward its post-independence goals of self-determination and autonomy.

Table 4.1 Balance of Payments, 2002-07

	2002	2003	2004	2005 (est.)	2006 (proj.)	2007 (proj.)
Current account (million U.S. dollars)	-22.2	-30.0	-23.9	-36.8	-30.9	-55.7
(in percent of GDP)	-9.7	-10.7	-7.3	-10.0	-8.0	-13.2
Of which: tourism exports (in	44.1	52.0	67.4	76.1	88.7	93.5

millions of U.S. dollars)						
Merchandise exports, f.o.b. (in millions of U.S. dollars)	20.1	26.6	38.1	38.1	38.9	40.5
(annual percentage change)	0.7	32.5	43.4	0.0	2.0	4.0
Merchandise imports, f.o.b. (in millions of U.S. dollars)	74.6	86.8	106.8	124.7	140.3	170.9
(annual percentage change)	-4.5	16.4	23.1	16.7	12.5	21.8
Gross official reserves (end of period)						
In millions of U.S. dollars	36.4	44.3	62.1	67.6	99.1	118.9
In months of corresponding imports of goods	5.0	5.2	6.0	5.6	7.2	7.1

Source: IMF 2007

As the table shows, the current account deficit improved from 2003 to 2004 but worsened in 2005. It is expected to have deteriorated to 13.2 percent of GDP in 2007. An improvement in the services sector, inflows of investment income, and official transfers in the next two years are likely to help stem this decline in the current account.

The merchandise trade deficit, however, deteriorated in 2006 and is expected to continue worsening in the coming years, reflecting high oil prices and demand for both consumption and capital project goods, particularly as a result of the projected increase in aid flows. Exports of major export commodities grew in 2005, and a number of proposed agriculture-based projects have the potential to contribute to export growth in the coming years, although not enough to offset the likely rise in imports.

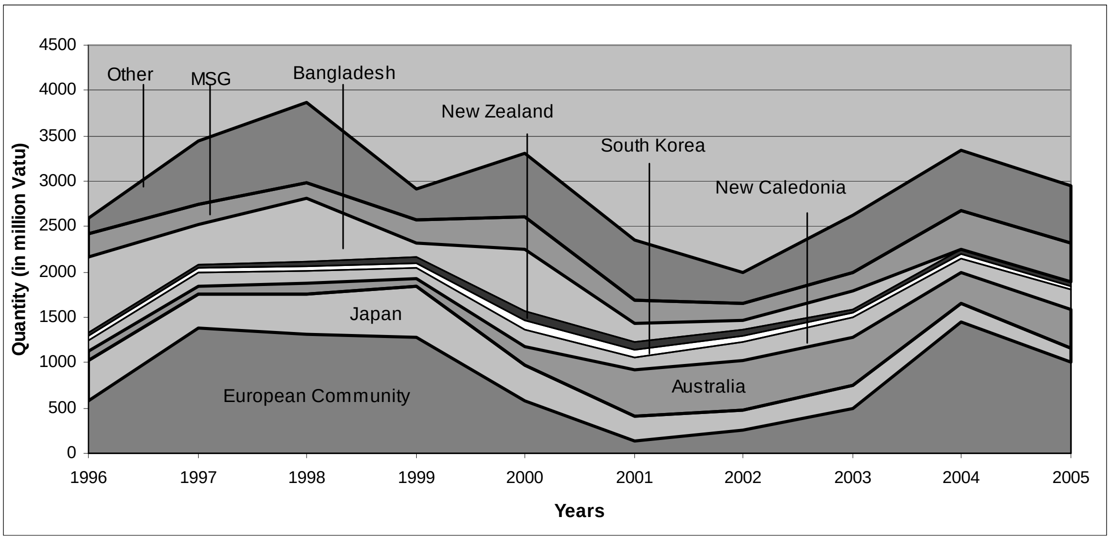
Growth in reserves remains strong and is predicted to rise to 7.1 months of import cover in 2007, the highest level for many years. Again, this is largely a result of rising FDI and an increase in aid flows.

4.2.2 Direction of Trade

Exports

Breaking trade down by country, exports shifted markedly away from the EU, a traditional destination, toward Australia from 1999 onwards. By 2001-2 the EU accounted for only five percent of Vanuatu’s exports. This can be attributed largely to a decline in sales of copra to the EU, but can also be explained by the ban in some European countries of kava-derived products owing to reports of liver-related illnesses. An upturn in copra exports to Europe after 2003 temporarily reversed this trend, although copra exports to Europe again fell after 2004 with general decline in Vanuatu of coconut oil and copra production. Exports of copra to Bangladesh have now ceased. Australia remains a significant destination for exports, along with Japan and to a lesser extent New Caledonia and the Melanesian Spearhead Group (MSG) countries.

Figure 4.1 Export by country grouping, 1996 – 2005



Source: Compiled from 2005 Annual Statistical Indicators (NSO, 2005a)

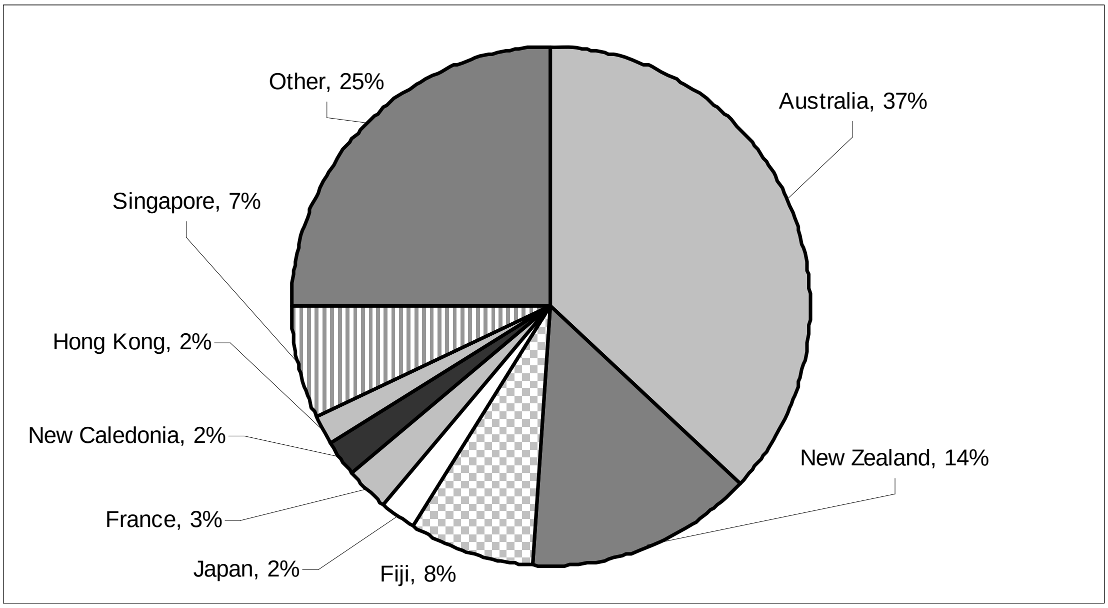
The figure shows that exports are relatively undiversified by country, with a handful of destinations accounting for most exports. This position leaves Vanuatu vulnerable to conditions in a small number of markets. The figure also shows that exports have proven volatile, experiencing a precipitous decline between 1998 and 2002.

Imports

Similarly to exports, Vanuatu's imports from the EU have recently declined. During the last five years the EU accounted for less than ten percent of imports. Australia and New Zealand are becoming increasingly important, and together account for just over half of imports, while other countries, mostly in Asia (although data is limited), account for an increasing proportion of imports.

The figure below shows that Australia (37 percent) and New Zealand (14 percent) are by far Vanuatu's two largest import partners. Again, Vanuatu is reliant on a small number of countries, but overall import growth is more stable than export performance. Notably, New Caledonia accounts for only 2 percent of imports despite being Vanuatu's nearest neighbour.

Figure 4.2 Import by country (percentage)



Source: Compiled from 2005 Annual Statistical Indicators (NSO, 2005a)

Box 4.1: Trade with New Caledonia

Neighbouring New Caledonia is a wealthy French overseas territory with a large market. Until now it has been relatively closed to trade with non-European nations. Pacific Island countries account for around 0.5 percent of New Caledonia's imports and 1.1 percent of exports. France accounts for approximately 40 percent of the territory's imports and 34 percent of exports.

Although there have been past discussions over building between Vanuatu and New Caledonia and there has been a minor recent increase in activity[38], increased bilateral trade would present significant gains for both. Vanuatu is a nearby exporter of agricultural products with cheap labour. New Caledonian producers and consumers face high domestic prices, while the territory's comparative advantage lies in areas other than agriculture – nickel from the northern Goro mine accounts for 90 percent of exports.

The population of the two is roughly the same but per capita income in the French territory, at USD16,750, is approximately 11 times higher than its neighbour. New Caledonia's markets are also large, with GDP of USD4 billion and imports of approximately USD1.8 billion. Even a small slice of this market would represent a

[38] Including an agreement with Shefa Provincial Council to export certain agricultural products to Noumea.

significant gain to Vanuatu, whose annual exports are currently only in the region of USD40 million a year.

The trade policy of New Caledonia aims at developing local agriculture and industry in the face of high local costs. A policy of import substitution is actively pursued and local producers are sheltered behind an extensive array of protective measures.

According to Scollay (2003), a system of non-tariff controls, designed to encourage and protect local production, includes the following measures:

- A complete prohibition on the import of some 200 products, mostly foods and beverages.
- A prohibition on a further 34 imports from sources other than the European Union, including Vanuatu.
- Quotas, decided monthly and annually, on imports from all sources on some 120 products, mainly foods and beverages
- Import quantities for all meats and for potatoes determined by OCEF, an organisation designated as the sole importer of these products.
- Separately, a list of import controls applied on grounds of public health or safety, environmental protection, consumer protection, or technical requirements.

All of the above measures are reviewed annually. Local producers may seek to have new products added to one of the lists of controlled imports.

Scollay states that in addition to import controls the following taxes are levied on imports:

- Customs duties at five rates up to 20 percent. Imports from the European Union, French overseas territories and ACP countries including Vanuatu are exempt. Customs duties yield less than 10 percent of revenue from import taxes.
- A general import tax (TGI) is levied on imports from all sources, including the European Union. Rates range from 4 percent to 31 percent, with a small number of products exempt. TGI makes the biggest single contribution to Government revenue.
- A basic import tax (TBI) is levied at a fixed rate of 5 percent on all imports apart from a small number of specified exceptions (some of which are subject to the tax on airfreight – see below).
- A consumption tax is levied on imported alcohol, tobacco and fuel.
- A tax on airfreight (TFA) is levied at a fixed rate of 8 percent on goods imported by air, except for those goods already subject to TBI.
- The tax for the protection of local production (TCPPL) and the tax for support of agricultural production (TSPA) are levied on imports of goods that are produced locally which are also likely to be subject to one of the import controls listed above.
- Other minor taxes on imports include a motorway tax, a tax on renewable energy tax, and a tax on alcohol and tobacco to assist the health and social

sector.

Revenue from all import taxes yields around a third of total Government tax revenue, a proportion comparable to that of Vanuatu. At present all taxes on goods in New Caledonia are based on imports. There are no taxes on locally-produced goods.

New Caledonia's WTO status

Metropolitan France has ceded responsibility for trade policy to the European Commission. Yet the trade policy of the French overseas territories does not fall within the jurisdiction of the EU, and France therefore also participates directly in the WTO on behalf of its territories. The tariff bindings of the territories are covered by a schedule of concessions compiled in 1952.

Some officials in France and the territories believe that the obligations of the territories relate only to the 1952 schedule and that the territories are not covered by other WTO rules and disciplines. It is unclear whether the bindings cover only customs duties or whether they cover all taxes (such as TGI) within the WTO definition of import duties. If the latter, it is possible that the overall rate of import duty on some New Caledonia products would exceed the WTO tariff bindings.

An alternative view is that the territories are covered by all rules and disciplines applying to WTO members. This interpretation could raise questions as to whether the import prohibitions and import quotas meet WTO obligations. If New Caledonia was considered to be covered by France's GATS commitments, it is also unclear which authority would ensure compliance, given that not all competencies for regulation of all service industries have yet been transferred to all territories.

An application for WTO membership by the territories today would involve the full rigours of the formal accession process, and it is unlikely that the territories would be willing to submit to this.

It might be argued that, as in other markets, Vanuatu cannot produce in sufficient consistency and quality to supply the New Caledonia market. Yet special circumstances apply. Many families are divided between Vanuatu and New Caledonia. Personal links tend to improve trade flows. The New Caledonia market is much nearer than either New Zealand or Australia. To this end, a number of Vanuatu exporters, including Tanna Coffee and Kava Store, have expressed their frustration at the lack of market access.

Formal membership of a trade agreement would be better than ad hoc measures, in order to take advantage of possible future export possibilities. The issue might even be brought up in EPA negotiations. The inclusion of New Caledonia in any trade agreement would be in Vanuatu's interests.

Sources: PriceWaterhouseCoopers; Scollay (2003)

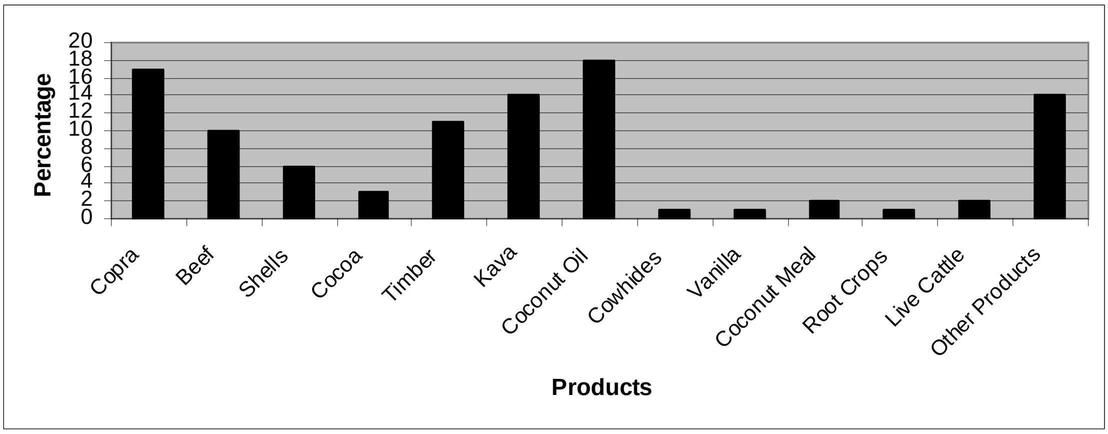
4.2.3 Composition of Trade

Exports

Agriculture comprised 71 percent of total goods exports in 2006. Exports are traditionally driven by copra, which in recent years was increasingly processed into coconut oil until the closure of the coconut oil factory on Espiritu Santo in 2006. Value-adding remains minimal. Only 20% (Coconut Oil 18% and Coconut Meal 2%) of total domestic coconut exports from 2001 to 2005 involved value addition.

Together coconuts account for over a third of exports, as shown in Figure 4.3 (further breakdown of the figures is given in the agriculture chapter). Kava, timber and beef are the next-biggest exports. Other agricultural goods such as trochus shells, cocoa, vanilla and root crops make up the remainder of exports. The production of these cash crops is closely linked to the economic activities of the rural areas, as discussed in the chapters on human development and agriculture. Again, production and export is volatile and undiversified.

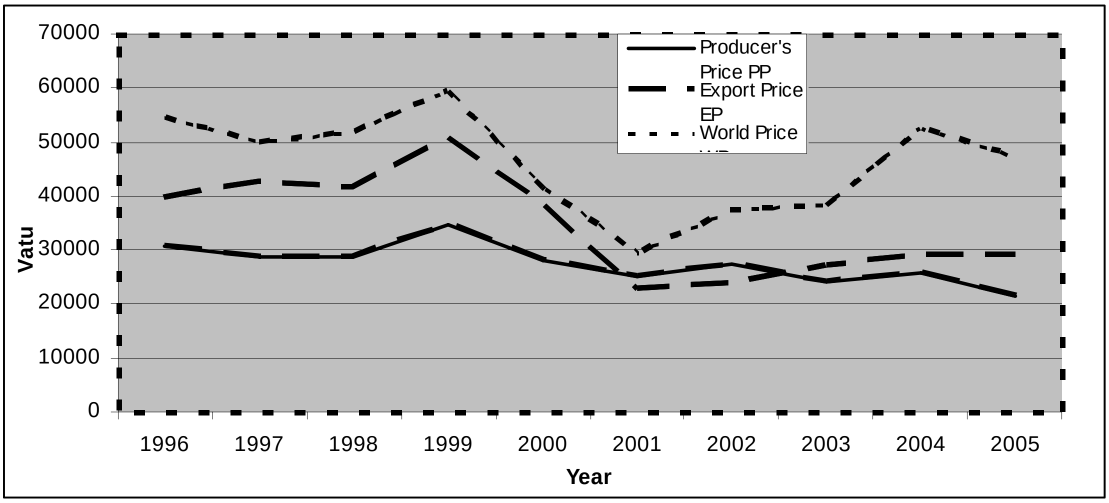
Figure 4.3 Vanuatu Total Export, 2001 – 2005 (in percentage of total exports)



Source: Compiled from 2005 Annual Statistical Indicators (NSO, 2005a).

The following figure shows that the international copra price is volatile, which, as can be seen in the chapter on human development, constitutes a disincentive to cash production. The price has also declined over the last decade. Farmers remain somewhat open to the vagaries of the international market despite domestic attempts to cushion the impact.

Figure 4.4 World price of copra (Vatu)



Source: Compiled from Annual Statistical Indicators 2005 (NSO, 2005a)

Imports

Vanuatu's persistent trade deficit is the result of limited production of products suitable for domestic consumption. The result is that in the cash economy, most consumer products are imported. It should be noted, however, that the traditional economy in effect plays an import substitution role since subsistence reduces the need for the import of consumer goods.

In 2006 the ten major imports by value (million Vatu in brackets) were fuels (207); pharmaceutical products (761); rice (802); household effects (305); motor spirit (272); cement (354); frozen chicken wings (171); liquefied gas (164); prepared and preserved mackerel (59); wheat flour (156). Selected imported agricultural /food items accounted for VT1190 million (USD11 million).

4.2.4 Services

The table lists the sectoral composition of GDP and highlights the growth in the service sector and its contribution to GDP from 2004 to 2005. Although the data is clearly not a record of trade in services, it gives an indication as to the overall importance of services for the economy.

Table 4.2 Sectoral composition and change in GDP at constant (1983) prices, 2004-2005

At constant (1983) prices	Rate of Change (%)		Contribution to change in GDP (%)		Share of GDP (%)	
	2004	2005	2004	2005	2004	2005
Agriculture, Fishing and Forestry	7.2	-1.5	1.4	-0.3	19.7	18.2
Industry	5.4	8.4	0.5	0.8	9.7	9.8
Services	**5.1**	**8.8**	**3.6**	**6.2**	**70.7**	**72.0**

Wholesale and retail trade	***-1.7***	***11.7***	***-0.5***	***3.3***	***28.4***	***29.7***
Hotels and Restaurant	***13.6***	***7.5***	***0.7***	***0.4***	***5.5***	***5.5***
Transport and Communication	***15.5***	***7.6***	***1.5***	***0.8***	***10.4***	***10.5***
Finance and Insurance	***6.3***	***18.7***	***0.5***	***1.5***	***8.0***	***8.9***
Real Estate and Business Services	***17.6***	***10.9***	***1.2***	***0.9***	***7.9***	***8.2***
Government Services	***0.7***	***2.0***	***0.1***	***0.3***	***13.2***	***12.6***
Personal Services	***0.7***	***1.7***	***0.0***	***0.0***	***0.9***	***0.9***
Domestic Services	***4.2***	***4.2***	***0.0***	***0.0***	***0.9***	***0.9***
Gross Domestic Product	5.5	6.8	5.5	6.8	100.0	100.0

Source: (NSO, 2005b)

The table shows that the services sector has grown slightly faster than the overall economy in recent years, contributing 6.2 percentage points of the 6.8 percent growth in GDP during 2005. It now accounts for nearly three-quarters of GDP. The driving forces behind the growth are wholesale and retail trade and finance and insurance. Tourism has contributed considerably to service sector growth in recent years, as is indicated by the rapid growth in the hotel and restaurant trade. Tourism now contributes an estimated 16.6 percent of GDP, according to the South Pacific Tourism Organisation. Further discussion can be found in the tourism chapter of the DTIS.

Rural Vanuatu also experiences out-migration of labour (which is likely to be predominantly male) in search of employment (seasonal and/or permanent) both domestically and abroad. This phenomenon is likely to comprise an increasing proportion of trade in services. In 2006, the Governments of Vanuatu and New Zealand signed a Labour Mobility Scheme that permits workers from Vanuatu to work in New Zealand. This will have a significant impact on the national and household economies. The remittance from labour out-migration will be an additional source of foreign exchange and will boost household income. It is worth noting that remittances, particularly to the rural areas, may give women greater autonomy over household spending. The latter could in turn increase households' ability to access health and education. On the other hand labour out-migration could increase wages and put upward pressure on the Vatu. Both of these processes could negatively affect the competitiveness of Vanuatu's exports. The chapter on trade, poverty and human development discusses labour mobility in greater detail.

4.3 The Department of Trade, Industry and Investment (DTII)

Mainstreaming trade and improving the economic contribution of trade require institutional change. There are signs that now is an opportune moment for such reform. The PAA indicates a change of policy focus, along with the MTEF and the initiation of the IF itself. The Government appears increasingly aware of the importance of trade for economic growth and human development.

The DTII, which is responsible for external trade policy, focuses largely on international trade agreements, particularly the World Trade Organisation (WTO). As suggested below, considerable time and resources have been spent on WTO accession. However the Department exerts limited influence on overall Government policy. WTO membership receives little or no attention at Ministerial level despite trade officials spending considerable time discussing it and attending training courses.

The DTII operates somewhat separately to other departments because of the general peripheralisation of trade, a paradoxical situation given its international focus and presence. The budget is inadequate and covers only basic costs. Visits to the outer islands are rarely practicable under the regular budget, while there is no budget for international travel. It is estimated that 75% of the overheads budget goes towards the cost of telecommunications.

The international policy focus of the Department of Trade comes at the expense of export promotion, largely as a result of the considerable funding provided by international organisations for technical assistance and training. Yet, as will be seen below, Vanuatu's main economic challenge is to build supply-side capacity rather than to secure or increase the size of access to international markets. This is not to suggest that international trade agreements are unimportant (indeed SPS and other measures are critical), but that export development has received a relatively low priority until now.

Given that the Department already has an inbuilt focus on trade agreements, it is proposed that it be moved to the Ministry of Foreign Affairs (an idea that was mooted in 2004/5) and given a mandate to administer international trade policy. The existing Ministry of Trade, Industry and Tourism (MTIT) could then be charged with the normal duties of a Ministry of Commerce, including export promotion. This move should be conducted for the following reasons:

- International affairs are increasingly a matter of trade policy as well as political relations;
- The Ministry of Foreign Affairs is better-funded and generally closer to everyday Government operations than the Ministry of Trade;
- There is a more natural fit with commerce and export promotion in the existing MTIT (which encompasses the offices dealing with the productive sectors: the Vanuatu Investment Promotion Authority; Chamber of Commerce; Department of Co-operatives; Ni-Vanuatu Business Centre and the National Tourism Development Office);
- Moving the DTII would clarify its relative responsibilities versus the MTIT;
- Staff changes in the DTII make it an opportune time to conduct such a move.

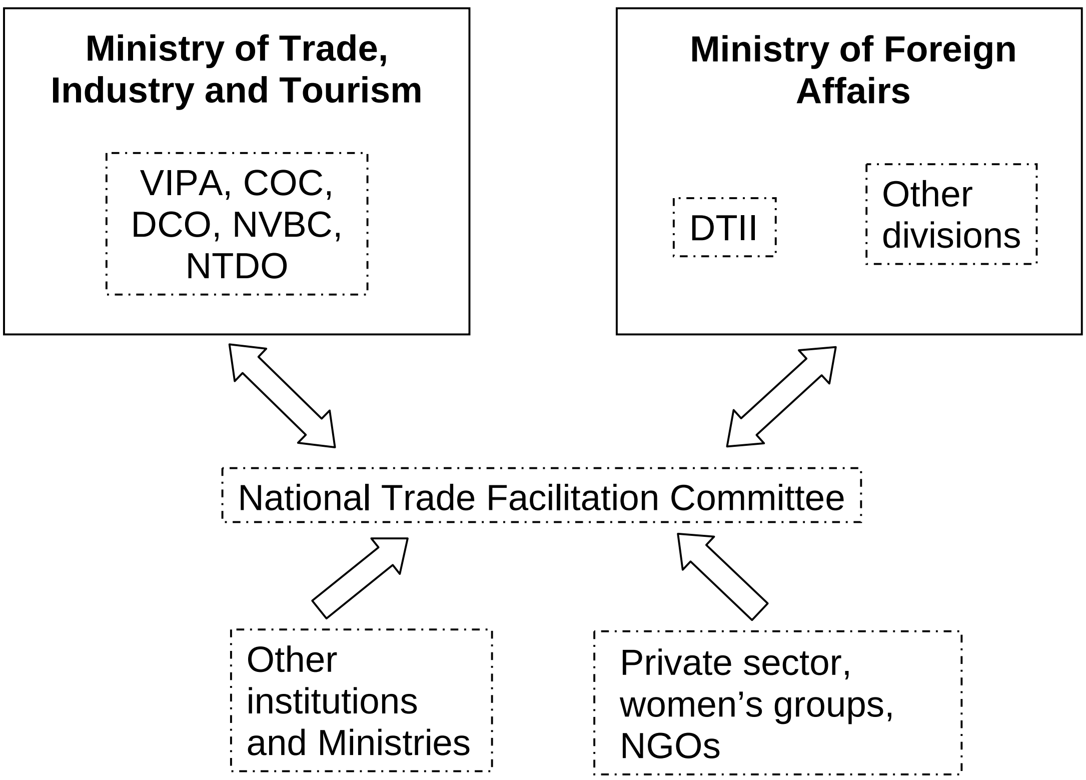
The Ministry of Foreign Affairs would then become the Ministry of Foreign Affairs and External Trade (a similar move has recently been made in the Solomon Islands. In Fiji the Department of Trade has long been part of the Ministry of Foreign Affairs). The existing Ministry of Trade would be able to operate effectively as the Ministry of Commerce, putting policy for the productive sectors under one department.

A potential disadvantage of the proposal is that it would separate the DTII from the departments dealing with the productive sectors, arguably leading to greater mismatch between trade and overall policy for the productive sectors. Yet interaction between these departments is already limited, and to mitigate any such possible outcome it is proposed that the NTFC be revamped and funded as a forum within which to co-ordinate export development. Specialisation between the MTIT and DTII would improve the division of labour.

A further advantage of moving external trade policy to the Ministry of Foreign Affairs would be that the existing Foreign Affairs Act could be altered to make it necessary for the Minister of Finance to consult the DTII on trade-related tax changes, which have until now been made largely for revenue-related rather than economic reasons. This would eliminate the need for the introduction of a separate Trade or Commerce Act, a move which has been discussed. Such a move might still be considered, depending on political will.

When a consensus has been built on WTO membership, resources can be moved into appropriate areas. Overall, these moves would help mainstream trade within the development process.

Figure 4.5 Suggested structure of MTIT and MFA



Finally, Vanuatu has no trade policy. The DTII, in conjunction with the NTFC, might consider adopting a trade policy based on the DTIS (with appropriate amendments).[39] Crucially, the policy must retain its concentration on building export potential and developing the supply side, signalling a move away from the limited and unsuccessful import substitution industrialisation that has operated hitherto. Science, technology and innovation should be central. It should also include agricultural SPS standards (see the chapter on trade facilitation). The policy crucially needs to be owned and generated by all relevant national policymakers and politicians rather than just being a formal document. The risk remains (as with the original WTO accession) that outsiders with little knowledge of the domestic environment will prepare "cut and paste" policy for Vanuatu which may at a later date be rejected once the Government is made aware of its implications. This trade policy should involve all relevant arms of Government, with a view to mainstreaming trade in the policymaking process.

4.4 Trade regime

The trade regime is relatively open, and any business can import or export goods as long as it has a business license and meets the relevant sectoral requirements. Exports face a limited number of restrictions for environmental reasons. Exports of eels and live fish attract a 10 percent export duty, while there is a quota on some forestry products.

4.4.1 Legislation

Two pieces of legislation administered by the Ministry of Trade, Industry and Commerce (MTIT) have at the same time been used – with increasing frequency – to impose more fundamental restrictions on the flow of trade.

The first of these is the Vanuatu Commodities Marketing Board Act, which is discussed at length in the agriculture chapter.

The second is the Import of Goods (Control) Act, under which the Minister of Trade has the authority to restrict imports using quota, bans and import licenses of any good for the purpose of "protecting and stimulating local industry". Over the last few years the Act has been used to protect a number of Vanuatu's local industries, usually with poor results:

- In 2004, a ban on imported iron roofing sheets was lifted only after a school in Eton Village complained that after raising the money to buy a new roof, they suddenly found they had to pay twice as much for the local product.

- In 2004, imported whole chickens were banned in order to protect the local supplier, Toa Farms. The ban was lifted and replaced by a tariff in May 2005 after local sellers and restaurants complained that Toa Enterprises could not meet local demand, resulting in shortages in the market.

[39] There is also a proposal for the EU-ACP TradeCom facility to develop a trade policy.

- In 2004 and again in 2005, the expatriate owner of a small cracker factory in Santo successfully lobbied the Government to ban rival Fijian "Breakfast Crackers".

In the latter case, the action by the Vanuatu Government was deemed to have broken the MSG Free Trade Agreement, which in line with most trade agreements included commitments against the use of quantitative imports. After Fijian authorities had made several unsuccessful attempts at settling the dispute through mediation with the Vanuatu Government, Fiji took retaliatory action in mid-2005 in the form of a reciprocal ban on kava exports from Vanuatu. While the Vanuatu domestic cracker market was worth only VT20 million per year, the market for Vanuatu kava in Fiji at the time had grown to VT350 million. Furthermore, local consumers started complaining about the inferior quality of the Vanuatu-produced crackers. After several months of mounting pressure, the Minister agreed to lift the cracker ban, only to immediately replace it under the same Act with a restrictive quota, prompting Fiji again to threaten retaliation. The issue was finally resolved after 16 months in late 2005 when quantitative restrictions were removed, and normal trading relations resumed. The action put a severe strain on the MSG-Free Trade Agreement within the first months of full operation and lost Vanuatu's farmers many millions of vatu in lost kava revenue.

There is an urgent need now to update the Import Control Act to reflect modern trade practices, and the Department of Trade have already carried out an assessment in this regard (see box). The need for reform springs not just because of the outdated method of applying bans and quotas, but also because in its current form Vanuatu's trade legislation contains a number of important gaps, such as simple safeguard measures, or regulation of consumer standards, which Vanuatu may need or should be looking to develop in the future.

In some ways the habitual use of protective discretionary powers can partly be seen as a result of the failure to develop a modern trade policy and a role for the Ministry of Trade. It is worth noting that apart from the ability to negotiate trade agreements, the only current formal powers of the Minister of Trade are vested in essentially protectionist pieces of legislation: the Import Control Act, the VCMB Act, and the reserved industry list of the VIPA Act. By contrast there is no competition law, regulation of commercial standards or consumer protection.

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Box 4.2: Weaknesses of the current Import of Goods (Control) Act

The DTII has carried out its own internal review of the Import Control Act, and has listed at least ten negative consequences:

1. Import restrictions and quotas for protection protect are – except in special circumstances – not allowed under modern trade agreements and can quickly lead to disputes which threaten trading and diplomatic relationships.
2. Currently the Act contains no criteria for deciding which industries should be given protection, or for how long. In addition there are no provisions for the Minister to

make public his or her reasons for granting protection, resulting in a lack of transparency.
3. The current provisions of the Act are unlikely to achieve their objective of stimulating sustainable local industries in the long run. Restricting imports means that industries do not face competition and therefore lack the incentive to become more efficient and self-reliant. Tariffs are a better option in this regard, as they can be gradually reduced over time.
4. The Act makes no mention of the essential need to consult our trading partners about the protective measures we apply.
5. The Government loses duty revenue from bans and quotas, compared with protective tariffs.
6. Bans and quotas are extremely difficult for Customs to enforce, and in the past the Government has been exposed to potentially costly legal action by protected local companies because imports have entered Vanuatu illegally.
7. Bans and quotas restrict consumer choice. Protected companies often lack the capacity to fill the gap in the local market, resulting in product shortages. Tariff protection solves this problem by keeping trade open, but at the same time still giving a high protective barrier to local companies.
8. The current Act creates uncertainty for businesses, and stand in contrast to the Government's current emphasis on promoting a stable business environment.
9. Over the last few years, the Department of Trade's work plans have been regularly disrupted as officers have been forced to deal with the consequences of such import bans.
10. The Act is weak in the area of granting Ministers the power to stop imports of dangerous or undesirable goods, or those which do not meet Vanuatu consumer standards, since it makes reference only to "stimulating local industry". This may however be covered in other legislation, such as that governing Quarantine procedures.

Source: DTII

4.4.2 Duty Exemptions System

The Department of Customs and Inland Revenue (DCIR) administers a duty exemptions system which consists of the granting of full or partial exemptions on duty, excise and VAT for a wide range of approved economic activities. The system is also used for administering standard duty relief on items for personal use and diplomatic privileges.

The exemptions system has already come under scrutiny in several previous studies of Vanuatu's trade and business environment. Looking at the broad allocation of exemptions from a trade policy perspective, Gay (2005) found that the most duty was waived in areas – such as import-substituting manufacturing – that did not feature in those mentioned by the Government as priority sectors or activities. Hence there was an inconsistency in what the Government was stating to be its priority policy goals, and what it was doing with its main instrument of industrial policy.

In the manufacturing sector, the exemption scheme has become closely linked with trade policy and tariffs, effectively providing another instrument that the Government can use to give support to local businesses. Following recent declines in protective tariff rates under the MSG Trade Agreement, DCIR has faced pressure from some producers to extend exemptions to some products that were not previously included, such as fuel. This has the overall effect of simply transferring the burden from consumers (through falling tariffs) to taxpayers, in order to support industries that are clearly unsustainable in the long run.

Following work done on the Castalia (2004), attention has also focused on the specific exemption granted to the country's monopoly electricity producer UNELCO, which is the single biggest beneficiary of the system. In effect the duty relief given to UNELCO on the diesel it uses to generate electricity acts as a subsidy on the consumption of electricity in the urban areas of Port Vila and Santo, a disincentive against investing in alternatives to diesel, and also significantly privileges the company over businesses or households which might choose to run their own generators.

In a 'Review of the Tax Structure and Investment Environment in Vanuatu', Millar (2003) also examined the system from a policy and procedural perspective, highlighting the lack of criteria for exempted activities, the unnecessary categories of activity and the discretionary nature of the system. A number of changes to improve the efficiency of the system were proposed.

What has not been addressed so far, however, and what is striking about the exemptions system from a trade facilitation point of view, is the administrative burden it places on customs officials, senior management in an array of Government departments, as well as the businesses who apply.

Procedures for applying for exemptions are unnecessarily complex. For example in order to obtain an exemption under one of the sector-specific headings – industrial, mining, tourism, fisheries or agricultural – the procedure is the following:

- Visit the relevant sector ministry or department where payment of a fee for an exemption form is required;
- Answer detailed questions on the nature of the business, number of staff, and so on – with forms often running to six or seven pages;
- Obtain the approval and signature of the relevant sector director, who assesses the application usually based on a points scoring system. The information provided on forms should in theory be verified at the time, although this is seldom done, creating opportunities for fraud;
- Submit the approved form to DCIR, with the Director of Customs carrying out a further assessment to decide whether or not to grant the exemption.

There are also separate procedures for dealing with personal allowances, although DCIR has witnessed growing fraud in this area, with such goods frequently appearing later for sale in shops in Port Vila. In a recent response to this problem, DCIR found it necessary to obtain signed letters from every person importing consignments of goods attesting to their intended use, effectively adding another piece of paperwork to the process.

Currently, each department (agriculture, fisheries, livestock, forestry, tourism, health, public utilities) grants its own exemptions for Customs to approve. There is a need to avoid duplication and promote transparency.

Until recently, the Director of Custom's decision on exemptions was final. However, an amendment in 2007 has given applicants the right to lodge an appeal with the Minister of Finance. The new system does not stipulate any circumstances for which this right can be exercised, beyond an importer disagreeing with the decision of the Director of Customs. In effect therefore, it places the power to grant duty relief in the hands of the Minister. This is likely to compound existing inefficiencies in the system, and greatly increase the discretionary element.

In addition to the administrative burden of applying for and assessing exemptions, a major problem with the exemption system is fraud and checking for compliance. There are inherent difficulties in checking *ex post* whether exempted products are being used for their purpose as stated at the time of exemption. There are also no clear regulations or guidelines for investigating and controlling potential fraud within the exemption system.

In total the senior management of the customs department estimate that dealing with company and individual exemptions takes up some 60 to 70 percent of their time in meetings and paperwork. If this is an accurate assessment, it would imply that senior management in DCIR spend more time concentrating on giving tax away than on developing policy to collect it. It is a waste to be concentrating resources on an inefficient exemptions system as opposed to other functions such as border inspections.

Box 4.3: Exemptions on Cars for International Meetings

While there are numerous examples of the often counterproductive nature of the exemptions system in Vanuatu, this is exemplified most clearly by the inefficient practice of new cars being imported duty-free by Government for major high-level regional meetings, and then being sold on barely-used to private dealers once the meeting is over.

Here, there would appear to be no clear rationale for the exemption to be granted in the first place, and indeed it may even be cheaper to rent cars on such occasions then to lose the revenue. The end result of this practice is simply to give a significant tax break to a few wealthy, as well as a small windfall to the car industry, which may not pass on the full duty reduction to consumers.

The duty lost from, for example, 15 cars brought in such a way for a single meeting would be roughly equal to three times the total duty exemption granted to the entire agriculture sector in one year.

Given the need for a substantial review of this area of customs and trade facilitation, a number of reform options for the exemptions system exist. These can be summarised as:

1. Removal of all non-essential exemptions. This would have a number of benefits: it is relatively simple to carry out, would result in a better allocation of resources across the economy, and would free up customs time for other trade facilitation activities, for example increasing manpower for inspections. It would also free up time for the other Government offices that also currently consume time administering the system.

2. Removal of certain less important and less relevant exemptions: this would retain the use of exemptions as an instrument to boost some key areas of the economy (such as inter-island shipping) and align the exemptions system better with Government's priorities. It could also cut the need for compliance monitoring significantly by focusing attention on fewer areas. Millar (2003) has already done some work on which exemptions could be removed without significant impact in terms of Government policy.

Table 4.3: Sensitivity of Government Revenue to General Tariff Rate Cuts on Frequently Exempted Items

Estimated revenue Loss from dropping tariff to zero	Number of tariff lines	Percentage of all lines on which exemptions are given
Less than VT 10,000	229	19%
Between VT10,000 and VT50,000	151	12%
Between VT50,000 and VT100,000	132	11%
Between VT 100,000 and VT200,000	144	12%
Between VT 200,000 and VT1m	333	27%
More than 1,000,000	230	19%

Source*:* Author's estimates, based on 2005 data from DCIR; indicative only

3. Reform of tariffs to reduce the amount of unnecessary claims for exemptions: there are currently a number of products where it may be better simply to reduce tariffs to zero than to continue to administer exemptions for a single business or a few importers. These are products on which all or virtually all the duty collected on them in a year is refunded through exemptions – effectively creating an unnecessary and costly 'paper chase'

between DCIR and importers. The table above gives a preliminary indication, based on data for one year, of the usefulness of exemptions at the tariff line level, though further work on the exemptions data is required.

4. Restricting and tightening limits for exemptions: this would involve setting annual quotas per applicant on amounts of duty exempted, or number of duty-exempted goods imported (e.g. only one car per year). While this may help in reducing fraud, this would create further administrative complications however, in an already complex system.

5. Increased post-exemption audit: this may help to increase compliance over the long term if penalties for contraventions are sufficiently tough and convictions sufficiently cost-effective. In addition, the audit system itself would require a substantial amount of resources.

6. Greater transparency of exemptions procedures: this would include publishing clearer criteria for the granting of exemptions, guidelines on how forms are assessed, as well as annual data breakdowns of amounts exempted from duty across various sectors and types of businesses benefiting. Regular analysis of the costs and benefits of the system would also be useful, with comparisons between amounts of exemptions granted and general applied tariff rates.

Given that the necessary comprehensive reform of the exemptions system may be difficult at this time, it is likely that a combination of these options would be more practical for the Government to achieve in the short run.

4.5 Multilateral/ regional trade agreements

The textbook case for trade liberalisation is that it allows countries to concentrate on their comparative advantage. Unilateral tariff reductions reduce the 'deadweight loss', resulting in a more efficient allocation of resources and an increase in consumer and producer surplus (dynamic gains are also possible). According to this argument, Vanuatu should not adopt a mercantilist attitude to international trade. The primary objective of trade is to import necessary goods and services, rather than to export.

In Vanuatu, however, as in many other countries, the practical reality is nuanced. The retail and wholesale sectors suffer from highly imperfect competition, so any price reduction due to lower tariffs is unlikely to be passed on to consumers. Instead it would probably be appropriated by one of the several large importers, a number of which are understood to reinvest a substantial proportion of earnings overseas. Rapid trade liberalisation may thus at least temporarily weaken the balance of payments. It may also fail to achieve the expected progressive effect of a reduction in consumer taxation.

The fiscal regime is also inflexible, making it difficult for Government to capture any additional surplus through other forms of taxation. The absence of income tax means that Government depends on import duties for a significant proportion of revenues, and that the DCIR already struggles to administer and collect existing tax revenues. A vulnerable revenue position leaves little room for the major fiscal changes that would result from significant and rapid tariff reductions with Vanuatu's major trading partners. Converting tariffs to excise tax would incur significant administrative and compliance costs.

As pointed out in the chapter on human development, many of the institutional pre-requisites to take advantage of trade liberalisation do not exist. These include a certain level of human development; competition policy; investment in infrastructure; and a pro-poor growth policy. These ingredients help ensure that trade liberalization translates into economic growth and poverty reduction. Until now, partly because of Government human resource constraints and the substantial amount of international assistance for training, dialogue over trade policy has largely revolved around international trade agreements. Yet in Vanuatu the major obstacle to increased trade is not the volume of market access but the limited development of the supply side.

Ultimately tariff reduction may best be achieved on a timescale with which Vanuatu can cope (such as under the WTO, PICTA and the MSG-FTA), and with accompanying institutional changes, rather than according to a schedule influenced significantly by trading partners that have an interest in improved market access to the Pacific region. It is also important that Vanuatu retain the policy space to be able to promote the selected areas in which it has an actual or potential comparative advantage, such as tourism, food processing, fisheries and other agricultural products. This does not necessarily mean retaining high industrial tariffs for protective purposes in a large number of areas – indeed it is recommended that the Government reduce existing tariffs aimed at protecting the inefficient domestic light industries. Yet studies such as Biggs (2007) have shown that LDCs and other developing countries must be permitted space within which to sensibly develop a selected number of industries. Vanuatu's long-term economic future does not lie with the export of copra, among the lowest-cost of any commodity traded on international markets.

4.5.1 Economic Partnership Agreement (EPA)

Following the establishment of an interim EPA agreement, Vanuatu must continue to engage with the EPA process. Policy space is important, meaning the maintenance of an acceptable import regime, including tariffs. Vanuatu must ensure that its productive interests are represented, including the fisheries sector, beef and fruit and vegetables, particularly at a time when the Integrated Framework is urging a renewed effort to develop the productive sector and when the EU is seeking greater access to Pacific fisheries. Although Vanuatu will at least in the meantime retain duty and quota-free access to the European Union along the lines of the Everything but Arms (EBA) initiative, it may suffer preference erosion as developing countries gain improved market access for their own exports. And following its expected graduation from LDC status it may lose EBA preferences. A bilateral – reciprocal – agreement to ensure access to the New Caledonia market would make sense if no deal is reached on the current EPA negotiations.

But depending on what happens in forthcoming negotiations, it is possible that Vanuatu and other Pacific states would have to begin reducing some tariffs on imports from the EU. A more likely scenario is that, on signing up a trade in goods agreement, Pacific

Islands will begin by binding their tariffs at current rates for a set period of time, before a schedule of tariff reductions starts at some later date. However it makes sense to adopt a cautious approach.

While imports from the EU are currently minimal it will be important for Vanuatu to be aware of the possible precedent that an EPA trade in goods agreement may have for a future agreement with Australia and New Zealand under the Pacific Agreement on Closer Economic Relations (PACER). Ideally within an EPA with the EU, negotiations will therefore lead to:

- Long transition and adjustment periods, given Vanuatu's unique reliance amongst Pacific Island Countries on tariff revenues;
- Flexibility with regard to coverage of tariff lines;
- Support in the form of technical assistance to adjust to new taxation system;
- Supports for existing regional integration efforts, by providing sufficient time for any positive 'trade creation' effects of the MSG and PICTA trade agreements to take effect (while balancing against negative 'trade diversion' effects).

It is worth pointing out that from an administrative and trade facilitation point of view there is a strong rationale for having the same schedule of tariff reductions, covering the same goods, for both the EPA and PACER agreements. This would prevent a situation in which every year the DCIR had to update several different schedules, and more importantly avoid Customs having to administer and monitor possible fraud when there are several different possible duty rates at the border. This highlights again the need for coordination and balance between trade facilitation and broader trade policy goals.

A recent report by the Economic and Social Commission for Asia and the Pacific (ESCAP) Pacific Operations Centre, based in Fiji, estimates the total potential costs of adjustment to a regional EPA with the EU over a five-year period to be €170 million. Initially, many Forum countries thought that the EU would compensate for this loss via the provision of greater aid or direct budgetary support – however recently the EU indicated that it prefers to use the EDF 10 (its regular aid program) to help the Pacific islands to manage these effects. However, the EDF 10 program does not have sufficiently larger new funds (EU estimates it will need about an additional €50 million for the whole region) to meet these needs.

The newly-established diplomatic presence in Brussels may be useful in helping establish regular direct consultation in conjunction with other Pacific island states with the European Commission. The recommendation to relocate the Department of Trade to Foreign Affairs and to increase resources for the National Trade Facilitation Committee will assist with these objectives.

4.5.2 World Trade Organisation (WTO)

Much has been written about Vanuatu's WTO accession, including Grynberg and Joy (2001), Hayashi (2003) and Gay (2005). Vanuatu would have been the first LDC to join the WTO and would therefore have set a precedent for other LDC accessions, so it is understandable that so much attention has been focused on its case (Nepal and Cambodia have since joined and Samoa is close to acceding).

Vanuatu began its attempt to join the WTO in 1995 and completed negotiations with members of the working party during subsequent years. In 2001, just before the Doha Ministerial conference when Vanuatu was due to accede, the Minister of Trade withdrew a finalised working party report, citing ‘technical reasons’. During subsequent years little progress was made towards accession, although in 2004 Vanuatu began another attempt to accede by attempting to again discuss its GATS schedule, in particular health, education, environmental services and audiovisual services. Under the original WTO schedule of tariff concessions all bound rates were above applied rates (and remain so), meaning that WTO accession would have no immediate implications for tariff rates.

Since then Vanuatu’s WTO accession has remained in limbo. Vanuatu may wish to consider re-establishing its desire to accede to the WTO. As mentioned above, considerable time and effort is expended on WTO ‘capacity-building’ and training, perhaps with diminishing returns. While political will appears to be lacking and little progress is being made towards accession, there is little point in the DTII diverting limited resources to WTO issues.

By staying outside the WTO Vanuatu carries all of the costs of WTO accession with few of the benefits, which for a small nation can be substantial. They include the benefits of multilateralism over regionalism and a voice in international negotiations. Participation in the small economies working group would enable Vanuatu proactively to communicate its interests. As pointed out in the chapter on trade facilitation, Vanuatu stands to benefit from improved trade facilitation (TF) measures. GATS issues are also being treated in a more development-friendly manner. Membership of the WTO would also ensure that Vanuatu benefits from the capacity-building assistance that is built into the GATS and TF negotiations and potential new agreements. In addition, on aid for trade and the standards facility, Vanuatu will be able to participate in the discussions and decision-making as a full member. This is not to say that Vanuatu should join the WTO on any terms; successful membership would be about discussing appropriate conditions with members of the working party, and indeed some flexibility should be expected from developed-country members of the working party, particularly in light of the decision on the accession of LDCs adopted by the WTO General Council on 10 December 2002.[40]

It is suggested that Vanuatu start to rebuild a national consensus on WTO accession, using the DTIS validation workshop as an initial platform. The UNDP, as lead agency for the Vanuatu IF, is willing to help facilitate the process of building a national consensus. Problems with the initial accession process stemmed largely from a lack of national ownership and understanding at the political and the public levels. Several entities which opposed WTO accession were unable to transmit their concerns and hence campaigned against accession at a late stage. The opportunity must exist for critics to make their voice

[40] Document WT/L/508 recommends that “WTO members shall exercise restraint in seeking concessions and commitments on trade in goods and services from acceding LDCs, taking into account the levels of concessions and commitments undertaken by existing WTO LDCs’ members”. It allows acceding LDCs to take advantage of special and differential treatment, streamlines the accession process and improves access to technical assistance and capacity-building.

heard, whilst politicians must be briefed regularly. Successful accession is likely to be achieved not simply as a technical process between civil servants and international partners; rather it requires popular participation and active political backing. The National Trade Facilitation Committee, with the DTII playing a central role, should be tasked with building consensus on the WTO (which may require amendments to its ToR). This will involve at least three processes:

1. Awareness-building among civil society, via the media, NGOs and at public meetings. This should involve training sessions tailored to the national context.

2. The establishment of a systematic mechanism for briefing politicians.

3. Whilst Vanuatu has narrowed down its areas of concern mainly to the services sector, and the entire accession package does not need to be renegotiated, it would still be worth conducting further consultations, particularly on services, in order to establish national ownership. Consultations should be:

(a) on a one-to-one basis aimed at determining private views; and,

(b) on a national basis aimed at establishing a national position.

These may be combined with activities in 1. above. In Vanuatu's consensual cultural environment it is often imagined that 'consultation' means that all demands can be realised. However certain interests may be incompatible – such as those of some NGOs and some companies. Strong political leadership will be required if these interests cannot be reconciled - and in the end some demands may not be accommodated.

4.5.3 Pacific Island Countries Trade Agreement (PICTA)

Tariff reductions under PICTA began in 2007, after the agreement entered into force in 2003. Under the agreement, which includes 14 of the countries of the Pacific Island Forum Secretariat (Australia and New Zealand are excluded), tariffs on goods imports from Pacific island countries will hit zero by 2021. PICTA goods are defined as those with 40% local content. Provision exists for a negative list of sensitive industries.

In Vanuatu goods traded under PICTA, however, are mostly already covered by the Melanesian Spearhead Group Free Trade Area (MSG-FTA) (see below), so any trade creation or diversion effects due to PICTA itself are limited. Services are not included. Taxes on alcohol and tobacco and other specific duties are similarly excluded.

4.5.4 Pacific Agreement on Closer Economic Relations (PACER)

At the time of writing Vanuatu was not a member of PACER. The Government had signed the agreement but had not deposited the instruments of ratification with the Pacific Islands Forum Secretariat. Australia and New Zealand were likely to trigger Article 6 of PACER in August 2007, which would oblige members to start consultations over a free-trade area with the two countries. Vanuatu currently has duty and quota-free access into Australia and New Zealand under the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA).

Vanuatu must continue to monitor the potential costs and benefits of PACER membership, ensuring that the maintenance of policy space remains paramount. As time progresses the advantages of PACER will become clearer – for example there is a provision for potential temporary movement of natural persons into Australia. Under the Pacific Plan the regional trade facilitation program may also hold advantages for Vanuatu above and beyond the existing Guest Worker program with New Zealand. Further analysis before completing the PACER ratification process would help identify the costs and benefits and lead to a more informed decision.

4.5.5 Melanesian Spearhead Group Free Trade Area (MSG-FTA)

Under the agreement all duties have already been eliminated among members (Papua New Guinea, the Solomon Islands, Vanuatu and Fiji) except for a small number of 'negative list' products that are more sensitive, and in which ultimately most trade in the short run is likely to take place. Tariffs on these items are set to decline to zero in 2015 as set out in the table below.

Table 4.4 MSG-FTA Tariff Reduction Schedule, sensitive imports

Year	Maximum duty rate for sensitive items for Fiji, PNG and Solomon Islands	Maximum duty rate on sensitive items for Vanuatu
2005	20%	35%
2006	18%	30%
2007	16%	25%
2008	14%	20%
2009	12%	15%
2010	10%	10%
2011	8%	8%
2012	6%	6%
2013	4%	4%
2014	2%	2%
2015	0%	0%

Source: Draft 2004 MSG Trade Agreement

There is an intention to extend the agreement to services (although GATS commitments under WTO membership may render such a move less relevant). Problems already exist with enforcement, and some countries have already violated their tariff reduction commitments. Instances of trade diversion have occurred, with the import of tinned meat from Papua New Guinea displacing Australian imports. MSG rules of origin require only a “change in tariff classification at the 4-digit HS level”, which means that the meat merely had to be repackaged to qualify as a Papua New Guinea product.

The main advantage of the MSG appears to be political. Intra-regional co-operation has increased as a result of the MSG-FTA and a secretariat has been established in Port Vila. The MSG has the potential to act as a regional bloc independently from other regional organisations. The New Caledonia Kanak party is an observer at the MSG. As suggested above, continued engagement of New Caledonia would be strongly in Vanuatu’s interests.

4.6 LDC graduation

Vanuatu may be scheduled to graduate from LDC status in 2013, assuming that the current rates of growth in human development and per capita GDP are maintained, and that Vanuatu’s low vulnerability score does not deteriorate to the extent that it outweighs any gains in the other two criteria. Graduation from LDC status may affect the privileges and preferences that Vanuatu currently enjoys. It would also have an impact on Vanuatu’s WTO status, should the country accede. The prospect of losing these advantages makes it all the more important to promote export development and to make the economy more internationally competitive.

The only recent precedents for LDC graduation are Cape Verde and the Maldives[41], which having met the criteria for graduation will establish some important precedents for transitional arrangements. WTO members (through the Committee for Trade and Development) have agreed to grant the Maldives a transitional period based on a roadmap for graduation prepared by the Maldives Government.

In recent years Vanuatu has only exported one item, copra (HS1203), to the EU in significant volume. It comprised just over 16 percent of exports by value from 2001-5. The EU MFN duty rate for copra is zero, so graduation would have no tariff consequences for this item. Up to five other products (coconut oil, coffee, cocoa, beef and kava) are currently or could potentially be exported by Vanuatu and would gain preferential market access as a result of the country’s LDC status.

Coconut oil (HS1513), the next major agricultural export, has been exported mainly to Australia, and it is likely that duty-free access under SPARTECA will continue or a new duty-free arrangement will be put into place under PACER. However coconut oil production in Vanuatu as a whole is more expensive, on a smaller scale and less competitive than major producers such as Indonesia and the Philippines, each of which produce hundreds of times the output of Vanuatu and which are benefiting as relative tariff rates decline. This product will clearly face increasing competition in international markets.

[41] Botswana graduated in 1994.

It is possible that coconut oil might be exported to the EU. In this case the EU MFN duty rate for coconut oil is 2.4 or 6 percent, depending on its usage. Using data from the most recent peak year of 2004, and assuming that the entire product was exported to the EU and there was no switch to another export destination, loss of duty-free access could be worth up to USD250,000 a year. Although this is not a considerable sum relative to overall exports, graduation from LDC status could have a potentially serious impact on the smaller islands for which copra is the sole cash product. As a result there would be clear effects on national income distribution and therefore human development.

Beef, coffee, cocoa and kava are currently exported to developed countries in small amounts, either because of limited productive capacity (in the case of coffee and beef), or because of SPS issues (kava) or certification (beef). Kava is now exported mostly within the Pacific region. Cocoa beans (HS1801) enter the EU duty-free on the MFN rate. Beef markets are being developed in Australia, the Solomon Islands, Papua New Guinea, New Caledonia and Japan. In the longer term EU markets may open up to Vanuatu beef. It will remain particularly important to monitor the potential loss of tariff preferences for beef, although SPS issues are a bigger priority.

In addition to static losses, the end of LDC preferences may cause a reduction in potential future export development and diversification. As has been shown already, Vanuatu has a number of natural disadvantages including high domestic and international transport costs and the cost of inputs to production. Without the additional preferences accorded to LDCs, Vanuatu will be less able to develop industries which might become a future source of economic growth or diversity. The importance of transitional arrangements thus becomes all the more clear.

A further possible disadvantage of graduation is technical cooperation. Several WTO agreements encourage trade-related technical assistance and support to LDCs to enable them to fulfil their obligations. Accordingly, after graduation Vanuatu risks losing access to technical assistance and support.

WTO agreements would clearly only come into play if Vanuatu accedes. In some of these agreements, the benefits for LDCs take the form of non-binding commitments. These provisions simply encourage developed members to provide “special consideration” to these countries, without any specific details or legal commitments. These include Article XI(2) of the Marrakech Agreement; Article 10(1) of the SPS Agreement; Article 12.8 of the Technical Barriers to Trade Agreement; Article 3(5) of the Agreement on Import Licensing Procedures; Article IV(3) of GATS; 6(d) of the annex on Telecommunications in GATS; and Article 66 of TRIPS.

Several provisions such as Article 11.8 of the Technical Barriers to Trade Agreement and Article 67 of the TRIPS Agreement encourage support and provision of technical assistance without any commitments.

Two provisions are the same for developing countries as for least developed countries, but least-developed countries are specifically mentioned: Article 8 of the Understanding of Balance of Payments Provisions and Article 5(3) of the TRIMS Agreement.

This leaves five (up-to-date) areas where least-developed countries receive specific and concrete benefits greater than other developing countries.

Under *Article 15(2) of the Agreement on Agriculture,* LDCs are not required to reduce subsidies or agricultural import tariffs. Vanuatu does not currently use either production or export agricultural subsidies, although it has done in the past. This article is likely to have minimal implications, particularly if the VCMB is reformed or stripped of its ability to impose subsidies. Vanuatu has already offered to bind all of its tariffs, including for agricultural products. These bound rates are generally substantially higher than applied rates, so that any commitments to reduce bindings would have little real effect in the medium term.

Under *Article 27(2) of the Agreement on Subsidies and Countervailing Duties,* the prohibition on the use of export subsidies is not applied to Annex VII countries (least developed). Vanuatu, however, does not currently use any export subsidies, so this provision is of little relevance, although it may become important should Vanuatu use export subsidies in future.

Article 66(1) of TRIPS Agreement provides a 10-year implementation period for LDCs that can be extended (subject to agreement from the Council on TRIPS). The Council has granted further extensions to LDCs that have not yet fully implemented their commitments. The TRIPS laws have been already been passed in Vanuatu and transitional arrangements would likely be brought up to date in its accession package.

Article 24(1) and (2) of the Understanding of Procedures Governing the Settlement of Disputes provides for more consideration to be given by members to LDCs and procedures which allow arbitration by the Director-General of the WTO to resolve any dispute amicably in the interests of an LDC.

LDCs have less frequent trade policy reviews and the WTO Secretariat provides technical assistance in the preparation of the Government’s report. Since most developing countries are reviewed on a six-yearly basis, this is unlikely to provide Vanuatu with any problems after graduation.

Finally, under the modalities adopted for the Doha Development Agenda negotiations on non-agriculture market access, LDCs are not expected to make any commitments other than to bind existing tariffs. Vanuatu would still be able to apply this provision assuming it graduated and that the Doha negotiations are completed before the country's graduation as an LDC.

4.7 Conclusions

The contribution of trade to development in Vanuatu can clearly increase; and with this in mind a number of appropriate policy changes have been identified here, particularly those which will boost exports. Export development requires institutional change. Moving the DTII to the Ministry of Foreign Affairs would help delineate responsibilities, allowing the DTII to deal with trade agreements while the existing MTIT concentrates on the productive sectors. The activities of the two should be co-ordinated within the NTFC.

Revitalising the NTFC would help build a focus for trade-related policy. It is suggested that a legislative requirement be put in place regarding trade-related tax changes. Currently tariffs are decided solely by the Minister of Finance, which means they are used for revenue-generation rather than for economic policy ends.

Building export capacity is vital considering Vanuatu's reliance on foreign aid and its persistent goods trade deficit. Diversification of export markets and products is also important. It is worth singling out New Caledonia for special attention. Despite years of discussion and recent minor pick-up in activity, trade between the two remains minimal. An increase in bilateral trade would carry advantages for both.

The services sector increasingly dominates the Vanuatu economy, and trade in services, particularly tourism and the movement of workers, will comprise an increasing proportion of economic activity in the years ahead. This reality should be recognised during supply-side development efforts and the negotiation of trade agreements.

Vanuatu faces special sensitivities when negotiating and engaging in trade agreements – in particular the need to stabilise Government revenue and to impose the institutional requirements to take advantage of trade liberalisation. Clearly multilateralism would carry advantages – such as increased international representation and the avoidance of potential trade diversion. Yet the Government has yet to accede to the WTO. Building a national consensus on this issue will be vital, and further technical assistance may be appropriate.

Relatively few major official obstacles exist to export or import, although many of the bureaucratic hurdles common to LDCs can be found. The VCMB and Import of Goods (control) Act stand out as particularly obstructive legislative measures, and both require immediate reform or repeal. The exemptions system disincentivises trade in appropriate areas, and needs to be reformed.

A final, important issue is Vanuatu's possible graduation from LDC to developing–country status. Copra exports appear likely to retain duty-free access, but given the volatile nature of other exports it is possible to make only general estimates of costs and benefits due to loss of tariff preferences. It will be necessary to continue studying the potential loss of LDC privileges in the years ahead.

5. TRADE FACILITATION

5.1 Introduction

In spite of a number of often-cited disadvantages, Vanuatu's trade environment already has some valuable assets, including a relatively efficient administration, a favourable SPS and agricultural environment and a comparative advantage in several high-quality products.

The conduct of trade facilitation contains a mix of good and poor performance. The large majority of day-to-day operations experience mostly adequate levels of service, together with recognition of the need to continually improve. Without addressing a small set of core problems, more substantial reforms and investments in other areas are likely to be rendered much less effective[42].

5.2 Roles and responsibilities in trade facilitation

On the initiative of the Minister of Trade, the National Trade Facilitation Committee (NTFC) was established in mid-2005, with the aim of bringing together key stakeholders, and developing and coordinating work in this area. The terms of reference for the NTFC are outlined in annex 2.

Though the NTFC is a useful step forward, experience suggests that setting up a committee alone seldom leads to real change on the ground. Part of the problem in Vanuatu is that, until now, little work has been carried out to link, assess and prioritise the different areas that might be covered under a trade facilitation program, if such a program should even be considered, and what might be needed in order to carry it out. Without these first steps, it is difficult to build an agenda to which all stakeholders can commit. Furthermore, the NTFC needs to be funded and organised properly. Until now it has had no separate budget.

Work is, however, occurring in trade facilitation – for example in the areas of quarantine, customs, and food standards. The DTII has run several *ad hoc* consultations as part of its current trade negotiations, though in some departments scepticism remains about trade negotiations. A number of cross-departmental committees are also operating or have operated at various points in the past, including the CODEX committee, the VIPA board, Port Users and Airport Users Committees, and a Customs Administration Committee. A new committee dealing with export of labour has recently been set up to strengthen relations between departments with a stake in this issue.

Table 5.1 SWOT Analysis of Potential for Trade Facilitation

Strengths	Weaknesses

[42] This conclusion bears some resemblance to similar diagnostic work done for the agricultural sector. AusAID/NZAID (2006) used the concept of 'binding constraints' to explain why Vanuatu's economy has not grown faster over the years.

▪ Culture of cooperation within Government departments ▪ Much existing work already ▪ Desire to do something on trade facilitation ▪ Strong macroeconomic framework and growing economy	▪ Lack of trade policy framework ▪ Lack of trade facilitation program ▪ DTII not structured around facilitation ▪ Broad lack of knowledge and training ▪ Lack of clarity on roles in some areas
Opportunities	Threats
▪ National Trade Facilitation Committee ▪ Integrated Framework (IF) and wider interest of donors ▪ Wider Government reforms (e.g. in the area of regulation) ▪ Current trade negotiations ▪ Regional integration and regional support in some areas	▪ Lack of resources ▪ Potential for backsliding on previous reforms ▪ Current trade negotiations

5.3 National and Regional Approaches

In addition to national-level efforts, regional organisations led by the Pacific Islands Forum Secretariat (PIFS) are also implementing the Regional Trade Facilitation Program (RTFP). Funded by Australia and New Zealand under the Pacific Agreement on Closer Economic Relations, the RTFP is a USD2.7m, five-year program. In addition to PIFS, the program also draws upon the resources of the Oceania Customs Organisation (OCO), and the Secretariat of the Pacific Community (SPC). The program began in 2005, after some delay.

In practice, Vanuatu has not benefited greatly from the program. One of the biggest problems of the RTFP from Vanuatu's perspective is that many elements of the program are designed around the concept of achieving uniform minimum standards (e.g. adoption of the Harmonised System or WTO Customs Valuation systems). This 'one size fits all' concept is somewhat flawed, not least because such changes require a political will that does not often exist in some of the smaller countries – due mainly to the fact that in fact the technical and administrative costs of implementing some procedures may simply outweigh the benefits – and therefore cannot be driven by a regional process, especially one without the budget for such national-level activities.

However, because Vanuatu completed much of the WTO accession process, it has already undertaken a number of key reforms and therefore meets virtually all of the minimum standards under the program. Vanuatu is more advanced even than existing

WTO members in many areas.[43] A more flexible and nationally-focused program for Vanuatu would therefore seek to build on the existing progress of target current areas of priority or weakness.

A more fundamental problem is that while improving and harmonising customs procedures makes it easier in general for the trading community, the benefits of regional integration in the Pacific may be overstated by frequent comparisons to dissimilar regions, such as those in Africa and Asia where countries have contiguous land borders and through-shipment issues (not to mention higher levels of intra-regional trade).

5.4 Sanitary and Phyto-sanitary Systems (SPS)

Vanuatu already has duty-free and quota-free access to major markets such as Australia, New Zealand and the European Union[44]. Collectively these three markets apply among the most stringent SPS requirements in the world, and there is reason to believe that SPS-related measures and compliance will become increasingly important.

In the past Vanuatu has traditionally exported commodities – copra and cocoa – which are relatively unconstrained by SPS requirements. As these products have declined over the past few years, the country has been exposed in several exports to growing requirements for its other fast-growing products, in particular kava and beef. As the export sector looks to diversify away from copra and into these areas, the challenges in meeting SPS standards are also likely to grow. Annex 5 shows SPS and environmental standards potentially applied to Vanuatu agricultural and food exports.

5.4.1 Existing SPS-related Constraints

Vanuatu's export performance has already been constrained by SPS restrictions. In two industries – beef and kava – significant struggles have taken place over access for Vanuatu exports overseas, especially into lucrative markets in the European Union.

In the case of beef, Vanuatu authorities have targeted certification to the EU market partly because of the higher prices, but also as a stepping stone to other markets in which gaining SPS certification is problematic yet less stringent than the benchmark EU standard. Securing access to the EU market, combined with Vanuatu's organic status, would guarantee even higher premiums. Compliance with EU protocols has required a significant amount of up-front investment, and authorities report experiencing frequent changes and additions in what was already a fairly time-consuming process. Nevertheless, VQLD expect to secure access to the EU market in 2007 or 2008.

[43] The Solomon Islands, for example, has not yet fully adopted the Harmonised System for tariff classification.

[44] Indeed, the only potential market that Vanuatu does not have effective market access to is New Caledonia, which maintains duties and quotas on products including beef.

The kava ban is Vanuatu's best example of an SPS constraint at a time when kava looked set to become a major export commodity for the country. The best account of the ban is given in Gay (2005), and is worth repeating here:

Box: The 2001 Kava Ban

"Kava is again becoming an important export crop following the ban originating in Europe in 2001. The ban originated in reports from Germany that 30 to 40 people had become ill or died after taking kava-derived herbal supplements. Following the German action, other European countries restricted or ceased kava imports, as well as Canada and Singapore. The US, New Zealand and Australia either partially banned the product or issued warnings against it. Health agencies argued that products involving extracts from the kava plant had contributed to liver disease.

A late-1990s boom in the use of kava as a herbal alternative to manufactured relaxants had prompted many Vanuatu farmers to begin planting large quantities of the crop for export. Kava represented 22% of the overall value of domestic exports in 2001, and normally comprises around 15% of exports.

The impact of the ban on the economy was severe, contributing to a decline in GDP growth. An estimated one-third decline in kava exports during 2002 cut a fifth from Vanuatu's total yearly export earnings. Not only is the export of kava itself important for the economy, but the fall in overseas sales resulted in domestic oversupply and lower prices as farmers tried to sell excess produce.

Some commentators allege that European and global drugs multinationals lobbied for prohibition because the natural sedative was beginning to rival benzodiazepines like Prozac and Valium. Doubts surround the true cause of the casualties in Germany, with reports suggesting that one of the victims was an elderly alcoholic. Other countries banned kava without evidence of similar cases within their own borders.

Kava has been drunk traditionally in Vanuatu and the Pacific region for many centuries with no adverse effect on physical wellbeing. The country has normal levels of liver health. Kava's biological origins are claimed to be in Vanuatu, although the plant, of which there are over 80 cultivars in the country, is grown in other Pacific island nations. Some scientists suggest that poor processing of the product by companies in Europe is to blame for the few health problems, rather than the raw product itself."

Source*:* Gay (2005)

5.4.2 Potential to Benefit from Increased SPS-related Requirements

Vanuatu has managed to achieve considerable success already in some industries in meeting SPS requirements to break into new markets or re-establish old ones, particularly in beef. For a majority of its exports however, Vanuatu is in danger of falling behind other countries in a number of SPS-related areas, such as developing robust export quality standards (e.g. in kava) or organised systems for achieving value-adding certification such as organic and fair trade.

It is important to remember that constraints in meeting SPS standards are common to all developing countries, and success in meeting them can confer significant long-term competitive advantages. For Vanuatu such advantages may even outweigh the perennial problems of 'distance from markets' and 'lack of scale' – there is no point in being large and close to export markets if you are restricted from exporting by a failure to comply with SPS standards. With adequate investment in capacity and well-thought out strategies linking trade and SPS, Vanuatu is well placed to reap the benefits of its current relatively disease-free environment and largely organic production techniques.

5.4.3 Overview of SPS Architecture and Capacity in Vanuatu

The functions of an effective SPS system can be divided into four broad areas:

- Plant health protection
- Animal health protection
- Quality assurance and standards
- Food safety

When outlining the SPS 'architecture' or system many studies have tended to focus on the responsibilities of various stakeholders in the system. What sometimes goes unrecognised in Vanuatu, however, is how often a number of different agencies and private sector stakeholder will be working in the same broad area at the same time. By looking at the SPS architecture in terms of its outputs, as in the table below, a clearer picture emerges of some of the overlaps, synergies and potential conflicts in the work of different departments.

Table 5.2. Key organisations in Vanuatu's SPS architecture by function[45]

Function	Key Activities	Government agencies	Private Sector
Animal health	Disease surveillance Border inspection Fumigation/incineration Butchery inspection	VQLD Dept of Fisheries	Beef industry Fish industries

[45] Background details of the different government and private sector stakeholders are given in section 10 of the UNCTAD Study on Costs of Agri-food Safety and SPS Compliance, August 2006.

	Information/training	DARD, COC	
Plant health	Pest surveillance Border inspection Fumigation/incineration Emergency response Information/training	VQLD DARD/POPACA, COC	Copra, cocoa kava, coffee, root crop, fresh produce industries
SPS Certification	Issuing SPS certificates SPS market research Negotiation of protocols SPS diplomacy	VQLD DTII/FDTC-Codex	Industries seeking market access
Quality Assurance and Standards	Developing standards Enforcing standards Training	VCMB (copra, cocoa) VQLD (beef) DARD/POPACA COC DTII/FDTC-Codex	Exporters/buyers, Farmer Support Associations
Food Safety	Inspection and licensing of food establishments Training	MoH Municipal Councils DTII/FDTC-Codex	Food establishments

Roles are not clearly defined in every area. In quality certification, a large mix of different Government departments, statutory boards, exporting purchasers and smallholder organisations are involved in the development and application of agricultural standards. In some cases (e.g. beef and vanilla) efficient systems have developed for maintaining high quality and obtaining premium organic certification, while in other areas (such as copra and cocoa) outdated and inefficient systems simply raise costs to employers for little added value. For the remainder of commodities (including kava) very few standards are applied, which has resulted in uneven export quality and the use of potentially dangerous processing techniques, which have led in turn to problems with expanding beyond established local and regional markets into potentially lucrative developed country markets.

In particular the role of the Vanuatu Commodities Marketing Board in monitoring standards in copra, cocoa, and more recently kava has been questioned by a range of industry participants and observers who note the inefficient, expensive and anti-competitive service it provides (see the chapter on agriculture).

Apart from the issues around standards however, other areas have not seen the emergence of different interests in seemingly inefficient competition with one another. In another area where there is potential overlap between Government departments, food safety, a hierarchy has emerged between those developing policy and monitoring it (Ministry of Health) and those helping to implement it (Municipal Councils and Trade, through the Food Technology Development Centre). Coordination and consultations are carried out frequently through committees such as the national CODEX committee.

Although this not uncommon in developing countries, the characteristic features of the SPS system in Vanuatu's case are firstly the varying quality of interventions – high standards in some areas accompanied by weaknesses and gaps in other – and secondly a lack of any governing institutional or policy framework for SPS matters, leading to:

- a lack of clarity over the role of different agencies (notably between VQLD and VCMB but also between VQLD and the Department of Agriculture and VQLD and the Food Technology Development Centre), resulting in a duplication of effort, a spreading of scarce resources, and occasional conflicts;
- a varying quality of interventions across different Government authorities, with some providing a cost-efficient service tailored towards the goal of increasing exports, while others extract unjustifiably high fees for basic services such as quality inspections;
- a lack of a driving policy, coordination and communication between agencies and a common understanding of the overall objectives;
- major gaps and inefficiencies in the architecture itself, in particular in the areas of quality/standards and food safety.

5.4.4 Quality assurance and export standards

Looking across the range of SPS-related functions in Vanuatu, the picture is perhaps most confused – and requires the most attention – in the area of quality assurance and export certification. One study summarised the current situation as the following:

> "To date, the development of quality standards has been relatively uncoordinated, with VCMB providing minimum standards in copra and cocoa (and to some extent kava) and private exporters providing often highly variable standards for other commodities"
>
> AusAID/NZAID (2006)

In terms of the role of the VCMB in administering standards, criticism has been uniformly strong.[46]

[46] Indeed the government's own economic planning framework, the Priorities and Action Agenda stated as one of the six needs under its trade section to 'Clarify the role of the private sector in commodity trade by reviewing the role of the VCMB'

Recently recognition of that fact that there are major gaps and inefficiencies in the area of agricultural standards has grown and a large amount of analysis and diagnosis has already taken place, with each of the three key donor-funded studies looking at the agricultural sector over the last two years placing a high priority on the need to do something in this area, and making recommendations and proposals in each case. These studies are:

- EU/POPACA 'Review of Vanuatu Cocoa and Coconut Products', 2005
- AusAID/NZAID 'Vanuatu Economic Opportunities' study, 2006
- UNCTAD 'SPS Cost of Compliance' Study, 2006

Rather than duplicate work that is already available, it is worth collating the key general points to emerge from these studies, as a first step in developing a more coherent approach. The major ones are that:

1. Standards themselves should be industry-driven: ultimately it is private sector producers who have the key interest in (and must therefore carry the bulk of responsibility for) ensuring that their products meet importing country SPS standards, as well as any additional quality standards.

2. There can nevertheless be a significant role for Government agencies to play in the regulation, monitoring, development and promotion of both general and sector-specific standards.

3. Any new initiative on standards should include exploring niche certifications such as organic and fair trade.

4. Consideration should be given to including trace-back systems, while acknowledging that this will be difficult.

5. There is a need to review institutional arrangements, including the role of the VCMB.

6. A high priority should be given to the kava industry in the first instance: as part of the UNCTAD study a project proposal was produced for funding under the Standards and Trade Development Facility (STDF)[47]. The AusAID/NZAID study suggests possibly using the kava industry as a model for other sectors.

7. The EU/POPACA study also present detailed proposals for improved cocoa and copra Quality Control Systems, which would see a combination of VQLD and provincial offices replacing VCMB.

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[47] This proposal has already been approved by various stakeholders at a workshop on SPS measures in Vanuatu in August 2006, and was thereafter submitted to the Standards and Trade Development Facility (STDF) for funding. It should if possible be built into the Integrated Framework program.

Given the apparent willingness – but potential lack of coordination – between different donors, this would appear to be a suitable area for a project under the Integrated Framework. It is suggested that approval for the STDF proposal on kava be expedited, and built into a wider program involving other donors through the IF. The importance of this area for Vanuatu cannot be underestimated: it has already been noted that as a small island economy, in order to sustain its export industries in the future Vanuatu will increasingly need to develop niche markets and compete on quality. Here Vanuatu is already noticeably behind in some areas compared to other Pacific Island states.

5.4.5 Conclusions on SPS

It is clear that improving capacity in SPS-related areas should be an area of priority under the Integrated Framework. With tariff barriers now virtually non-existent, the major barriers to trade for Vanuatu products are SPS-related. This is only likely to grow in the future as countries grow more vigilant and buyers in importing countries demand higher quality. Such trends will also create opportunities, however, with investment in meeting demanding SPS-related standards being rewarded with competitive advantages which can sustain higher values for exports over the long run. Conversely, a failure by Vanuatu to invest in such areas will continue the cycle of dependence on uncompetitive commodities with low and declining value.

For Vanuatu there are a number of pressing needs. Foremost amongst them is the need to sort out roles and responsibilities within the SPS 'architecture'. Notwithstanding that need, it is clear that capacity is strongest in export certification of traditional quarantine requirements and negotiating protocols, but this needs to be supported with a renewed focus on building capacity to manage and monitor potential risks, including import management, and pest and disease surveillance. The lack of standards and quality assurance systems points to greater potential for value-adding in a number of commodities, and this is an area where numerous donors have already expressed a willingness to invest resources. Finally, food safety systems are set to improve with the introduction of new regulations, but implementation will be costly, requiring possible assistance.

Drawing on these conclusions, the foremost needs for Vanuatu in the SPS area are:

- SPS architecture: clarification of responsibilities in SPS related areas, in the first instance through the development of an agricultural export policy covering comparative advantages, trade preferences and markets, the various roles of Government agencies and the private sector, programs and levels of support for specific sectors, and overall objectives. In line with the recommendations of a number of previous studies, the role of the VCMB should be reconsidered. It is likely that some legislation in the SPS sector will need to be introduced, reviewed and updated.

- Quality standards: a project, or several projects, aimed at creating systems for the development, promotion, monitoring and certification of a range of agricultural produce standards. This should include the STDF proposal on kava that is already in the pipeline, but also extend to other sectors raised in the current NZAid/AusAID and EU/POPACA proposals on this.

- Import and border control: improvements in capacity to monitor import risks at the border, including investment in facilities (e.g. an office at the main wharf in Port Vila, fumigation and incineration facilities, x-ray equipment) and funding for emergency response plans. There is a need for better information sharing between DCIR and VQLD in particular, which may be achieved through updating the ASYCUDA system. A website – possibly combined with Trade and DCIR – would also be useful in helping to deal with front-line public enquiries on quarantine more efficiently, and thereby freeing up officers time to concentrate on more pressing needs.

- Plant and animal health and SPS certification: there is a need to improve capacity to monitor and control pests and animal diseases. This will require training, equipment (support for laboratory) and extra resources to update databases. It may also involve better dissemination of information amongst stakeholders.

- Food safety: following new legislation the focus of authorities will be on inspecting and licensing food establishments. In the medium term there will be a need for Government to develop training programs and monitoring mechanisms. In the longer run, there is a significant need in the area of standards and conformance (for example metrology, product safety and consumer rights), which are currently weak in Vanuatu, and the food establishment licensing system may serve as a model for this work.

5.5 Transport, Storage and Wharfage

The effect of transport, storage and wharfage on Vanuatu's competitiveness has been underestimated. As noted earlier, 'distance from markets' is routinely cited as one of the major reasons for Vanuatu's relatively poor export performance over the years. Yet a closer examination shows that even compared to smaller and more remote island countries in the Pacific, the cost of importing and exporting goods (as opposed to freight costs) in Vanuatu is still extremely high, suggesting that more in-depth study of the workings of the sector is required to find out what is driving costs higher.

Donors have done considerable work on transport infrastructure. Existing work must be built upon and re-assessed from a trade facilitation or 'whole supply chain' point of view. It is entirely possible that the current investment in infrastructure might be undermined by blockages further down supply chains.

5.5.1 Context of Transport, Storage and Wharfage in Vanuatu

- In effect the persistent trade deficit means that containers and boats come to Vanuatu filled with goods, and leave empty.

- Most imports arrive at the administrative, financial and tourism centre of Port Vila, while the vast majority of Vanuatu's largely unprocessed agricultural exports leave from the northern port of Luganville.

- While some 75 percent of imports are shipped from Australia, New Zealand and Asia, the bulk of exports leave on different vessels bound for Europe.

In terms of trading patterns, as a result of existing regional trade agreements growth in both imports from, and exports to, local Pacific Island markets has grown slightly in recent years – albeit from a low base – with the trend possibly continuing over the longer term as these economies find and develop their areas of comparative regional advantage. If the long-term decline in traditional exports of copra continues as expected and Vanuatu diversifies into other products, it is also likely to find itself exporting more to Australia and New Zealand, Japan and the rest of Asia.

5.5.2 International Shipping

Given its small market size and relatively small export volumes, Vanuatu is generally reasonably well serviced by international shipping lines. At heart the problem is not that shipping services prohibit or restrict an increase in export volumes, but rather that export volumes are not of sufficient voume or consistency to require increased shipping services.

Port Vila receives, on average, around seven container ship visits per month, with two to three monthly services to Fiji and New Zealand and one to Australia. The main export ship is the Bank Line, which calls at Santo on every tour, and Port Vila as necessary, and then on to major ports around the world carrying Vanuatu coconut oil, copra, beef and cocoa to destinations in Asia and Europe. Annex 4 shows the main international shipping services to Vanuatu.

Compared with potential competitor countries such as Fiji, Vanuatu faces a disadvantage in access to shipping in addition to having a smaller production base. The availability of only a single monthly shipping service to Australia, for example, creates a greater level of uncertainty for potential exporters looking to export to that market. The lack of existing shipping routes adds another reason for Vanuatu to pursue a trade and agricultural policy that encourages expansion in a few traditionally successful crops with established markets (e.g. beef, kava, coconuts, cocoa, coffee) rather than experimenting with seemingly lucrative alternatives (e.g. rice, palm oil).

5.5.3 Air Transport and Facilities

As a result of 'open sky' policy introduced by the Government in 2004, the number of flights into and departing Vanuatu has notably increased – and with it airfreight capacity. This has been accompanied by investment to upgrade facilities at international airports, including a new airport terminal at Pekoa in Santo and new freight-handling facilities at Bauer Field in Port Vila.

The tourism sector is undoubtedly the main beneficiary of better air transport linkages. Compared to sea freight, the volume of goods (in particular exports) currently sent by air is minimal. Nevertheless improved air transport linkages are a useful element in the trade facilitation chain in Vanuatu, for a number of reasons:

- They facilitate and open up opportunities for regular trading in non-traditional exports and niche markets, particularly fresh produce and low-volume, high value-added products such as live reef fish.
- While volumes are much more limited, air freight is much more regular than sea freight and subject to fewer unforeseen delays, important in some export industries.
- Air freight can be used to establish markets, enabling exporters to gradually build up a regular base of supply before achieving the scales necessary for container shipping.
- They can provide a potential source of competition for shipping, putting downward pressure in the long run on freight rates.
- They facilitate a growing amount of e-commerce, bringing lower import prices for some goods and enabling Vanuatu exporters to react and dispatch orders more quickly.

In particular, the combination of signing new SPS protocols (Import Health Standards) for selected Vanuatu fruit and vegetables with New Zealand, and increased air transport linkages from Port Vila, is a good example of where synergies might be created through a more coordinated and strategic approach to trade facilitation. Although current volumes for export of fruit are small, and careful thought must always be given to prioritising the right crops in Vanuatu, potential new opportunities exist.

Vanuatu still receives far fewer flights than its potential competitors – particularly the regional air hub Fiji. In addition to handling daily departures to major markets in the United States, Japan, New Zealand and Australia for competing airlines, these Fiji flights also tend to be larger aircraft, including Boeing 747s.

In storage and handling there are also problems. In 2004 a new purpose-built facility for handling air freight was opened at Port Vila airport. After two years in operation however, Airports Vanuatu Limited (AVL) and Air Vanuatu recently introduced a VT20 per kilogram storage charge in addition to their regular freight charges. By adding the equivalent of roughly USD200 per tonne to the shipment price, this would appear excessive for such a fairly basic function, especially for those exporters who are making regular bulk shipments.

Finally, there is no infrastructure at the moment at Port Vila (or elsewhere) for handling airfreight containers, which can hold up to 4-5 tonnes and can save exporters time and costs with packing, insurance and onward transport.

5.5.4 Ports and wharf facilities

Port Vila

Port Vila main wharf currently displays a number of weaknesses in managing the 350 or so containers and 8 or so cruise ships it receives every month. The layout of the wharf is somewhat outdated: a large storage shed for loose cargo dominates the body of the wharf, when virtually all freight arrives in containers which are either broken up outside the shed, or remain as full container loads. A building for DCIR and the Department of Ports and Harbours are inconveniently situated in a place where it restricts access to the wharf key. The wharf itself is a 'key' design, with access to the 212-metre wharf head restricted to only three bridging points.

One problem in particular is that there are no facilities for the thousands of tourists who disembark at the wharf on 'cruise ship days'[48]. On several occasions recently the congested and sometimes unmanaged atmosphere has fed into conflicts between groups – for example taxi drivers and tour operators – leading to threats from cruise ship operators to remove Port Vila from their future itineraries.

The wharf is due to receive an upgrade in 2008, which will have some impact of solving some of its current problems. The plan to remove the storage shed, and possibly to relocate the DCIR office, will create much more space for container storage and operations. The main work of the project however will involve extending the wharf by some 31m – ostensibly to enable it to receive even larger cruise ships[49]. There are however no plans as yet for a separate terminal or facilities for tourists, and the 'key' design will remain (as against the possibility of filling in the gaps between the bridging points).

Luganville Wharf

After an earthquake caused severe structural damage to the old wharf, a new one was built for Luganville in 2002. The wharf is generally sufficient for exporters' purposes, and operates below capacity at present. Storage facilities at Santo are generally thought to be adequate, although some of its units are Quonset huts dating back to the Second World War.

One concern is the lack of commercial basis for storage on the wharf. Unlike any other business in Santo and elsewhere in the country, the parastatal Vanuatu Commodities Marketing Board (VCMB) and its company Vanuatu Coconut Products Limited are not charged for storage of its goods prior to shipping. This deprives the Government of revenue, and also acts as an indirect subsidy on VCMB's operations.

Other Wharves

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[48] The two most frequent cruise ship visitors are the P&O-operated *Pacific Star* (carrying up to 1,800 people) and *Pacific Sun* (2,250 passengers).

[49] The extension will not be long enough to allow for multiple ship dockings except on rare occasions, and it is questionable whether the support facilities exist at present to deal with such an occurrence.

In addition to the main wharf in Port Vila, there is also nearby the Government Star Wharf, used for domestic inter-island shipping vessels. There is also a smaller wharf in the centre of Port Vila, also used for inter-island ships. On some occasions congestion has forced these vessels to dock without permission alongside the seafront promenade area. It is likely that at some point in the future this area will be put to other uses, creating an additional problem for authorities about where to relocate its functions.

Fuel is also off-loaded at a separate depot with a different channel access to the main wharf, with tankers passing alongside the main town area. Entry to the depot is restricted by its location and by an overhead power cable to a five-star tourist resort in the centre of Port Vila Bay, thus preventing Vanuatu from accepting larger and more cost-efficient tankers, which helps to push up fuel prices in the country.

Smaller domestic wharves on the outer islands range from concrete piers to crumbling rock jetties, with some islands having no facilities at all. The Government has prioritised upgrades to several wharves under the forthcoming US Millennium Challenge Account (MCA) project, with plans also to build five new storage warehouses under the MCA.[50]

5.5.5 Stevedoring and container delivery

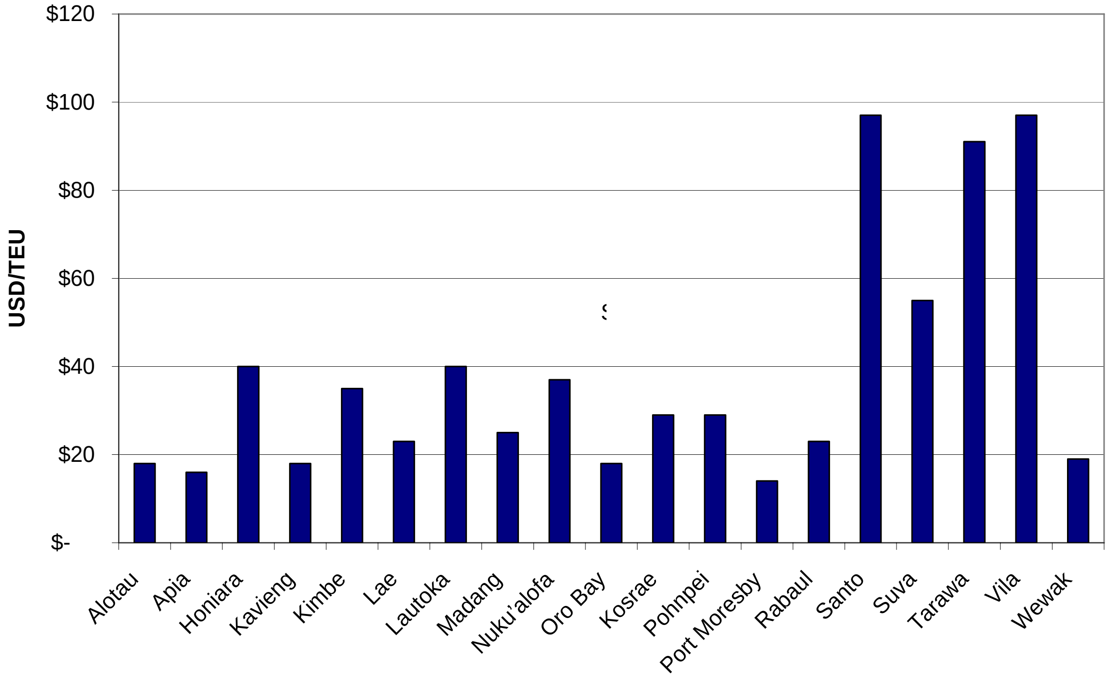
A striking feature of Vanuatu's current trading environment is the inefficiency and high level of dissatisfaction with stevedoring services in Port Vila and Santo, and the largely unrecognised knock-on effects these have for the rest of the economy.

Currently a concession for the provision of stevedoring services at the main wharf in Port Vila until 2015 is held by Ifira Wharf and Stevedoring Limited (IWS), which is owned jointly by Ifira Trustees and the Government of Vanuatu. An investigation by the Vanuatu Ombudsman in 2004 found however that the concession – an extension to the existing one – had been granted illegally and that 'there is no presently enforceable contract for the provision of stevedoring services' at the wharf. In Santo the provision of wharf stevedoring services has been contracted since 1991 to Northern Islands Stevedoring Company Limited (NISCOL).

Stevedoring charges in Santo and Vila are the highest in the Pacific region, as shown in the following figure.

Figure 5.1 Comparison of stevedoring charges in Pacific Island Countries

[50] See: http://www.mcc.gov/countries/vanuatu/030206VanuatuCompact.pdf



Source: reproduced from ADB (2007); original data attributed to Vanuatu MFEM

According to the ADB (2007), the cost of stevedoring in Vanuatu is roughly seven times that in Papua New Guinea. IWS charges VT44,674 (USD400) to move a full 20-foot container from ship to the wharf area, with an additional charge of VT10,861 when the container has to be unpacked on the wharf. NISCOL charges similar amounts.

High charges are only half of the stevedoring problem. There is also a considerable amount of delay in the movement of containers from ships to the wharf. The average turnaround for a ship unloading 60 or so containers in Port Vila is 16 hours, with stevedores working at a rate of about 7 container movements per hour. Using exactly the same equipment, the same job is done in other Pacific countries in as few as 6 hours, where stevedores operate at speeds of up to 22 container movements per hour. Some of the equipment in Port Vila is also outdated and cannot move some of the newer, heavier containers. Pay scales do not reward workers for increased productivity. Many businesses complain that IWS management is unwilling to sit and discuss these problems. Because the Government is a major shareholder in IWS, it could change these issues if it wanted to.

Time delays do not only create an inconvenience for traders but also add to ships' costs: where long turnover times cause ships to delay their itineraries by a day or more they incur large costs which eventually end up being borne by consumers and producers. Long turnaround periods in Port Vila also have serious knock-on effects for the management of the wharf, and create avoidable and unnecessary conflicts between the trading community and those in Port Vila who rely on cruise boat tourism for their income.

5.5.6 Storage and Domestic Transportation of Containers

Related to stevedoring services is the issue of storing and transporting containers once they have been unloaded onto the wharf. Again the problem is unjustifiably high charges by the monopoly transporters, also in this case IWS in Port Vila. At current rates it costs over VT20,000 to move a container less than kilometre down the wharf road.

The problem is twofold, with high charges accompanied often by substantial time delays in the delivery of containers. IWS sometimes do not collect empty containers at the same time as delivering full ones, meaning a second trip needs to be made at extra expense. There are estimated to be some 1000 empty uncollected containers in Port Vila, which has an impact on tourism development.

Containers which have not been cleared by border control authorities can be stored along the wharf road, representing a serious and clear breach of Customs and Quarantine legislation, and opens up a clear opportunity for customs fraud or theft of goods, and increased risk of a breach of quarantine. The practice may well also be in breach of Vanuatu's obligations under the International Ship and Port Facility Security Code (ISPS).

Unlike in the stevedoring business, competition is in theory allowed in the transportation of containers to and from the wharf. When one company set up in Port Vila to do this there was some suspicion however that IWS was exploiting its position as stevedore to place containers in such a way as to make them inaccessible to its competitors. Indeed, the revised version of the IWS contract legitimises this practice, by allowing the company to impose a VT9,000 'repositioning' charge for any container it has to move. In effect the possibility of having to pay this charge represents a sufficiently large barrier to entry to discourage new competition and cement IWS's position as the *de facto* monopoly.

5.5.7 Internal Transport

A major assessment of infrastructure in rural areas was carried out in 2004 by the ADB as a feasibility study for a potential loan program – the Vanuatu Outer Island Infrastructure Development Project – which has yet to materialise. The MCA has taken up this work.

Road Transport

Road transport is undeveloped outside of the two main islands of Efate and Santo, with a deteriorating network of mainly compressed coral roads, often damaged at key areas such as river crossings which have not been adequately maintained through the years. Most islands have few trucks, with small boats being used as the preferred option on many islands for conducting transport and trade.

Upgrading the road network is the major tasks of the MCA, which will also strengthen the Public Works Department's capacity to maintain the network.

There is some existing evidence to support the conclusion that better roads can create new trade opportunities in Vanuatu, at least around the two urban centres. Since an upgrade and sealing of part of the main ring road on Efate, commercial farms in areas surrounding Port Vila such as Teouma and Mele have prospered and been able to supply supermarkets with fresh locally-grown fruits and vegetables, as well in some cases as starting to develop an export capacity. Having an adequate road network is likely to provide a bigger boost initially to the tourism sector however, though this in turn should generate increased levels of trade in rural areas.

Inter-island shipping

Vanuatu's trade and investment policies have had a major influence on the workings of inter-island shipping services. Firstly the operation of smaller vessels under 80 tonnes is reserved under the VIPA Act for ni-Vanuatu.

In terms of the openness of competition for larger inter-island vessels, the Vanuatu Maritime Authority (VMA) Act was repealed in late 2007. Amongst other criticisms, there were concerns about the transparency of the VMA's process for granting licenses, with some accusing the authority of seeking to prevent the development of competition in the sector, as well as questioning their regulation of ship safety and insurance more generally. Following one successful legal challenge in 2005, VMA was ordered to grant a license to a foreign-owned vessel after being found to discriminate unfairly against it.

The definition of inter-island shipping was also clarified recently when – for a short period at least – two high-speed foreign-owned passenger ships were granted licenses to carry tourists, providing healthy competition in this market for the domestic airline.

Inter-island shipping was particularly affected by the change in policy to monopolise the internal purchase of key export commodities such as copra, cocoa and kava in 2005 under the VCMB. Now unable to purchase export commodities, and in turn sell the basic consumer goods such as kerosene and rice they carried back to islanders from the income generated from the purchases, some inter-island shippers have decided recently to withdraw services on some routes.

The shipping industry benefited from a reduction in the duty rate on fuel under the Customs exemption system, though this was reduced in the last budget, with shippers now paying VT15 per litre instead of VT6.

As well as exports, inter-island shipping is also important for domestic trade in foodstuffs, the level of which have notably grown in Port Vila and Santo over the last few years. As trade has grown and because of traditional differences in the crop mix across Vanuatu, some islands have started to develop specialisations – for example oranges and peanuts from Epi, water taro from Pentecost – which are seen at the main markets. Kava remains the main commodity traded domestically, with periodic shortages in Port Vila resulting in *nakamal* (kava bar) owners having to weaken the beverage, or sometimes closing for business. In 2005 the Government introduced a VT50 cargo tax for cargo transported on board ships, at the same time as a VT100 to VT200 passenger departure tax for flights. Both taxes are designed to help provincial governments maintain local wharves and airstrips, although they also present a barrier to domestic trade and tourism development in rural areas.

5.5.8 Conclusions on transport, storage and wharfage

Vanuatu's many structural weaknesses – distance from markets, lack of scale, dispersed production centres – makes it all the more important that the country aggressively pursues efficiency in other less rigid areas affecting its competitiveness.

Generally speaking, the Government has taken a proactive approach in some areas of policy, such as the 'open sky' policy, and its prioritisation infrastructure development through the MCA and Port Vila wharf upgrade. The Government is also starting to take a proactive approach to dismantling barriers to competition in other crucial infrastructural services, such as telecoms.

Nevertheless, some of the most urgent problems – i.e. those requiring the most immediate attention in terms of making trade less costly – exist in the area of transport and wharfage, and these threaten to limit the benefits of greater investment in basic infrastructure. In particular the sector of the economy is characterised by inefficiencies and a high level of Government intervention, with protected, unregulated and often inefficient oligopoly and monopoly service suppliers. Cheaper transport and stevedoring costs are essential to increase incentives to export and help grow the economy.

Some key recommendations are:

- Inline with ongoing work on other public utilities, and in light of the fact that Vanuatu has the most expensive port and stevedoring costs of any Pacific Island Country, the Government – in its role as major shareholder – should review existing stevedoring contracts, to improve efficiency of existing operations and ultimately to reduce costs to consumers and exporters.

- The review should also cover the transportation and delivery of containers, to ensure that this service is carried out in a competitive manner.

- The regulatory unit being set up by the Government at the moment should also have a responsibility for monitoring and enforcing effective regulation of stevedoring contracts and operations, port services and the inter-island shipping sector, with a view to ensuring goals of service quality, universal service provision and prevention of anti-competitive practices.

- As with other underperforming sectors of the economy, Vanuatu should consider making GATS-type commitments in stevedoring and port services in the context of trade negotiations (e.g. EU Economic Partnership Agreements).

- Facilities at Port Vila wharf need to be improved to address the lack of space available to carry out necessary port functions and to store containers. Both of these problems should be eased with the planned upgrades to the wharf area to take place in 2008, subject to final donor funding approval. In the longer term access to the wharf head should also be considered, along with the provision of separate facilities for tourists, whether at the main wharf or elsewhere.

- Vanuatu should continue to develop its transport infrastructure in line with priorities and capacity to maintain the network, while ensuring that there is coordination between the transport sector and other policies affecting trade, such as agricultural export policies.

- In line with existing Government policies, Government should seek to encourage competition in the inter-island shipping sector, and ensure licensing decisions are made in a way that is consistent with foreign investment legislation. Furthermore Vanuatu should consider cement the openness of the sector by making commitments in inter-island transport in the context of ongoing trade negotiations, while also considering how best to the aforementioned goals of service quality, universal service provision and an environment of fair competition.

- The port users' and airport users' committees should be re-established with involvement of private sector representatives from stevedoring, inter-island transport and freight forwarders, with information also shared with National Trade Facilitation Committee.

- Charges for storage at Santo wharf should be reassessed to ensure that they are applied equally and based on market principles.

- Air companies and exporters should explore ways to bring down the cost of international airfreight, such as bulk purchase of freight space. Airports Vanuatu Limited should investigate the benefits of installing equipment to handle airfreight containers.

5.7 Conclusions

A number of key points emerge from the discussion:

- The day-to-day bulk of trade facilitation activities – clearance at the wharf, quarantine export certification – are generally carried out fairly well by departments lacking manpower and facilities, yet there is a recognisable need to improve services. Where inefficiencies are occurring in these services, they are often caused by poor communication and information-sharing between departments, a lack of training or a lack of consultation with the trading community.

- At the same time, prominent weaknesses, gaps, inefficient practices and wasted resources exist in a small but important minority of key trade facilitation areas. Some of these include: disputes within Government over roles in key agricultural export sectors; poor regulation and oversight of key monopolies such as stevedoring and inter-island shipping; lack of space and competing interests at Port Vila wharf; misallocation of resources within existing Government priorities, in particular through the customs exemptions system; the current lack of clear overarching policies in both agriculture and trade; major institutional gaps in areas such as product standards and regulation of commerce.

- Trade facilitation problems are often grossly underestimated in terms of their effect on international competitiveness. More conventional explanations for Vanuatu's poor performance – for example distance from markets – are often perceived to be more important.

- Without taking steps to address core trade facilitation problems, more substantial reforms and investments in other areas (e.g. outer island infrastructure under the Millennium Challenge Account) are likely to be rendered much less effective.

- In many ways Vanuatu is in a better position than other countries where problems in the field of trade facilitation are more endemic.

- A dedicated trade facilitation program to address these issues could help. The Ministry of Trade has already taken steps to raise the profile of trade facilitation issues, which can be used to share key information and build a separate and coherent agenda in this area, behind which different parts of the Government can unify and align to achieve common goals.

Finally, it is worth noting that policy on international transport, the post office, banking, telecoms and utilities has achieved visible results in recent years. This is somewhat ironic since a minority of ni-Vanuatu people travel, use postal services or a bank, or have access to a telephone. Fewer have electricity, and some do not even receive basic services.

Disappointingly, perhaps the worst policy still occurs in key areas of trade facilitation – including inter-island shipping, trade restrictions, and agricultural export. The ability to sell agricultural commodities and buy cheaper goods touches on the life of every person. In terms of poverty reduction, reform in these areas matters more than in others. The broader linkages between trade and other parts of the economy are often unappreciated. Though the wealthy urban centre of Port Vila has boomed in recent years, agriculture, particularly on the outer islands, has been left behind. Long-term solutions to rural hardship lie in investing in ways to increase income generating opportunities on the outer islands, and this can only be achieved through making it easier to trade.

6. TRADE, POVERTY AND HUMAN DEVELOPMENT

6.1 Introduction

The human development situation in Vanuatu remains under-prioritised; in particular socio-economic inequality and the unique role played by the *kastom* economy. The relationship of subsistence with the cash economy and its internal dynamics could also be better understood. A more comprehensive analysis of the rural economy shows how trade can positively impact on poverty reduction and human development. The economic contribution of women can be better recognised, whilst measures to improve gender equality should also be considered. Given the dualistic nature of Vanuatu's economy – rural and urban – any analysis of the linkages between trade, poverty and human development must make inequality central.[51]

In order to address human development concerns in Vanuatu, trade policies need to focus on increasing competitiveness of the service sector; increasing investment in human development; and improving and expanding service delivery in health and education. Whilst the relationship between human development and science, technology and innovation may not at first be apparent, this chapter makes a number of proposals in this area, including efforts to increase entrepreneurship, improve access to capital and raise land productivity.

The concept of human development suggests that other dimensions of development must complement income. As such human development has been variously defined as 'human flourishing in its fullest sense – in matters public and private, economic and social, and political and spiritual' (Alkire 2002), and as 'a process of enlarging people's choices and freedom' (Sen 2000). The UNDP has published a Human Development Index (HDI) annually since 1990, using three indicators -- education, longevity and income -- as proxies for knowledge, long and healthy life and standard of living.

As Sen (2000) argues, while economic growth is essential for development, other determinants such as 'social and economic arrangement (for example, facilities for education and health care)' also need to be adequately attended to. Economic equality is particularly important in Vanuatu. The dichotomous nature of the economy allows individuals in urban areas more material choices than others in rural areas.

The issue of inequality is fundamental to achieving the Millennium Development Goals[52] (MDGs). The World Bank report *Pro-Poor Growth in the 1990s: Lessons and Insights*

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[51] Primary research for this chapter was conducted in the islands of Tanna, Gaua and Santo. A simple household survey (annex 1) was undertaken to assist in the basic understanding of household economics in the rural areas. Extensive field interviews of approximately 100 people from all walks of life were carried in the three islands of Gaua, Santo and Tanna in the course of one month, with at least one week devoted per island.

[52] The MDGs are: (1) Eradicate extreme poverty; (2) Achieve universal primary education; (3) Promote gender equality and empower women; (4) Reduce child mortality; (5) Improve maternal health; (6) Combat HIV/AIDS; (7) Ensure environmental sustainability; (8) Develop a global partnership for development.

from 14 countries states that while many developing countries experienced high economic growth, rising inequality has reduced the impact of growth on poverty reduction and that it will continue to do so in the future (WB 2005). In Vanuatu high economic growth in the last three years has resulted in little poverty reduction and the exacerbation of economic inequality.

A growing body of academic literature discusses the relationship between inequality and crime, social unrest, and/or violent conflict (Deraniyagala 2005; Mancour 2006; Mushed and Gates 2005). It has been argued that rising inequality (deprivation) results in grievances that can lead to social unrest and/or violent conflict. This is particularly important in the case of Vanuatu where growing inequality coupled with rapid urbanization against a backdrop of a dichotomous economy may be lead to an increase in crime and social unrest.

6.2 Poverty and human development in Vanuatu

Vanuatu enjoys a reasonably high per capita income for an LDC (USD1,500 according to ADB 2006 and USD3,051 in PPP terms according to UNDP 2006). Per capita income, however, does not account for the subsistence-based population and the growing income inequality between urban and rural areas. Wagle (2007: 4) rightly argues that the "dichotomy of a well-off urban populace (including a sizeable expatriate community) disconnected from the rural majority presents compelling challenges to spread the benefits of trade in Vanuatu".

According to the ADB, 40% of the total population and 51% of those living in rural areas have an income of below USD1 a day (ADB 2003). Living standards remain below those of many of Vanuatu's neighbours, measured by literacy rates, mortality rates and access to roads and telephones. Access to basic services, above all health and education, could be improved considerably. Women stand to benefit, since girls often tend to receive lower levels of education and improvements to health services can have a disproportionate impact on women.

However some doubt has been expressed about income statistics. Due to the informal nature of the rural economy and poor data it is very difficult to determine income in the rural areas. Many people are richer in terms of capital than the income data suggests, since they own or claim stewardship over a substantial area of land. The subsistence nature of much of the economy means that under-nourishment is rare and quality of diet is high for an LDC. In simple terms the majority of people have sufficient leisure time and live well, with the notable exception of those who inhabit makeshift urban settlements.

Vanuatu was recently assessed by a UK-based think tank as being the 'happiest' country in the world. The New Economics Foundation (2006) placed Vanuatu in first place on an index measuring happiness and environmental wellbeing in 178 countries. Using subjective and objective data, the report highlighted Vanuatu's low 'ecological footprint', reasonable life expectancy and sense of social welfare. Whilst doubts can be expressed about the methods used (Colombia ranked second), it points to some intrinsic advantages of life in Vanuatu. Many people do not appear to consider income to be an over-riding motivation, preferring environmental and social goals. Human development, rather than simple economic output, is thus a useful framework within which to discuss development.

6.3 Human development performance

Whilst Vanuatu may be relatively wealthy in a capital and social sense, it is easy to romanticise the village lifestyle. Capital and social wealth are not being systematically translated into better health and education outcomes. According to the most recent Human Development update work undertaken in 2004[53], Vanuatu's human development performance can be summarised as follows:

- The best English literacy results in the Pacific;
- Steady health outcome gains; a limited spread of communicable and lifestyle diseases; and,
- High private sector participation in all three human development areas,

But…..

- Highly unequal distribution of human development outcomes between rich and poor;
- Highest fertility rates in the Pacific;
- Very high per capita public expenditure in education, with limited results.

The following table shows that Vanuatu ranks 119th of the 177 countries in terms of Human Development and fares better than its neighbours the Solomon Islands (128th) and Papua New Guinea (139th), but lower than Fiji (90th) (UNDP 2006).

Table 6.1 HDI Values for Vanuatu, 2006

Country	HDI Rank	HDI Value	Life Expectancy at Birth (years)	Adult literacy rate [% ages 15 and older]	Combined gross enrolment ratio for primary, secondary and tertiary schools (%)	GDP per capita (PPP$)	Life Expectancy Index	Education Index	GDP Index	GDP Per Capita (PPP$) rank minus HDI rank
Vanuatu	119	0.670	68.9	74.0	64	3,051	0.73	0.71	0.57	-1
Solomon	*128*	*0.592*	*62.6*	*76.6*	*47*	*1814*	*0.63*	*0.67*	*0.48*	*18*

[53] World Bank Pacific Islands Human Development Review 2004/1999 population census.

Islands										
Papua New Guinea	*139*	*0.523*	*55.7*	*57.3*	*41*	*2543*	*0.51*	*0.52*	*0.54*	*-15*
Fiji	*90*	*0.758*	*68.0*	-	*75*	*6066*	*0.72*	*0.87*	*0.69*	*-2*

Source: UNDP 2006

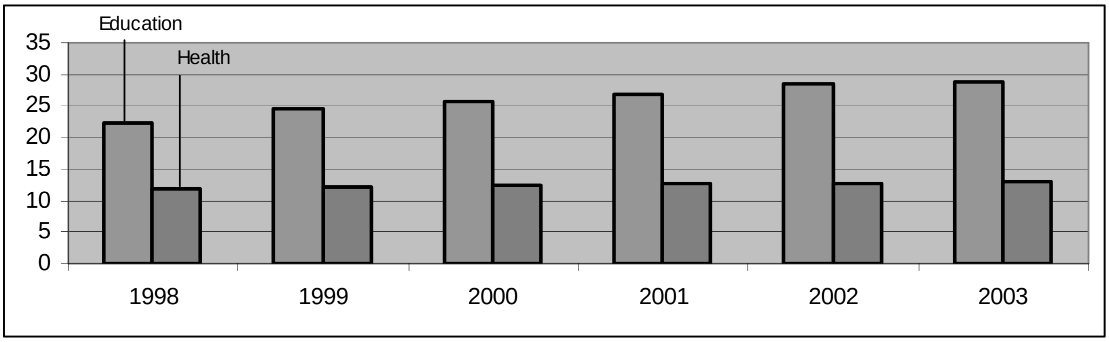
Life expectancy at birth in Vanuatu is better than most of its neighbours, at 68.9 years, compared with 68 years in Fiji, 62.6 years in the Solomon Islands and 55.7 years in Papua New Guinea. Numerous people working in the field of health have stated that the Pacific region enjoys (in comparison to other developing areas) a disease-free environment. There are very few cases of epidemics. However, while people live in a relatively disease-free environment, they are extremely susceptible to widespread epidemics for which they have not built immunities.

Health standards remain low by global standards. 40 percent of the population does not have continuous access to clean water. Twenty percent of children are underweight and under height for their age. Infant mortality, at 31 deaths per thousand births, remains high and immunisation coverage of one-year-olds for TB and measles is only 63 percent and 48 percent respectively. Furthermore, low household incomes restrict access to health services for households in the outer islands.

The adult literacy rate for Vanuatu is 74% compared with 76.6% for the Solomon Islands and 57.3% for Papua New Guinea. Children in Vanuatu have fairly good access to primary education with impressive gender equality. However the standards of education from primary to tertiary have received criticism. For example anecdotal evidence on education in rural Vanuatu found that the quality of education is poor, to the extent that children are made to do chores such as washing and cleaning by the teacher during school time, and teacher absences are high.

The figure below shows that there has been a gradual increase in public expenditure on health in recent years, and to a lesser extent on education. The overall increase can be explained partly by the rapid growth in population (2.9%) during these years. Education forms a high proportion of overall expenditure owing to the dispersed nature of the population and transportation difficulties. Schools are small and numerous because it is difficult to travel within and between islands. Yet the efficiency of education spending is clearly low, both in quantitative and qualitative terms.

Figure 6.1 Expenditure on education and health as a percentage of total Government expenditure



Source: Budget-Section, MFEM, 2002-06

6.4 The rural economy

More than 80% of Vanuatu's population depends on agricultural for their livelihood, so much so that the 'welfare [of the people] rises and falls with the state of the agriculture sector' (Welegtabit and Longmore 2006: 5).[54] The contribution of the rural sector to the overall economy is a much smaller fraction of GDP, and "agricultural growth has been very slow, averaging 0.72%…[T]he relative contribution of the agriculture sector to GDP has been declining over time" (ibid.). Yet despite its lukewarm performance, the agricultural sector seems to be meeting the growing needs of the population.

Unravelling this paradox requires first sub-dividing the rural agricultural sector into two: subsistence and cash crop production. The cash crop production possibilities of the household are constrained by its endowments – land, capital and labour. The functioning of these factors of production (supply side constraints) coupled with market (demand side issues) determines the prospect for households to trade and earn income. Income in turn is vital for households to access other dimensions of human development. However households in rural areas are also embedded in subsistence modes of production. In other words, the need to secure subsistence first influences the household decision over allocation of resources such as land, labour and capital.

A lack of transportation and infrastructure are some of the primary constraints to cash crop production and agricultural growth in the rural sector. But other constraints exist. In particular these involve the relationships between cash crop production, the primary factors of agricultural production and the 'subsistence effect'.

Each household (see annex 1) in Vanuatu has access to at least 4-5 hectares of land, which is divided into two major types of production; subsistence and cash crop. The 2006 Agricultural Census states that 94.3% of household in Vanuatu claimed access to 'subsistence' (or Garden Plot), with 92.9% and the remaining 0.6% claiming access to 'small holder' and 'plantation' respectively (see table below). The latter two are mostly used for cash crop production (NSO 2006).

[54] Not all of the informal economy is subsistence agriculture. So-called 'black market' stores sell a variety of goods from alcohol to basic foodstuffs. A variety of other mostly male and sole owner-operated businesses provide buses and taxis, *nakamals* (kava bars) and even rudimentary financial services.

Table 6.2 Household access to agricultural plots, 2006

	Total Household	Garden Plot	Small Holder	Plantation
Vanuatu	37,848	94.3%	92.9%	0.6%
Urban	5,128	86.0%	80.1%	0.7%
Rural	32,720	95.6%	94.9%	0.6%

Source: Compiled from 2006 Agricultural Census (NSO 2006)

A plot of land carved out for subsistence referred to as 'karen' or 'garden'[55] is strictly used for daily food intake. It mostly involves production and consumption of root crops[56], vegetables and fruits. A second form of labour employed by households on land is for cash crops such as copra, kava, vanilla, timber, coffee, cocoa, cattle, etc.[57] The 'garden' is usually situated closer to the house, whereas the same is not necessarily true for land used for cash crop. Further, each unit of production must allocate limited labour and scarce capital between the garden for subsistence and cash crop production for income.

6.4.1 Land

Broadly speaking two distinct forms of landholding can be found. Private landholding conforms to the modern principles of private landownership with recourse to formal law for the protection of landowners' rights. 'Customary' landholdings are owned communally and enforced by community norms and chiefdom systems. The main distinction between the two systems is in the nature and form of ownership.

The conventional idea of ownership does not fully capture the relation of people to land. Instead 'no one actually owns land', but, has 'either access or custodianship over land' (Nari, 2000). Such an arrangement of land tenure is distinctive from the formal concept of land, landownership and usufruct rights.

Land issues in Vanuatu have been the subject of a vibrant and ongoing debate. Some stakeholders call for land reform along the private property system, aimed at assuaging land-related conflict. Others continue to advocate customary land tenure arrangements. However other land-related issues are submerged in this debate, including land productivity and possible conflicts within existing tenure arrangements.

The current debate tends to focus disproportionately on the types of ownership to the neglect of more specific issues such as conflict and underdevelopment. In the southern island of Tanna, the field study identified that there is potential for conflict arising from land scarcity[58]. On the islands of Espiritu Santo and Gaua, and throughout rural Vanuatu, low levels of land productivity seemed to be the main problem.

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[55] The 2006 Agricultural Census defines garden as temporary crops planted around the area near the house for household food requirement.

[56] Surplus root crops from the garden are also sometimes sold in the market.

[57] For further discussion on cash crops see Weleglabit (2006).

[58] There is little discussion on land conflict arising from scarcity. There seems to be plenty of land for a population of only two hundred thousand. A vast area of land is untouched. Much land remains unexploited and in its most pristine form -- jungles and bush. Most of this land is claimed by individuals and clans.

On the island of Tanna, all land is divided and demarcated along different and numerous clans. Two major inter and intra-clan issues concern such distributions. First, some clans have more land than others. Second, the customary landholding system is along a hereditary system where the 'first born' of a certain family receives privileged custodianship (custodian rights) over the land of that particular clan.[59] Such a person carries a title name (in form of a last name) that guarantees custodianship over the clan's land. The rest of the family or extended members of the clan merely have 'access' to the land, albeit often guaranteed. Hence, it could be argued that such a system creates and maintains a privileged class of landowners with custodian rights and an entire subclass with mere access rights upheld by their respective clans. Whilst the inheritance of property is in some areas along matriarchal lines, land is largely passed from father to sons. Women therefore tend not to have direct and autonomous control over land, and therefore effectively constitute part of this subclass with only access rights.

During the course of the fieldwork it was found that not all clans experienced similar population growth. Furthermore, there existed a relationship between population growth and land fragmentation or subdivision to meet the custodian rights or access rights of the entire population of the clan. Taken together, the interplay of these factors has come to mean that clan population growth is inversely related with subdivision of land. As land is clearly demarcated along clan lines, this has resulted in heightened perceptions[60] of land scarcity[61] in some areas of the island, while other areas remain uncultivated. A possible implication of this is that people may have less land for cash crops as they will continue to prioritize subsistence.

Other islands with comparable structures of land distribution may be witnessing similar pressures. Without a detailed study it is difficult to conclude one way or other. This issue, however, has important implications for trade, given that it directly influences the production-related behaviour patterns of rural households. On the basis of perceptions of land scarcity, households may be further prioritizing subsistence-oriented production, diverting resources away from cash-crop production and thereby reducing household income.

Land productivity also has important consequences in rural Vanuatu. Most of the households in the field survey reported that they have access to 4-5 hectares of land, of which only a third was cultivated. Farmers employ rotation techniques and deploy all the members of the household for subsistence and cash crop production. Given the availability of land per household, preparation of uncultivated land, and labour intensity of agricultural production the labour needed was not always sufficient. Field interviews did indicate that labour scarcity in relation to available land was negatively affecting land productivity (see the section on labour below).

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[59] The same privileges are not given to second or third born, and so forth, or to other members of the same extended family.

[60] There is enough scope for further increase in land productivity, which could reduce the pressures of land scarcity.

[61] The pressure on land is not necessarily from the literal sense of 'land scarcity' but more so from stagnant land productivity. In the absence of better technology, land productivity remains stagnant. Given the archaic farming technology, increasing population (all else equal) in certain pockets is putting pressure on land.

<u>Case Study: Copra farming on the island of Gaua</u>

Lorna Surle farms copra on the northern island of Gaua. During a field interview, she explained how increasing labour costs have reduced her profit margin.

Labour Cost: VT 5000 (per day) * 60 days (3 months) = VT 30,000
Total Production of copra in 3 months: 4 tonnes
Price of Copra per tonne: VT 12,000.
Price for 4 tonnes of copra: VT 12,000 * 4 tonnes = VT 48,000
Profit margin for three months: VT 48,000 – VT 30,000 = VT 18,000 (approximately USD180)

The domestic market price is usually determined freely. However at the time of the field survey, the MTIT had intervened to increase the domestic market price of Copra to VT28,000 per tonne. This action was performed through the Vanuatu Commodities Marketing Board (VCMB), which is the main buyer of copra. Such subsidies have at times raised the market price of copra above the export price. Private actors have no option other than to stop purchasing copra and wait till the subsidy runs out so that the market price of copra can adjust back to its normal price.

It is questionable whether the subsidy system truly supports farmers, since traders appear to appropriate a large proportion of the subsidy rather than passing it on to farmers, who are the intended beneficiaries.

Farmers also suggested that the ship was not guaranteed to arrive. In such instances copra collected by farmers in Gaua would be wasted and farmers would be left guessing as to whether the ship would return again in another three months. Unpredictable transportation links were accentuated by the fluctuations in the international copra price, and the VCMB copra subsidies.

The (un)reliability of the market is a very important factor in understanding household cash crop production behaviour in rural areas. The case study of Tanna Coffee (below) reveals that a reliable market source helps motivate farmers to produce certain cash crops. In the absence of a consistent price and buyer, it is rational for farmers to concentrate on subsistence production.

An increase in capital input, in theory, could have increased labour productivity and partially overcome the concerns of labour shortage for the production of cash crops. However most islands suffer from capital scarcity (more below). Even when both land and labour is available, a lack of capital (on its own) can also hamper the improvement of land productivity. During the course of fieldwork in Port Olry, Santo (a mainly copra farming area) it was found that there was both vast amount of land available for cattle farming and also interested cattle farmers. Most farmers, however, lacked the needed funds to invest in fencing large plots of land and to purchase other capital equipment. Consequently they were forced to remain in copra farming even though cattle farming would have been more profitable given Port Olry's proximity to beef export market in Luganville.

So far, two supply-related factors—labour and capital—that have implications for land productivity and subsequently production of cash crops have been discussed. But there is evidence to suggest that farmers exercise considerable agility in shifting production according to market signals. In this respect, while supply issues do play a significant role, demand does seem to have an equally important role in influencing production behaviour. Tanna coffee provides a good case study of how market signalling impacts the production behaviour of farmers.

Case Study: Tanna Coffee[62]

Many farmers on Tanna have switched from traditional cash crops such as copra to coffee for the following reasons:

1) Coffee has a secure market at the Coffee Organisation of Vanuatu (COV) in the island of Tanna. On specified days of the year farmers can bring their coffee to COV and will be paid instantly (depending on its quality). This is a marked difference from the days of EU-funded coffee project in Tanna where buying times were irregular and farmers were not paid immediately.
2) Farmers have the flexibility to make their own decisions on production. For instance, farmers can either sell roasted beans (which need considerable water and labour) and receive larger payment or not process the product and settle for a lower price. Further, such a decentralized system provides the needed incentives for farmers to work collectively on the various stages of production.
3) Decentralized production has been accompanied by appropriate and user-friendly training such as how to dry, roast and store coffee beans.
4) The factory at Tanna managed by COV has been recently staffed by well-qualified managers from Peace Corps who ensure that managerial tasks (such as ensuring sufficient cash flows to compensate farmers as soon as coffee is brought into the factory) is professionally and reliably taken care of. According to field interviews, this one factor has had a major impact on increasing the confidence of the farmers over coffee production. Not only are existing farmers continuing with coffee production, but many farmers are also switching to it. In one of the farmers' words: "As long as I have a reliable market at COV, I would prefer planting as much coffee as possible over other cash crops. It requires minimal labour and provides the highest return."
5) A single entrepreneur has given a long-term commitment to the development of coffee production. Mr Terry Adlington, the owner of Tanna Coffee, has been crucial in the overall growth of coffee production. He has been the critical link between production,

[62] Thanks are due to Terry Adlington (Owner and Manager of Tanna Coffee) and Brett Serwalt (Peace Corps Volunteer) for the information in this section.

marketing and selling of coffee domestically and abroad to the extent that current demand exceeds supply.

In recent years production has barely been sufficient to satisfy local demand of around 10 tonnes per year. However, green coffee production in 2006 was 23 tonnes, auguring well for the future. The case of Tanna Coffee shows that market security, price stability and a layered production structure are important in enhancing land productivity and producing a reliable export product.

6.4.2 Capital

Given the limited availability of labour, capital can play a crucial role in augmenting land productivity. Theoretically, capital can be generated in the rural economy either internally (through savings) and/or externally (through financial transfers from Government and/or commercial banks). But a lack of financial institutions to transform surplus income into savings and in turn into investment is a crucial missing link between income, saving and capital. After all, it is not individuals who transform income into investment. Financial institutions provide the necessary incentives to individuals by giving them an interest on their savings, and simultaneously to invest by giving out loans to potential investors.

Three points emerge with regards to capital in relation to agricultural production in rural areas.

First, it emerged that the need to pay for school fees and make certain basic transactions[63] primarily motivate farmers to sell their crop.[64] As these expenditures are not regular (i.e. weekly, monthly, etc), the farmer's selling patterns are also irregular.

Second, income does not always equal expenditure. Because farmers sell irregularly and in bulk, there is often surplus income. But lack of accessible means of savings (at least on most islands) has meant that the surplus income does not result in productive usage. The field survey in the island of Gaua revealed that the surplus income for re-investment is usually sizeable. But in the absence of proper financial institutions such as banks or a co-operative society to facilitate saving, the surplus income is buried in the earth for 'safe-keeping'.

Third, the lack of financial institutions may also be influencing farmers' irregular selling patterns—selling only on cash needs basis. For instance, in Tanna where financial institutions are present, farmers tend to sell coffee at regular intervals irrespective of cash needs and save surplus income in these institutions. In contrast, in Gaua where there are no financial institutions, farmers sell cash crops (mainly copra) when they require cash and store any surplus income in their house. Field interviews, however, revealed that the option to save would alter production behaviour. The following case study shows why.

[63] It was found that farmers in the island of Santo would sell their cash crops to Chinese dealers and then would spend most of their income in the Chinese dealer's retail shops; mostly on rice.
[64] Though this might sound like a gross generalization (and to a certain extent it may be), based on field study that covered three islands and multiple interviews such a generalization may hold relevance to Vanuatu at large.

Case study: Relationship between savings and production

The following case study was gathered through interviews with three types of farmers in Gaua. These farmers were divided along those who; (1) had access to savings in financial institutions outside the island (mainly in Santo), (2) did not have any access, and (3) did not have any access but were interested in saving.

Each of these farmers divides his/her labour-time into four major activities: (1) subsistence, (2) cash crop production, (3) reciprocal obligations and (4) leisure. While subsistence production is relatively constant (i.e. contingent on the number of mouths to feed), cash crop production can, in theory, be increased if greater labour-time is to be invested. But labour allocations depend on a number of factors, of which an important one is 'ability to save'. In the absence of saving-options in financial institutions, surplus income (income beyond the immediate cash requirement needed to meet expenditures) is 'stored' in the house. The latter is neither secured for future usage nor used to generate interest in the future. As the farmer has little use of the surplus income in an almost cashless economy, lack of savings options means the farmer is discouraged from increasing his or her labour for cash crop production.

All else being equal, the presence of savings options (complimented with awareness building if needed) could therefore assist farmers to increase labour on cash crop production.

As the above discussion on capital demonstrates, the issue of lack of capital in Vanuatu arises not strictly from an absence of actual capital. Rather a lack of financial institutions in the islands curtails the transformation of surplus income into savings and in turn into investment. Increased access to micro-finance, particularly among women's groups, has the potential to raise the role of the private sector and to increase the rate of human development.

6.4.3 Labour

According to the last Labour Market Survey (NSO 2000), 15% of the total labour force (14,272) is employed in the formal sector and 75% (157,000) in subsistence agriculture. A more recent publication states that the population has been increasing at the rate of 2.9% and implies that the labour force has also increased accordingly (NSO 2005). But changes in labour force distribution have not been documented since the last Labour Market Survey.

The debate over labour issues in Vanuatu has focused largely on unemployment and the lack of skilled labour. While these are valid concerns, another equally pressing issue relates to changes in the labour supply in the rural areas and its implications for cash crop production.

Labour has become an extremely important factor in determining production patterns. Household labour time in rural areas is usually divided into subsistence, cash crop production, reciprocal obligations and leisure. Because of the importance given to subsistence, subsistence production is unlikely to alter quickly. This would imply that scarcity of labour would reduce the other four activities, including cash crop production.

The increasing out-migration of labour from the rural areas to urban centres may be exacerbating the labour scarcity experienced by households for agriculture (including cash crop production)[65]. International labour out-migration may exacerbate this scarcity. Such scarcity of labour, all else being equal, will lead to an increase in cost, which will in turn put upward pressure on price of cash crops, making them less competitive globally.

6.4.4 Labour mobility

Some of the most successful labour-exporting countries, such as the Philippines, have achieved their advantage through a targeted strategy. As opportunities increase for international movement of labour due to global demographic trends, the competition in this sector is likely to increase, and countries with a good track record of success are likely to reap greater opportunities, if they want them.

6.4.5 Unskilled movement of labour

A growing body of research and debate already exists on labour mobility in the Pacific. A groundbreaking study – 'At Home and Away' – was carried out by the World Bank in 2006, looking specifically at the potential for increasing opportunities for unskilled agricultural workers from the Pacific in the two developed countries in the region, Australia and New Zealand. This followed similar work, in particular Maclellan and Mares (2005) which outlined a proposal for a pilot scheme for the Australian agricultural sector. Over the years there have been repeated calls from leaders and high-ranking ministers from the Pacific highlighting the need for their nearest developed country neighbours, Australia and New Zealand, to consider temporary labour mobility schemes as an addition to existing development assistance. It has also been noted in the Pacific that much agricultural fruit-picking in Australia is currently done by European backpackers under a working holiday scheme.

In response to these efforts, a 2006 Australian Senate inquiry recommended that their Government set up a pilot project for unskilled Pacific workers – though the Government rejected the proposal in favour of more aid for technical training. At the same time however the New Zealand Government announced that it would create a new Regional Seasonal Employment (RSE) scheme, under which up to 5,000 Pacific Islanders could gain temporary employment for up to seven months in a year. Under the proposal five

[65] There is no data, analysis or study to corroborate this. Nonetheless, during the field study it was observed that labour mobility is having negative effect on agricultural productivity. In Vanuatu, unlike many developing countries, each household has access to a large plot of land. Further, there are severe capital constraints. Therefore, existing land productivity (measured in agricultural output) is constrained by available labour. Further decreases in available labour, all else being equal, may have a negative impact on land productivity.

countries – including Vanuatu – would also receive priority assistance to help them put measures in place to facilitate the flow of workers.

Although it has only very recently begun, New Zealand's RSE has a number of features that give it potential to become an example of best practice as a development-friendly seasonal labour scheme.

Most importantly, following internal consultations over the best way to manage recruitment issues, the Government agreed in 2006 to a framework in which only approved and licensed private recruitment agencies would be permitted to recruit and supply workers overseas. Legislation is currently being proposed to that effect covering all aspects of the licensing, regulation, and disciplinary procedures of approved seasonal worker recruitment agencies. Vanuatu also has a history of bad experiences in relation to labour mobility schemes, particularly one which involved millions of dollars of 'lost' wages for workers recruited onto commercial fishing boats during the 1980s, as well as several cases of con men within Vanuatu who were able to exploit people's desire to work overseas.

Although legislation is still pending, based on the current situation under which more than 100 ni-Vanuatu people are currently employed in New Zealand, recruitment agencies will play an important role in the scheme.

6.4.6 Semi-skilled and skilled movement of labour

Vanuatu already has a limited number of overseas skilled and semi-skilled workers. These include cruise ship workers, a few UN peacekeepers and a small number of private individuals working in nursing and in higher skilled professions mostly in Australia and New Zealand. The situation in Vanuatu and other Melanesian countries stands in notable contrast to other PICs, which either have long-standing residency or work visa agreements with New Zealand – for example Tonga, Cook Islands, Samoa – or access to the US through Compact of Free Association agreements in the case of the Federated States of Micronesia, Palau, and Marshall Islands.

The immediate focus for Vanuatu in terms of semi-skilled and skilled labour is in negotiating access to the EU market in trade in services negotiations as part of an EPA. The Pacific Island Countries have identified four particular areas where they have some comparative advantage – nursing, construction, tourism and hospitality, and seafaring – and are seeking access to the EU market at appropriate levels of qualification that would go beyond the EU's existing commitments at the WTO.

However, given the distance and the complexity of the EU market, Australia and New Zealand are in the long run the more likely target markets. In this regard, the guiding regional framework for development – the Pacific Plan – includes provisions for negotiating temporary movement of labour with Australia and New Zealand under a PACER arrangement. Another alternative would be to expand existing bilateral labour agreements over time to cover more semi-skilled and skilled occupations – this has already been mooted as a possibility under the New Zealand RSE scheme. Within the Pacific Islands themselves, there is also a provision for including movement of skilled labour within new services chapters of the PICTA and MSG trade agreements.

If managed correctly, one major benefit of increased temporary access is that it promotes learning and technological transfer through enabling staff to gain valuable experience of different approaches by working abroad. Similarly, linking opportunities to having qualifications creates a strong incentive for individuals to invest more in improving their skills and education, and for the Government to provide training.

Table 6.3 Potential costs and benefits of skilled and semi-skilled labour mobility

Benefits	Costs
▪ Additional income for Vanuatu through savings and remittances ▪ Increased training and skills transfer, for example through valuable experience of different approaches by working abroad ▪ If linked to qualifications, provides an incentive for people to invest in education, and for Government to provide it ▪ Reduction in illegal migration and improved regional security ▪ If part of a regional scheme, potential to develop regional training institutes and centres of excellence (e.g. in tourism) ▪ Creates greater competition for staff within home country, leading to better pay and conditions ▪ Reduction in social pressures occurring as a result of population growth	▪ Risk of legal extensions or illegal overstaying in host countries ▪ Potential for "brain drain" of skilled and semi-skilled personnel out of Vanuatu ▪ Social pressures if families remain in home country ▪ Skills shortages may raise wages, and therefore employment costs, while lowering productivity in home-country firms

The best way of ensuring the importance of qualifications would be to build them into any future agreements on movement of skilled and semi-skilled labour. This is the approach that has already been suggested for the EPAs, and under PICTA countries have also been considering opening labour markets for skilled workers in a similar way to the Caribbean countries' 'Skilled National' scheme, with a common regional list of mutually recognised qualifications that provide an automatic right to work across all participating countries.

Additional measures could include those aimed at making return more attractive, such as a favourable personal taxation system. In light of research showing that levels of remittances decrease for longer-term economic migrants, one approach espoused by the EU in their recent 'Blue Card' proposal on permanent skilled migration was to encourage migrants to maintain links with their home countries with frequent visits (although it is unclear how such a policy would be implemented). In the Vanuatu context, one solution would be to use the loss of traditional entitlements as an incentive to ensure return.

Exports of unskilled and skilled labour create are two very different sets of problems and challenges. For unskilled labourers the focus is very much on the design of quite heavily monitored and regulated schemes, to ensure that workers are not exploited or do not overstay. Building on the example of the recently introduced RSE scheme, a strategy for unskilled workers schemes might include:

- Clear understanding and dialogue between host and sending governments as to their respective roles and responsibilities, and those of companies involved in the scheme;
- A fair, transparent and cost-effective application and selection process;
- Proper legislative framework for effective regulation of schemes and recruitment agencies, particularly where there are potential sources of abuse;
- Adequate pre-departure training, awareness and sensitisation;
- Agreement over responsibilities for monitoring employers and employees, in particular to ensure the rights of workers abroad;
- Ways of ensuring that remittances can be easily and cheaply transferred from host to sending countries;
- Additional development-focused measures to improve the flow of benefits back to sending countries.

By contrast, a different approach is required in trying to facilitate greater numbers of semi-skilled labour overseas. Here, the main concern for semi-skilled labour is preventing too much 'brain drain' and ensuring that skills are transferred back to the home economy. The focus should therefore be on:

- Consultation and coherence between education authorities and trade negotiators to ensure that the right occupational groups are targeted, and that there is planning for the provision of adequate levels of training;
- A clear approach to negotiating agreements which are designed to balance the desire to benefit from increased labour mobility the against the need to retain an amount of skilled in key sectors (e.g. tourism);
- Upgrading the Technical and Vocational Education and Training (TVET) qualifications framework, but with greater emphasis on linkages to potential

markets, and through fostering linkages (for example shared curriculum) with overseas training institutes;
- Additional measures to minimise ‘brain drain’ and ensure that skilled workers are encouraged to return home.

At the moment the biggest needs in Vanuatu are in making sure firstly that the regulatory process works in the case of the new RSE scheme, and secondly addressing how to take account of increasing opportunities for overseas employment within current education planning and thinking.

More attention also needs to be placed on whether or not the potential benefits of out-migration will outweigh the potential cost associated with labour out-migration. Three factors to bear in mind in such analysis would be:

- The nature of employment (temporary or permanent) from out-migration. If it is only temporary and large numbers of workers are involved, the market for cash crops may weaken. It will be difficult for workers returning to the rural areas to engage productively in income-generating activities.
- The extent to which remittances will offset or exceed the loss in income from cash crop production.
- The issue of remittances also raises a number of concerns, such as the type of employment found in urban areas, amount of income earned, cost of living and major expenditures incurred.

6.5 The subsistence effect

The three basic endowments of the household – land, capital and labour – determine household production capabilities, which in turn influence households’ capacity to trade. As suggested above, trade with external markets is the primary source of income for households’ income. In this respect, the productivity of household endowments will determine household well-being. The discussion so far has explored the status and changes in these endowments as it relates to trade in rural areas. But a prominent feature in the household’s decisions to allocate these resources in Vanuatu is based on what can be termed the subsistence effect: *In the absence of real and/or perceived economic alternatives that can provide sufficient economic security, households in Vanuatu prioritize ‘subsistence’ over all else and, in particular, cash crop production.*

The subsistence effect is crucial for determining households’ decision over allocation of resources. If the subsistence effect is not understood then households’ decisions on cash crop production will at times seem like economic anomalies. Below are some examples:

- *After Cyclone Ivy, the domestic price for coffee increased but the farmers did not respond by increasing production.* The cyclone had devastated their garden, which for them was more important than income from coffee. While subsistence had met their basic needs for generations, coffee was relatively new.
- *Why do farmers not respond to price? Why do they not increase production with an increase in price?* Farmers carefully study long-run prices. A short-term price increase will not alter the farmer’s behaviour. Harvesting takes time, and the farmer must be assured that the market will favourably compensate for her labour when the

product is harvested. The farmer will work only when she is assured that her labour on cash crops will be compensated favourably.

- *Why do farmers in Vanuatu take cash crops to the market only when its time to pay school fees? Why do they stop after that?* Once the need for cash is fulfilled the farmer then switches his/her labour back into subsistence and other activities. This has arguably led to the situation of a 'backward bending' supply curve for household cash crop production.
- *Many observers place considerable weight on lack of infrastructure as an overriding explanation for decreases in cash crop production (e.g. Welegtabit 2006). Why is there no significant increase in agricultural production in locations with reasonable infrastructure and transportation?* Again, where farmers have received assurance of a constant price and demand for a particular product, they switch to its production. For instance, vanilla (one of the smallest export commodities) is being grown in some of the most remote areas that do not have regular transportation. The issue once again relates to the 'subsistence effect' in farmers' decision-making process. Subsistence has persisted for millennia, while cash production is relatively recent and has proven somewhat unreliable. While both infrastructure and transportation are important for trade, farmers' production behaviour is often overlooked.

Development interventions in rural areas must recognise how the subsistence effect influences household behaviour. These interventions must also be aimed at securing 'subsistence' for households and simultaneously harnessing the benefits of the market economy. The latter is essential if trade and economic growth is to benefit the rural population.

6.6 Trade, poverty and human development in the rural economy

The field survey shows that school fees form one of the largest components of household cash expenditure. While Vanuatu has a high attendance rate at the primary school level, the same cannot be said of the secondary and tertiary levels. Across the three islands where fieldwork was conducted, there was a high dropout or non-attendance at the secondary and tertiary levels due to exorbitantly high fees relative to primary school fees along with a precarious student recruitment system.

Total annual travel costs for one child would be about 60% of rural household income. On top of this, if there are no social support networks in the island where the child is recruited, households find it very difficult to meet regular boarding and lodging expenses. The cost of sending children to school beyond primary level can far exceed annual income.

Rural households enjoy access to reasonably-priced primary medical facilities within the islands. More serious medical facilities, however, can only be found in Port Vila and are often prohibitively expensive. Traditional medicines, widely practiced in almost all of the islands, are an inadequate alternative.

Overall Government expenditure on health and education is already high, and sometimes of questionable efficacy. In the absence of increased expenditure or availability, income levels critically affect access to education and health services -- the basic dimensions of human development. As shown above, people in the rural areas derive income primarily form selling cash crops. Given the small market size in Port Vila and Luganville, export is the only avenue left to increase incomes. In this respect, export has a direct relationship with income (in the rural areas) and income, in turn, has a direct relationship with access to education and health, and vice versa. This can be summarised as follows: Export ↔Income ↔ Health and Education.

6.7 The urban economy

While the rural economy is based on subsistence agriculture and some cash crop production, the urban economy is predominantly based on the services sector (see the chapter on trade policy). Despite the difficulties associated with economic development in the urban economy, households there have a higher level of human development than in the rural economy. Such inequalities between the two economies of Vanuatu form a central part of the human development story.

Inequality can be illustrated with the analogy of a camel caravan crossing a desert. Everyone may be moving forward, but if the distance between those at the back and the rest of the convoy keeps growing there comes a point at which it breaks up. The analogy could not be more true for Vanuatu. The economy grew at an average of nearly 6% during the three years between 2004 and 2006 and per capita income also increased. These figures mask the growing inequality between urban and rural areas.

The following table shows Vanuatu's Gini coefficient of income inequality to be 0.58, one of the highest in the world[66]. The comparison with other Pacific island countries is particularly stark. Vanuatu's income gini coefficient is well over double that of Samoa (0.19).

Table 6.4 Gini coefficient of income inequality for Pacific Island Countries

Country	Gini coefficient
Fiji	0.38
FSM	0.34
Kiribati	0.36
Marshall Islands	0.42
Tonga	0.26
Vanuatu	0.58
Samoa	0.19

Source: (WB, 2004)

The 1999 Household Income and Expenditure Survey (HIES) calculated the median income to be VT52,875 (approximately USD528.75). Approximately 70% of the total household in Vanuatu resided below the median income, as shown in the following table.

Table 6.5 Household income by household size

Vanuatu	Household (HH) Size			

[66] A higher coefficient indicates a more unequal distribution of income.

Income Group	1	2 to 4	5 to 7	8 to 10	11 +	Total HH	HH dist. by median	HH distribution by median in %
Nil	321	1249	666	94	0	2330	**24731**	**70.67**
1 - 4,999	217	1648	1229	404	0	3498		
5,000 - 9,999	155	2425	1608	258	0	4446		
10,000 - 19,999	320	1800	2577	307	36	5040		
20,000 - 49,999	352	3528	3799	1027	231	8937		
50,000 - 79,999	369	2197	2081	363	0	5010	Median Income Mark (VT 52875)	
80,000+	379	2135	2474	607	138	5733	**10263**	**29.33**
Total	2113	14982	14434	3060	405	34994		

Source: (NSO 1999)

Comparisons in income distribution between urban and rural areas reveal the most startling inequalities. The figure below reveals that the majority of the households in rural areas reside well below the median income. In comparison, the relatively smaller populations that are in urban areas reside well above the median income. Moreover, the majority of the households in rural areas reside within the income group of VT 10,000-19,000, making the average household income in rural areas approximately *70% less* than the national median income. In contrast, the 1999 HIES reveals that the top 20% of the income group resided predominantly in urban areas.

Figure 6.2 Number of households by income group

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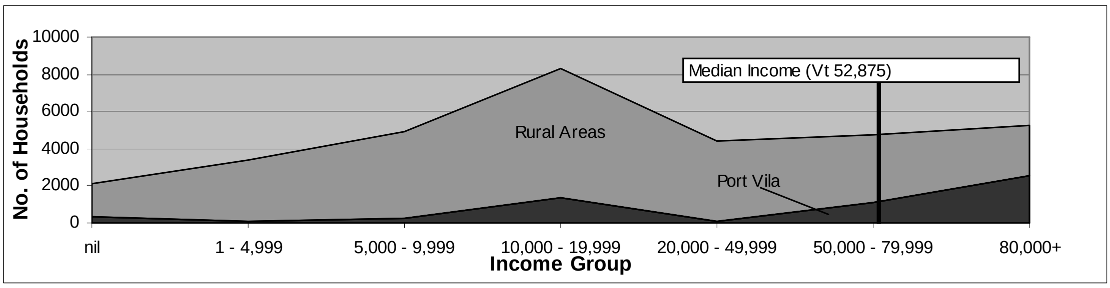
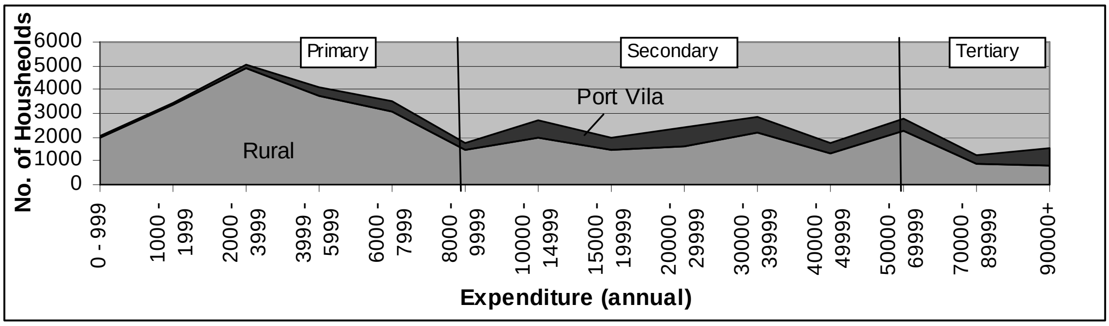


Source: (NSO 1999)

The section on the rural economy argued that income has direct correlation with household abilities to access education and health. The figure above reveals that urban households, in contrast, are predominantly above the national median income. It might be expected that urban households to have access to all levels of education and health. And in comparison, rural households can be expected to be constrained by income in accessing higher levels of education and health.

The following figure shows household expenditure on education. The households in Port Vila (urban) have an almost evenly spread expenditure on education. In other words, almost all households in Port Vila are able to access all levels of education. In contrast, as the level of education increase, fewer households in rural areas are able to sustain the cost. There is a continuous drop in rural access to education as the cost rises.

Figure 6:3 Number of households by expenditure (in VT) on education

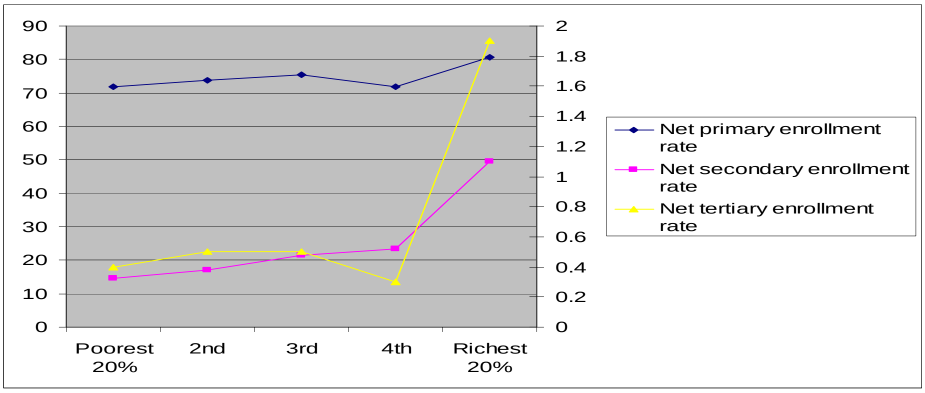


Source: (NSO 1999)

Access to health is also unequal between urban and rural households. Comprehensive health care is only subsidized in Port Vila due to the presence of a Government hospital (Vila Central Hospital). Primary and basic health care are provided for in rural areas at an average annual cost of approximately VT1,132. Beyond primary care, patients from the outer islands must come to Vila Central Hospital. The medical fee at Vila Central Hospital is reasonably low for a range of medical services. But the cost of a return airfare to Port Vila (of anywhere between VT20,000 (USD200) to VT50,000 (USD500) per person) plus lodging and food expenses, makes Vila Central Hospital inaccessible to people from the outer islands. Women are likely to benefit particularly from improved access to health services.

The net enrolment data confirms that tertiary and to a lesser extent secondary and primary enrolment are correlated with income.

Figure 6.4 Education enrolment rates and inequality

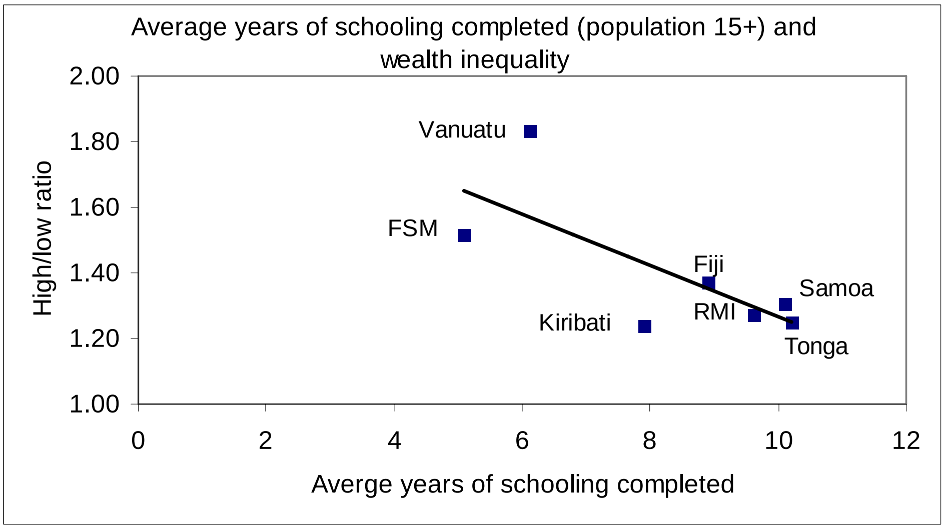


Source: NSO 1999

Wealthier households would be expected to send their children to the best schools and to realise its importance. Nevertheless the data does suggest that Vanuatu is creating a wealthy and educated urban elite which is perhaps preventing other elements of society from receiving some services.

The link between completing school and inequality in the Pacific region shows that Vanuatu's high levels of inequality may be linked with low levels of schooling.

Figure 6.5 Average years of schooling completed and wealth inequality



The data also suggests that the area of services where the wealthiest elements of the population benefit most – namely higher education – is also given a higher priority in terms of the Government's own resource allocation.

The impact of inequality is particularly stark in employment patterns. Some 3,500 school leavers enter the workforce each year with less than 1,000 new jobs being created. The stagnant rural sector is not in a position to absorb most of the extra workers, hence many of the youth continue to move to the urban centres in search of better education and employment opportunities. The rising number of youth in search of work in an environment of low employment-generation is of considerable concern to policymakers.

Disparities in wages, particularly that between urban and rural sectors of the economy will continue to fuel urban drift. Population growth in Port Vila and Luganville is more than 4 percent per annum. At this rate, the population of Port Vila will double to 60,000 by 2020, with the majority of such population being made up of young migrant workers. Absence of work for such migrants will raise pressures on land and the environment, and has the potential to cause social problems unless more jobs are created.

6.8 Conclusions

This chapter began with the argument that trade is important for poverty reduction and human development in Vanuatu. The section on the rural economy argued that cash crop production and trade were important sources of income. Households depend on income from cash crop production to access other dimensions of human development, predominantly education and health. The subsistence effect also influences households' allocation of resources, including production of cash crops. Productivity and scarcity of land may matter more than the form of ownership.

The section on the urban economy discussed the implications of urban growth on inequalities between urban and rural areas. It was argued that rapid growth in the urban economy would further exacerbate existing geographic inequalities. The section examined some of implications of trade liberalization for human development. In the present context, rapid and significant trade liberalization may not immediately increase consumer welfare and may adversely affect the Government's ability to provide for education and health services.

It has also been argued that "the effectiveness of trade liberalization and reform and the gains they yield are frequently dependent on associated and complementary policies, such as stable macroeconomic policies, pro-growth regulation and competition policy, investments in infrastructure, human resource development, governance and the rule of law[67]." (Supachai Panichpakdi, former WTO Director General). Due the absence of these pre-requisites in Vanuatu, rapid and substantial trade liberalization may not have the intended impact on inequality. It is worth noting that WTO accession is unlikely to result in rapid and substantial trade liberalisation. To the extent that it has the potential to benefit the supply-side it will improve human development, particularly by integrating the rural areas into the cash economy.

[67] A recent study conducted by Pacific Islands Forum Secretariat suggested that the Vanuatu State Law Office is over-burdened and does not have the capacity to handle trade-related issues.

SECTION II. SECTORAL ISSUES

7. TOURISM

7.1 Introduction

This chapter focuses on enhancing visitor yield. Such an approach enables economic benefits to be maximized and sustained. In simple terms the focus is on increasing per visitor spend, ensuring that spend is better spread throughout the nation and minimizing ‘leakage’ from the economy.

Many stakeholders remain equally focused on building visitor numbers – with most arguing for a two to threefold increase to 150,000 to 200,000 visitors within 10 years. The chapter argues that this ‘mixed’ focus and vision for Vanuatu tourism detracts from the ability to achieve sustainable yield enhancement. A focus on numbers alone would be likely to detract from environmental sustainability. In the context of current global discussions of climate change, there is a need to monitor the environmental impact of tourism.

Because of its focus on yield, the chapter does not cover in any detailed fashion the well traversed terrain of international air links and a lack of Government funding for industry marketing. Likewise land issues are not discussed – and vary considerably from locality to locality.

7.2 Tourism activity

Visitor numbers increased slowly and relatively consistently during the 1990s (Cleverdon 2004, NSO various). From 2003 to 2006 non-resident visitors rose by almost 30% (see table). Day visitor numbers (cruise ship visitors) have seen even greater levels of variation over the past 3 decades, with the last four years alone witnessing numbers ranging from 38,000 (2004) to 86,000 (2006). Santo alone received 13 cruise ships in 2006 but is expecting only 8 in 2007.

Table 7.1. Summary of Vanuatu arrival statistics 2003-6

Year	Residents	Visitors	Total Arrivals	Day Visitors (Cruise)
2003	12,115	50,400	62,515	51995
2004	12,787	61,453	74,240	37870
2005	13,747	62,123	75,870	63554
2006	14,896	68,179	83,075	85922

Source: Vanuatu National Statistics Office

The deregulation of Vanuatu's airways in 2003 led to a reduction in airfares from the major destinations (Australia and NZ) and an immediate spike in tourist numbers as Pacific Blue and other regional carriers entered the market (Vanuatu NSO 2007).

The Government forecasts growth of around 3% over the medium term, supported by the August 2006 entry of Air New Zealand into the market via a bilateral code share agreement with Air Vanuatu. The country is currently served by Air Vanuatu, Air Pacific, Air New Zealand, Pacific (Virgin) Blue and Solomon Airlines.

The recent growth in visitor numbers to Vanuatu has not matched visitor growth in major competitors (SPTO 2005). Vanuatu's tourist numbers have grown by 1.8% annually over the past 10 years, whereas Fiji's tourism sector expanded by 3.8% annually with visitor numbers rising to 500,000 in 2004. Using visitor numbers as a primary indicator, the 20-year compound growth rate for Vanuatu has remained consistently around 2.5% per annum. World Tourism Organisation statistics indicate that overall Asia/Pacific tourism growth over the same period has been in the range of 5% to 7%.

When asked how the industry has evolved in the past 15 years, a clear majority (over 80%) of those interviewed for this study felt that it had grown but not in a sustained fashion. The general feeling is summed up by one quote from a hotel owner: "just as we really seem to get the wind in our sails it seems to disappear again".

Most tourists stay in Port Vila and do not venture beyond the main island of Efate. It is estimated that only about 10-18 percent of tourists travel to the outer islands, mainly to Tanna and Espiritu Santo (TCSP 1995). The 2004 draft visitor survey report appears to show half of visitors to Vanuatu travel to Tanna and nearly half to Santo (Vanuatu NSO 2007: 25) – it is assumed that there is an error in either the reportage or analysis as it is too high to be realistic.

Australia's market dominance has continued unabated. In 2006 Australians accounted for 60% of holiday visitors (50% in 1987) (UNDP 1988). New Zealand has remained the second most significant market.

Seasonality remains a distinct feature of the tourism industry – with peaks reflecting the Australia/NZ winter period (especially school holidays) and summer holiday/Christmas period.

The average length of stay has remained relatively static in recent years though it should be noted that the data from which these figures are derived is based on a rather 'patchy' sample of operations. On average, visitors stay 8.2 days (VNSO 2007). This still remains the same since the last survey in 1997 (TCSP 1998).

Cyclone events and local unrest have occasionally disrupted the industry. The most recent unrest to achieve prominence in the international media was in early 2007, when riots in the outskirts of Port Vila resulted in three deaths and a number of arrests.

Growth in the tourism industry remains restricted by limited air access, shortage of labour, high prices and poor infrastructure in the outer islands (ADB 2003; 2004; Campbell 2002; IMF 2007).

Occupancy rate statistics are not consistent enough to allow for any long-term time series analysis to be conducted and are drawn from a relatively small sample of accommodation stock. In recent years they have remained static (see Table 7.2). Interviews reveal that there has been some improvement in larger properties, but that boutique-type operations have been the best performers. There continues to be poor performance in the lower-end sectors.

National occupancy rates remain considerably lower than major regional competitors such as the Cook Islands and Fiji and appear to be on par with Samoa and Tahiti. Since early 2007 Fijian rates have fallen considerably. It must be remembered however that in many countries the data is based on limited sample sizes or simple estimates.

Table 7.2 Vanuatu hotel facilities and occupancy rates

Year				Room-nights		Occupancy	Bed-nights		Occupancy
	Hotels	Rooms	Beds	Offered	Used	(%)	Offered	Used	(%)
2003	29	895	2,370	328,916	152,961	46.5%	869,812	306,927	35.3%
2004	29	874	2,064	338,025	175,483	51.9%	849,910	346,935	40.8%
2005	29	886	2,382	327,870	171,492	52.3%	853,397	346,802	40.6%
2006	29	924	2,466	332,362	171,359	51.6%	882,400	328,381	37.2%

Source : Vanuatu National Statistics Office

Occupancy rates are consistently higher in Port Vila and environs than for the nation as a whole.

Recent calculations undertaken indicate that the current total bed capacity across the country would support visitor numbers in the range of 100,000-150,000 p.a. (AVL 2007). Total rooms available have remained fairly consistent in recent years – with numbers fluctuating between 850 and 1000.

Table 7.3 Value of the tourism industry, 2000-2004

Year	**Tourist Arrivals**	**Average Visitor Spend (USD)**	**Average Visitor Spend (Euro$)**	**Total Visitor Spend (Mn. USD)**	**Total Visitor Spend (Mn. Euro$)**
2000	57,591	801.9	861.8	46.2	49.6
2001	53,300	827.6	939.0	44.1	50.1

2002	49,463	922.7	879.9	45.6	43.5
2003	50,400	1093.9	866.1	55.1	43.7
2004	60,611	1220.9	896.4	74.0	54.3

Source: SPTO 2005

Data on the economic value of cruise ships to the Vanuatu economy is very limited (TCSP 1991; SPTO 2003b). There is no doubt, however, that the increasing number of cruise ships visiting remote locations injects relatively large amounts of cash into provincial economies (estimates of USD40,000/day/ship to Luganville for example). As mentioned above the cruise sector is fickle and tends to be treated somewhat warily by many of the experts interviewed who feel its fluctuations make it difficult to view as a base for long-term development (see also Slatter 2006).

Estimates of the number of people employed in the tourism industry also vary quite widely. Figures range from 16,000 (WTTC 2005) to 3,000 (see SPTO 2005) to as low as 1,200 (resort sector only). A recent survey conducted by VATET revealed that the Vanuatu tourism industry created over 7,000 jobs for both local and foreign nationals (VATET 2005).

The lack of certainty in economic spend and employment data makes it very difficult to develop a yield-driven tourism strategy. Data deficiencies are a constant factor that has hindered the development of tourism. The industry desperately needs an effective decision support system based on robust data.

7.3 Regional competitive positioning

The key sustainable ‘point of difference’ of the Vanuatu tourism product is assessed by many to lie in the nation’s island geography, pristine environment, traditional cultures, and connections with ni-Vanuatu people. Much of the current marketing material for the nation presents marketing images and messages around these themes (GoV 2003; Cleverdon 2004; Bazeley and Mullen 2006; AVL 2007).

The provincial adventure tourism market is currently heavily focused on the Yasur volcano on Tanna, scuba diving on the wreck of the S.S. President Coolidge on Santo, and a limited number of high profile activities, such as the land diving on Pentecost. Most of these activities can be done in a single day, limiting benefits to provincial communities.

There have been attempts to develop other adventure tourism products, such as village life and culture, jungle treks, mountain climbs, alternative scuba diving sites and sporting events. However, the majority of these have not been supported by concurrent development of appropriate quality accommodation and other tourism services, or specific promotional campaigns (Bazeley and Mullen 2006; AVL 2007).

Tourism is more important for the Vanuatu economy than for most countries in the region. According to the following data, only in Palau and the Cook Islands does tourism comprise a higher percentage of GDP.

Table 7.4. Economic importance of tourism in the region

Country	Tourism GDP %	Tourism % Employment
Cook Islands	47.0%	-
Fiji	12.8%	9.5%
Kiribati	14.5%	1.7%
Niue	13.0%	-
Palau	49.0%	-
PNG	6.3%	3.2%
Samoa	9.5%	10.0%
Solomon Islands	2.9%	1.6%
Tonga	5.0%	3.2%
Tuvalu	3.0%	-
Vanuatu	16.6%	12.0%

Source: SPTO 2003c

Data here is particularly unreliable. The World Bank Pacific Islands Regional Economic Report (2002) shows that as a proportion of exports of goods and services, tourism ranges from around 3% (for Kiribati and the Solomons) to around a quarter for each of Fiji, the Federated States of Micronesia and Tonga, to one third in the case of Vanuatu and over one half for Samoa. However in Vanuatu it cannot be the case that tourism comprises one third of exports, as this would mean that tourism earnings were only around USD13 million per annum (3% of GDP). The most recent balance of payments data from the IMF (presented in the trade policy chapter) shows that tourism exports were in fact USD93.5 million, more than double earnings from goods exports.

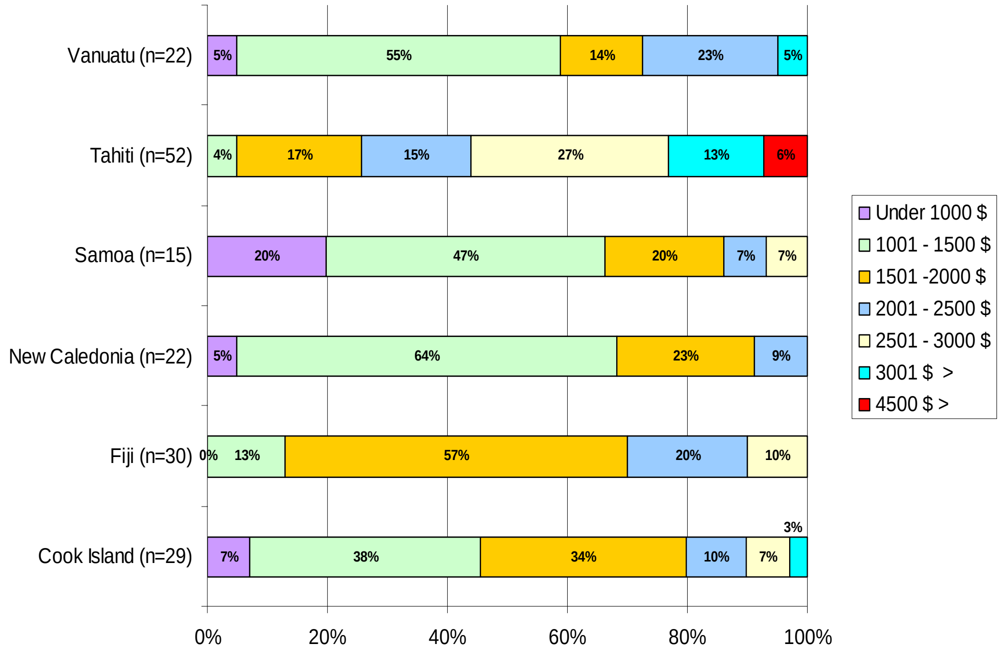
A review of regional visitor arrivals using SPTO data from 2001 to 2005 reveals that the real winner during the period has been Fiji – though recent political unrest has again seen that industry struggling to maintain market share**.**

Such comparisons, however, focus on visitor numbers rather than yield. Unfortunately, data on visitor yield is difficult to find for comparative use in the Pacific island context. One recent study does, however, shed light on the relative positioning of the Vanuatu product in terms of potential yield.

A review of package holiday costs and other components conducted for French Polynesia (Nodder et al. 2006) provides some insight into Vanuatu's relative performance. The authors reviewed the package offerings from the following major New Zealand wholesalers: Infinity Holidays, Travel Plan, Gullivers, Go Holidays, and Air New Zealand Holidays.

While package prices vary based on the number of nights and room types the overall offerings from Vanuatu are slightly cheaper than those provided by competitors such as Fiji and the Cook Islands (see Figure 7.1). On a per day visit the cost is on a par or slightly higher than Fiji, but lower than the Cooks and Tahiti.

Figure 7.1 New Zealand package prices by destination*

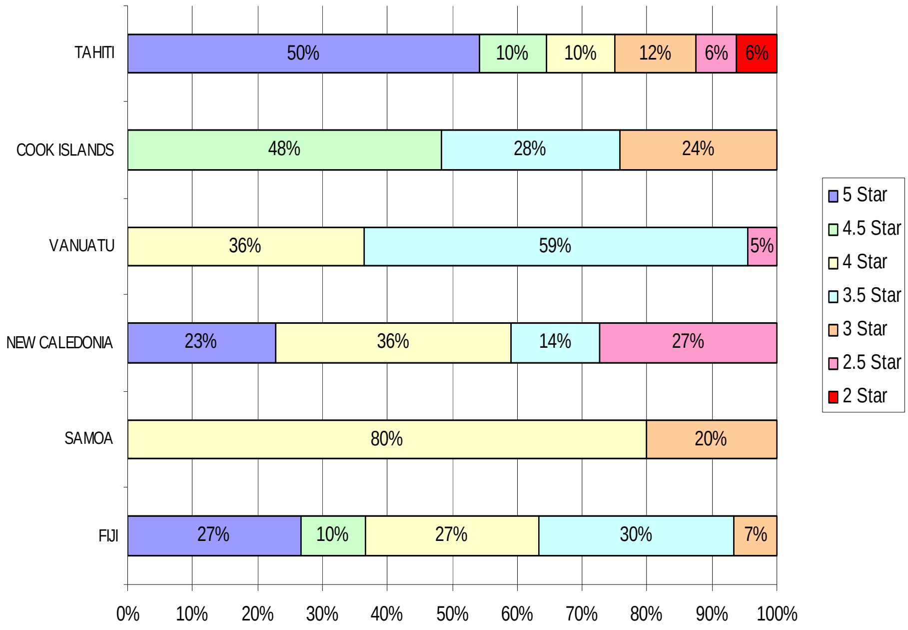


Source: Nodder et al. 2006

The accommodation offerings featured in the packages also vary considerably between the nations, with Vanuatu offering a much smaller lower range of 4- and 5-star offerings than Tahiti and Fiji – this reflects the lack of any true 5-star properties in the nation (see Figure 7.2).

Some of the focus group work conducted for this research highlighted that Vanuatu is seen as a relatively high-cost destination but with less quality offerings than some of its competitors (Nodder et al. 2006). Several of those interviewed drew direct comparisons between the product offered at Port Vila's top resorts and that offered by resorts at Denarau, Fiji. While costs are not dissimilar the quality of Fijian breakfast offerings, spa facilities and restaurant options were all viewed as superior to those available in Vanuatu. Likewise there is a strong feeling among those interviewed that backpacker markets in Samoa and Fiji are better served with transport and 'value for money' in the accommodation sector.

Figure 7.2. NZ package accommodation classification



Source: Nodder et al. 2006

At the same time the ability of visitors to link into the outer island attractions of Vanuatu is limited by infrastructural difficulties. While there is no doubt that the experiences to be gained are unique and offer some forms of competitive advantage, the difficulties and costs involved in travelling to outer islands are significant relative to many competitors. The quality of the facilities and infrastructure available in the outer islands is also often sub-par (Cleverdon 2004; AVL 2006; VATET 2005). In the outer islands, internal transport is a real problem. Both Samoa and Fiji provide far easier transportation options with relatively effective backpacker transportation and good levels of internal inter-island transport – much of it water-based.

A review of the comparative strengths, weaknesses, threats and opportunities of some core elements of the tourism sector are outlined in the following table. While the SWOT analysis presented does not attempt to be comprehensive it does raise a number of key issues that are relevant for the Vanuatu tourism industry and future attempts to enhance yield.

Overall a number of features emerge from a regional comparison. Vanuatu:

- has outstanding environmental and cultural attributes that surpass much of what its competitors can provide;
- lacks true five star, high quality properties and has limited options available to increase yield per resort visitor (limited spa facilities for example compared to Fiji);

- lacks lower end accommodation of a reasonable 1-2 star standard, especially in outer islands;
- is relatively expensive by regional standards in terms of the quality of experience provided and also in terms of the cost of doing business;
- features tourism experiences in the outer islands that can be difficult to organize and coordinate – partly because of the lack of telecommunications in outer islands. For example internal flights within Fiji can be booked on the Internet – this is not possible in Vanuatu;
- has a very heavy and growing reliance on a single source market – Australia, this places the destination in the potentially awkward position of having all its 'eggs in one basket';
- is characterized by limited and somewhat fragile air links both internationally and domestically – although things have improved in recent years;
- has very limited land and sea based transport options to support the development of outer island experiences.

Table 7.5 Tourism sector SWOT Analysis

STRENGTHS	WEAKNESSES
ACCOMMODATION • A good range of locally owned and 'authentic' options for accommodation – especially outside Vila • A relatively good mix of accommodation types in Vila • New business accommodation in Vila (Sebel) • Developments in mid-sized boutique type accommodation **INTERNAL TRANSPORT** • Taxi transport is readily available • Public transport available in Efate • Integration of domestic and international air services • AVL increasingly integrated in the tourism sector **TOUR OPERATIONS** • Excellent cultural and environmental resources to work with • Strong local involvement in the sector • Good links between communities and tour offerings • Some development of good tour guides	**ACCOMMODATION** • Expensive relative to the quality received • Some of the plant in need of renovation and refitting • Quality of locally owned 'bungalow' accommodation is often poor • Limited Internet access and related marketing options for smaller properties • Levels of staff training need improvement **INTERNAL TRANSPORT** • Inter-island air services do not have a good reputation for reliability and on-time performance • Local taxi quality is variable and cabs lack meters • Public transport is limited and hard to access outside Vila/Efate • Lack of water based transport options to outer islands **TOUR OPERATIONS** • Quality of transport equipment is limited • Anecdotal evidence points to unreliability of some operators • Improved training needed for some tour guides
OPPORTUNITIES	**THREATS**

ACCOMMODATION • Growth in boutique operations and locally owned operations taps into potential tourism niche markets • Development potential for web-portal and other network based marketing • New training resources coming on stream **INTERNAL TRANSPORT** • The potential growth of outer island destinations opens up new opportunities for investment • The water-borne sector offers opportunities for expansion **TOUR OPERATIONS** • The environmental and cultural diversity of Vanuatu opens many opportunities to develop innovative and high-yield experiences • Growing desire on the part of visitors to experience something unique and different – both mass tourists and niche groups • New training resources coming on stream that will make Vanuatu a regional centre for tourism training.	**ACCOMMODATION** • Regional competitors offer superior value for money – especially at the 4/5 star level • Tourism plant is older compared to many competitors • Costs of doing business are relatively high • Competitors are offering a wider range of quality add-ons – such as spa facilities **INTERNAL TRANSPORT** • Fuel costs continue to remain a long-term concern • General lack of interest from potential investors • Weather and ocean conditions create difficulties for water transport **TOUR OPERATIONS** • Competitors are developing new and innovative experiences elsewhere • Problems of sustainable resource use at some popular attractions – especially sites on Efate such as Mele Falls • Land and *kastom* issues are potential impediments to the development of new products

7.4 Tourism-related institutions

7.4.1 National Tourism Office

The Vanuatu Tourism Office (VTO) was established by an Act of Parliament as a Government Statutory body. The main function of the Office is, according to its website, "to encourage and assist the sustainable development of the tourism industry within Vanuatu by undertaking coordinated tourism marketing in overseas and domestic markets". The VTO is also charged with assisting in the statistical analysis of the industry, hosting annual promotional events and monitoring and accrediting accommodation standards.

Stakeholders interviewed generally felt that the office does a good job but has to work with a very limited budget. The key themes to emerge from the stakeholder communication are:

- There are good staff at the VTO many of whom have a very good knowledge of the industry – both past and present;

- A marketing TA would be a valuable addition to the VTO, especially in assisting the organisation to broaden the market base of the industry and in realizing the potential of the Internet;
- There needs to be closer coordination and cooperation between VTO and the NTDO;
- Air Vanuatu exerts undue influence on the focus of the VTO;
- Funding levels remain insufficient given the relative importance of the tourism industry.

7.4.2 National Tourism Development Office (NTDO)

The Vanuatu National Tourism Development Office was established in 1998 under the Ministry of Trade Industry and Tourism. The Office provides training, advice, assistance with funding, support with printing and promotion. A core focus of NTDO activities is to develop a viable and equitable tourism industry for ni-Vanuatu entrepreneurs.

Stakeholders interviewed in 2006 and 2007 generally felt that the NTDO does a reasonably good job within the confines set by its very limited budget. The key themes to emerge from the stakeholder communication are:

- Tourism development is a vital area and awareness/business development are very valuable areas for Government and donor funding;
- There are good staff at the NTDO but they could be more effective if coordinated with the VTO and relevant donor funded programs and training providers. Some mention was made of joint VTO/NTDO workshops presented in Tanna which were seen as a very positive step forward;
- There is some feeling that the NTDO and VATET should be working as closely as possible in the areas of awareness raising and training and that perhaps some of this work could be shifted to VATET to enable the expansion of available resources;
- Industry awareness of the NTDO could also be enhanced.

7.4.3 Vanuatu Investment Promotion Authority (VIPA)

VIPA is a key organisation in the process of inward investment into the tourism sector. Priorities for investment are accommodation supply; recreational services; inter-island cruises; game fishing and scuba diving; ecotourism projects; and general joint venture tourism projects. In the tourism industry the following investments are reserved for ni-Vanuatu operators (though as Slatter 2006 shows there is some ‘slippage’ in this area):

- guest houses with fewer than 50 beds, 10 units or turnover is less than VT20m;
- bungalows with turnover less than VT30m;
- motels and hotels where annual turnover is less than VT20m or the total value of the investment is less than VT10m;
- local tour operators/agents (investment less than VT50m or turnover less than VT20m);

- commercial cultural feasts, handicraft manufacture, road transport operators (taxi, bus).

Stakeholders interviewed generally feel that the VIPA does a reasonable job within its budgetary constraints. There is a feeling that not enough focus is placed on tourism and that VIPA perhaps lacks an in-depth understanding of some of the critical issues involved in the international tourism industry. It was also acknowledged that VIPA has a very difficult environment to work in – especially when clarifying to investors the problems with identifying land ownership and dealing with land disputes.

Stakeholders interviewed were also critical of the VIPA website – saying that investment opportunities are not readily available to view – and those that are often tend to be out of date, or non-existent. There was a feeling that better use could be made of existing resources on the web designed to facilitate investment links such as the new South Pacific Tourism Investment Marketplace (SPTIM), www.sptim.org.

A number of other government organisations have direct links to the tourism sector, including the Department of Cooperatives and Business Development Services; the Ni-Vanuatu Business Development Centre; the Chamber of Commerce and Industry; and the Rural Economic Development Initiative (REDI).

A range of NGOs play a role in the tourism development process, including the Vanuatu Association of NGOs (VANGO); VANWODS (a micro-finance body); the Vanuatu Rural Development and Training Centres Association (VRDTCA); Vanuatu Hotels and Resorts Association (VHRA); Vanuatu Tour Operators Association (VTOA); Vanuatu Scuba Operators Association (VSOA); and Vanuatu Land Transport Association (VLTA)

In each of the Provinces there are similar organisations – characterised by varying degrees of formality.

One particularly important group is the **Vanuatu Island Bungalows Association.** VIBA was established in 1996 to assist the smaller ni-Vanuatu-owned bungalow resorts. VIBA's aims and objectives are to:

- Represent members in any statutory or business matters;
- Develop business opportunities for all members;
- Improve quality, service and skills;
- Improve the marketing of small rural bungalows.

VIBA has grown to 33 members, about one-third of the total bungalow resort population, and has launched a common website developed by Vanuatu Hotel Link (VHL) (part of worldhotel-link.com).

7.5 Donor activities

The bulk of donor assistance to the tourism sector occurred in the period 1991–1998 when the EU allocated a range of funds through the Pacific Region Tourism

Development Program (PRTDP) (Cleverdon et al. 2003). The final review of the PRTDP revealed that stakeholders interviewed from Vanuatu were some of the least satisfied in terms of the outcomes of the tourism-related aid – only stakeholders from Papua New Guinea provided a lower overall rating of the program.

To borrow a phrase from Bazeley and Mullins (2006) some past tourism-related aid has been "transactional" rather than "transformative". In recent years this has changed: particularly as a result of education, SME development and awareness creation. The results have not been uniformly positive – but in many cases the funding is laying a platform that will support yield development.

According to the Department for Economic and Social Planning (DESP) the following are the main tourism-related donor projects currently funded in Vanuatu.

Infrastructure improvements under the US-funded **Millennium Challenge Account (MCA)** have the potential to spread the economic benefits of tourism. The MCA will also address limitations in tourism statistics and decision support data**.** The program will fund a study to look at visitor satisfaction and demographics, tourism multipliers/linkages and a number of other dimensions – including domestic travel. The final report is expected by the end of 2007. This data, if robust, will be an important platform around which to develop yield focused strategies. A follow-up study is scheduled for 2010/11.

The European Union's major in-country funding of relevance to tourism is the VATET project, based at the Vanuatu Institute of Technology (VIT) which has focused on developing a centre of excellence for the tourism industry in Vanuatu and the South Pacific. The Hospitality, Tourism and Leisure Training Centre (HTLTC) opened in April 2007 (EC 2006).

VATET funding also included a Rural Tourism Training Program focused on increasing pre-service and in-service training capacity in rural areas, especially in the outer islands. The Rural Tourism Training Program included training needs assessment; development and piloting of training modules and materials (all in Bislama); identification, selection and recruitment of three experts to train selected rural trainers; and support and mentoring in the implementation of the training plans in each province

An important additional component of the VATET project is tourism awareness, which is closely linked to the rural training program. A number of tourism awareness tools were produced as part of a 'Tourism Toolkit' and were distributed among the different training agencies and training providers (EC 2006).

The EU is also funding regional initiatives that have significant implications for the Vanuatu tourism industry. The recently funded review of the South and Central Pacific Regional Tourism strategy will have implications for Vanuatu (SPTO 2006), as will the forthcoming development of a regional 'green tourism' strategy and the development of a regional cruise-ship strategy. The 2006 Pro-invest funded 'Profit Pacific' tourism investment meeting also covered Vanuatu – although it largely failed to create investment linkages.

AusAID's current Australia – Vanuatu Joint Aid Strategy (2005-2010) does not feature the tourism sector as a direct area for targeted Australian assistance. Most aid focuses on issues concerning institutional strengthening, public and legal sector reform, police force capacity building, health, climate change monitoring and education. All of these areas have relevance to the tourism sector – particularly education. (Bazeley and Mullen 2006).

A regional AusAID initiative, the Australia-Pacific Technical College (APTC), aims to deliver vocational training across the Pacific to a standard accredited in Australia. It is anticipated that this project could complement the training delivered by the EU/VATET funded HTLTC/VIT as it will address a higher level of qualification. It is agreed that APTC will utilise the HTLTC facilities. This four-year regional initiative commenced in the second half of 2007 and is delivered through partner institutions in Samoa, Fiji, PNG and Vanuatu (EC 2006). Students from other countries in the region can decide to study at the APTC either in Fiji, Samoa or Vanuatu.

The VTO also indicated that AusAID may be providing some future funding to provide technical assistance for; international marketing.

NZAID (2006) and the Vanuatu Government have identified education, governance and economic development as priority areas in the Vanuatu Country Strategy 2006-2010.

The main elements of the NZAID Vanuatu Development Program Strategy with relevance to tourism are:

- A focus on increasing economic growth, growing private sector investment, strengthening livelihoods and increasing employment opportunities particularly in rural areas;
- Pacific Islands Trade and Investment Commission (PITIC) – limited funding for a survey of the NZ market for Vanuatu tourism;
- Ongoing support for the Vanuatu Chamber of Commerce and Vanuatu Investment Promotion Authority;
- Co-funding with AusAID of the report entitled *Vanuatu Economic Opportunities and Fact Finding* (Bazeley and Mullen 2006).

Significant support has been provided for the Rural Economic Development Initiative as a means of ensuring additional assistance reaches the provinces. NZAID (along with AusAID) has also implemented small grants projects – to support small businesses – a limited number of which have come from the tourism sector.

The French Government is involved in funding a small number of tourism related activities. It has assisted with new airport developments in Ambae, Pentecost, Malakula and Santo. It is also funding a basic review of the tourism sector.

The Asian Development Bank (ADB) in partnership with the National Bank of Vanuatu (NBV), has successfully pioneered a project to create sustainable, profitable rural micro-lending in Vanuatu, to be expanded in 2007. Two technical assistance grants amounting to USD500,000 provided by ADB in 2002-2006 supported the expansion and enlargement of rural micro-finance services. As of September 2006, NBV had approved about 1,480 loans. According to the NTDO tourism-related activities have received only a small percentage of the funding allocated.

International Finance Corporation technical assistance has been received in the form of the Pacific Enterprise Partnership (formerly known as Pacific Enterprise Development Facility) which has been providing support to individuals and intermediaries to allow them to on-deliver quality services in-country (IMF 2007). Two initiatives are underway in Vanuatu; one is working with the Melanesian Savings and Loans, and another with a tourism association. IFC has also supported the worldhotel-link.com website designed to enhance access to the market place and increase business-to-business networks.

The Japan International Cooperation Agency (JICA) has provided the NTDO with a limited amount of funding for technical assistance in the area of tourism awareness building. The **Commonwealth Secretariat** is also funding a review and update of the current tourism master plan.

7.6 Current tourism strategy and policy

The view that Vanuatu lacks a clear vision (and vision statement) for its tourism industry was often repeated in stakeholder interviews. However a number of common themes are featured in tourism strategy and discussion documents (UNDP/WTO 1995; GoV 2003; Bazeley and Mullen 2006; AVL 2007):

- The industry is a means of conserving Vanuatu's unique cultural patterns, the natural environment and sustainable economic development;
- Tourists should be attracted who appreciate the culture and environment of the country, and are willing and able to move beyond Port Vila;
- Adequate resources should be ensured for tourism planning, development and marketing;
- Ni-Vanuatu development should be supported but with flexibility for foreign investors where large amounts of capital or specialized skills are necessary;
- The benefits of tourism should be spread beyond Port Vila.

The focus on sustainable development is absolutely essential. But it is important to note that in most documents the one tangible target then outlined is increasing visitor arrivals to 200,000 within ten years. Even the AVL (2007: 3) document that focuses most explicitly on yield-related themes including high-end niche markets, targeted marketing and long-haul travellers still follows up with an overarching target of 150,000 to 200,000 arrivals in the next decade.

A clear vision is needed – one which focuses on building yield as well as achieving **realistic** growth in visitor numbers. It is essential that the growth in tourist numbers, especially in the outer islands, sustains the environmental and cultural experiences upon which both visitor experience and resident quality of life depend.

The Vanuatu Tourism Development Master Plan 2004-2010 contains a range of strategic initiatives. The core objectives of the strategy are to:

- Promote strong economic growth through sustainable tourism development;
- Generate substantial foreign exchange, local income and employment;
- Promote balanced regional tourism development;
- Promote greater participation of local people;
- Sustain local cultures/customary practices;
- Promote greater community awareness of tourism benefits;
- Promote national integration through tourism.

The Government has incorporated key strategic dimensions of the Master Plan into its Priorities and Action Agenda (PAA) (GoV 2006), which includes six key areas of action on the tourism front:

- A doubling of the NTO budget;
- An increase in airline capacity;
- The development of investor incentive packages by the NTDO;
- The development of tourism infrastructure in rural areas.

The general reaction to the Master Plan among those interviewed was not positive. Many had not seen the document, with some stating that it is impossible to obtain a copy. Those that had seen the document generally felt it was too long (250 pages) and that while it had many good ideas it does not present a practical way forward. Several interviewees stressed that the document was released only as the Internet was beginning to change the way people gather information on Vanuatu and purchase their holidays – making much of the document out of date. There was a very definite feeling among those interviewed that there is a need for a new or reviewed Tourism Master Plan that is more 'forward looking' and that provides concise and practical guidance. There was a clear feeling among the industry that tourist plans and other studies were not consultative and were seldom disseminated or implemented.

Provincial and even local tourism strategies and plans are also in place – many of them informal. Provinces have looked closely at strategy development, in some cases with donor or NGO assistance. The implementation of provincial tourism planning is a very complex issue, in particular affected by the specific *kastom* in each locality. The land situation and regular land disputes will make the implementation of planning difficult and complex.

In the absence of a concise, shared national tourism vision and readily accessible tourism strategy some bodies have created documents that can stimulate discussion on how the sector may develop alongside other areas of the economy.

Despite considerable attention in the Business Forum Matrix (BFM) to 'sustainable development', the core focus is on visitor numbers rather than yield, with attention focused on achieving visitor numbers of 200,000. The BFM also pays very little attention to cross-sectoral links and opportunities, thus tourism dimensions are almost entirely missing from the recommendations for the development of the air, shipping, land transport and agriculture sectors.

The lack of mainstreaming of tourism strategies is a problem. For example, while the primary sectors receive specific attention in the Priorities and Action Agenda 2006-15 tourism does not warrant a specific chapter, even though the PAA is meant to drive forward many of the recommendations in the Tourism Master Plan.

Another broad tourism discussion document with a strong policy/strategy dimension was produced by David Miles, a technical adviser to Airports Vanuatu Ltd (AVL 2007). To quote:

> There is no strong definition (either in a policy sense or in an investment sense) of what tourism product Vanuatu should be vigorously developing ”
>
> There is increasing evidence that niche marketing to adventure, eco and back-packer tourists has significant potential to deliver broad-based benefits to Vanuatu. These tourists tend to stay longer and spend more money, particularly outside of the major centres.
>
> Clearly an objective should be that at least half of the visitors travel to the outer islands and ideally up to half of the bed nights are spent there (AVL 2007: 6-7)

The document argues that the:

> marketing strategy is core to the achievement of the tourism growth goals, and given that the program outlined in this paper looks at fundamental redefinition of the tourism product, and target market segments, then it follows that the whole branding and marketing strategies for Vanuatu need to be reviewed from first principles, and if needed, realigned.

The key goal that drives the strategy remains, however, the target of 150-200,000 visitors within 10 years. It is not clear how the yield and regional development-driven strategies espoused in the document will enable a doubling or trebling of visitor arrivals. Any growth on this scale could only be achieved with a continued focus on, and development of, the traditional resort sector. To then discuss the fundamental re-positioning of Vanuatu risks ‘throwing the baby out with the bath water’.

Each of the strategy documents outlined above focuses heavily on the need for sustainable development of the tourism industry in a way that maximizes benefits for the more peripheral areas of the nation. At the same time each of the more recent documents also has an underlying emphasis on increasing visitor numbers to up to 200,000 within 10 years. If the documents themselves have this element of confusion, then it is clear why many of those spoken to in the industry say that they are not sure in what direction the industry is headed.

While growth in visitor numbers and yield are not mutually exclusive, the figures and focus presented in these documents must be questioned. To grow the industry threefold in 10 years will be impossible if the bulk of marketing and other resources are focused on outer island tourism development and growth. The outer islands do not have the infrastructural capacity to absorb a rapid increase in visitor numbers – and neither would it be culturally or environmental sustainable. It is impossible that this growth can be achieved without a continued emphasis on resort-type accommodation, much of it still in Port Vila/Efate.

Given the current global discourse on environmental sustainability, any attempts to develop sustainable yield must take into account the impact of environmental change on the tourism industry. The environmental performance of the tourism industry is also critical. Awareness among tourists of environmental issues is often heightened by policies in their home country – for example recycling programs, emissions regulations and reductions in plastic bag use. If the environment in Vanuatu appears spoilt or unpleasant relative to the tourist's home environment, they are less likely to return. Poor environmental performance on the part of the tourism industry has a negative impact on visitor satisfaction and also on the broader environment.

Of more significance in the long term is the issue of climate change and resultant changes in sea levels and storm activity. It is vital that the tourism industry link into the SOPAC integrated coastal management program that has been initiated in Vanuatu, as well as with future work.

7.7 Conclusions

The tourism industry is a vital component of future economic growth. It represents perhaps Vanuatu's most promising export in the years to come, and one to which further value can be added. It is a clear way of increasing the contribution of trade to development.

Vanuatu must focus on improving tourism yield, a goal which is compatible with environmental and cultural sustainability. Improving linkages, particularly with the fisheries and agriculture sectors, and encouraging each tourist to spend more means that Vanuatu can prosper from the tourism industry without a sudden influx of visitors, which could potentially overwhelm the environment and local ways of life. Resort-based 'mass' tourists will remain fundamental to the industry's survival but these visitors may be encouraged to spend a day or two gaining new experiences in outer islands and spending money outside the capital region. At the same time, the yield of niche tourists can also be enhanced through better infrastructure and an improved array of experiences.

Whilst a number of institutions do a good job of developing tourism in difficult circumstances, further efforts can help improve the contribution of Government and tourism-related agencies. Detailed recommendations are given in the summary of recommendations at the start of the DTIS. These include: SME development and networking; linkage creation and development; community awareness and participation; human resource development; measures aimed at improving internal transportation; research and decision support; marketing and information technologies; measures aimed at accommodating climate change and sustainability; and measures aimed at upgrading institutions.

8. AGRICULTURE, LIVESTOCK AND FORESTRY

8.1 Introduction

In Vanuatu, agriculture is a fundamental feature of both the traditional and the cash economy and thus has important implications for human development. It involves more people than any other activity, and through traditional subsistence methods contributes to the preservation of *kastom*. It is also the second-largest contributor to GDP and dominates goods exports.

This chapter outlines the agricultural policy background before giving an overview of the sector. It then discusses the agricultural institutions, with a particular emphasis on the Vanuatu Commodities Marketing Board (VCMB). Finally it gives an overview of specific agricultural products before making some suggestions as to future priorities. Throughout, the suggestion is that Vanuatu should attempt to move up the value-adding ladder and away from basic commodity production. Science and technology should play a greater role in the agriculture, livestock and forestry sector. This can achieved by maintaining and increasing donor investment in the agricultural training institutes as well as supporting moves to add value to traditional exports. A certain number of niche products such as spices and fruit and vegetables have the potential to increase the value-adding component of exports, and again donor funding can help.

8.2 Policy background

With specific reference to the agriculture, livestock and fisheries (ALF) sector the following proposed medium term development program is listed in table 8.1 below. Some have already been approved or are under development with donor support[68]:

Table 8.1 Proposed Medium Term Development Program: 2007 - 2010

Ministry/Sector	Programs (in priority order)	Total Cost (Vatu)	Timeframe	PAA Strategic Priority
Agriculture, Quarantine, Forestry and Fisheries	National Agriculture, Priority and Strategy	25,800,000	6-12 months	Private Sector Development and Employment Creation
	Increased Commodity Production	1,039,600,000	3 years	Economic Infrastructure and Support Services
	Biosecurity	308,400,000	3 years	Primary Sector Development
	Market Access and Trade Facilitation	386,800,000	3 years	Economic Infrastructure and Support Services
	Agro Processing and Trade Facilitation	499,000,000	3 years	Economic Infrastructure and Support Services

[68] Development Partners Meeting, 28/11/06, DESP

The following national MTSF priorities should be noted in the context of the ALF sector:

Vanuatu 2nd National Priority: "Improving the lives of the people in rural areas by improving service delivery, expanding market access, to rural produce, lowering costs of credit, and transportation, and ensuring sustainable use of natural resources."

Vanuatu 3rd National Priority: "Raising private investment by lowering obstacles to growth of private enterprise including lowering costs of doing business, facilitating long term secure access to land, and providing better support to business."

The Business Forum Matrix (BFM) has made comprehensive recommendations, which, although perhaps reading a little like a "wish list" when related to available resources for implementation, are admirable in their scope and ambition.

8.3 Sectoral overview

It is important to remember that most people are involved in subsistence farming. Agriculture and culture are therefore inextricably linked, so any discussion of the ALF sector must take into account cultural sensitivities. Agricultural production, however, remains a mainstay of the cash economy. Export performance by value over the past five years is shown in the table below.

Table 8.2 Value of Principal Agricultural Exports, 2002-2006 (in million Vatu)

Year	2002	2003	2004	2005	2006
Copra	174	282	446	126	324
Coconut oil	471	382	1026	733	193
Coconut meal	75	93	117	85	-
Total copra/oil/meal	720	757	1589	944	517
Beef/Veal	192	287	286	302	332
Live cattle	60	52	29	56	-
Cow hides	60	36	28	43	33
Total beef /cattle/cow hides	312	375	343	401	365
Kava	253	228	440	477	698
Timber	197	249	247	203	306
Cocoa	141	295	160	181	277
Shells	50	45	30	57	92
Root crops	50	38	47	39	19
Vanilla	50	34	33	15	8
Coffee	40	0	0	0	-
Other	417	579	630	615	1361
Total Agricultural Exports	1702	2599	3331	2908	3651
Agriculture as a % of Exports	66	80	80	70	71

Source: Vanuatu National Statistics Office

In 2006 kava was the leading export, for the first time in many years exceeding the value of coconut exports (copra, coconut oil and meal).

Beef exports, including cow hides, were the third highest in the sector, after kava and coconut products. Beef exports have remained static over the past four years, despite prices rising rapidly between 2004 and 2006. The outlook for beef cattle is positive, as shown below.

The only other significant agricultural export product by value is cocoa, which at VT277 million in 2006 was the fourth highest foreign exchange earner after kava, coconut products and beef. Cocoa is particularly subject to volatile international price fluctuations. However, production has been on an upward trend over the past five years, with volumes reported at 1,815 tonnes in 2006, which is close to the BFM target of 2000 tonnes. International prices remain depressed, and producers are seeking niche markets particularly in the organic and fair trade sectors. The industry provides cash income to a substantial number of small farmers, particularly on the islands of Malakula and Malo.

8.4 Agriculture-related institutions

8.4.1 The Ministry of Agriculture, Quarantine, Forestry and Fisheries (MAQFF)

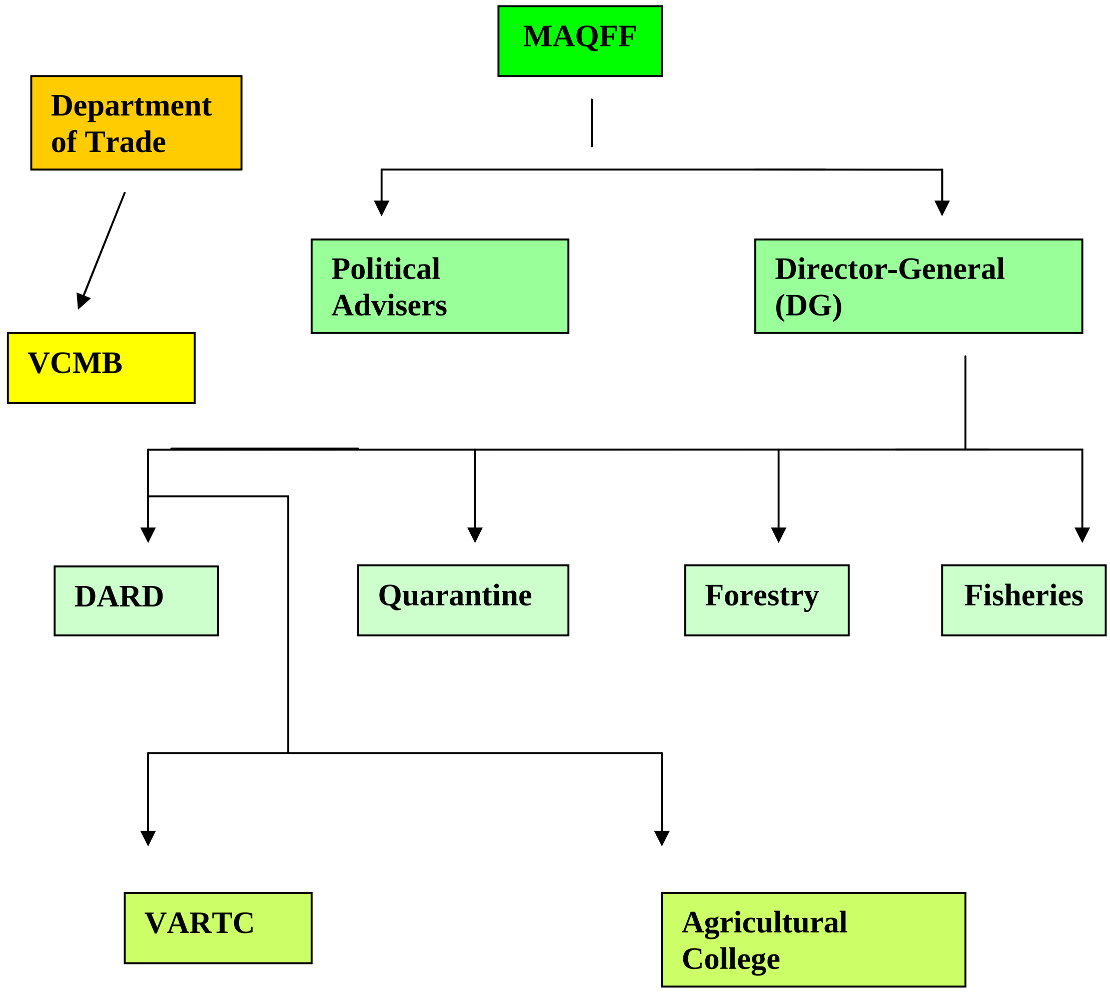
The MAQFF has overall responsibility for Vanuatu's Agriculture, Livestock, Forestry and Fisheries sectors and is headed by a Minister and a Director-General, a permanent civil service appointment. Additionally the Minister is assisted by a Political Adviser. The Ministry comprises four Departments each with its own Director.

The current objectives of MAQFF, highlighted in its Corporate Plan, are as follows:

- Increase the cash incomes of smallholders and build sustainable livelihoods in primary industries;
- Facilitate larger and more commercially oriented investment and carefully manage foreign involvement in Vanuatu's resource based primary industries;
- Ensure effective Government regulation and organisation/managerial infrastructure;
- Strengthen international partnerships with donor agencies;
- Increase revenue collection within the Ministry;
- Improve extension services.

It should be noted that the Ministry's corporate plans and those of its constituent departments and other institutions for which it is responsible, the VARTC and the Agricultural College, are integral parts of the PAA/MTSF process.

Figure 8.1 Institutional organisation of agricultural sector



8.4.2 The Vanuatu Agricultural Research and Training Centre (VARTC)

The VARTC aims to transfer agricultural knowledge and capacity to farmers through applied research activities. The VARTC has been under-resourced for a number of years and its capacity to influence agricultural development is very limited. Additional donor support to this institution may be considered, including further co-ordination of its activities with the agricultural college.

8.4.3 Agricultural College

The Agricultural College, located on Santo and funded by China (PRC), has only become operational in early 2007, with initial courses being offered in the processing of traditional foodstuffs. The future influence of the College on agricultural development and farmer capacity building will depend on available funding, human and financial resources, and innovative and relevant course syllabuses. Donors might consider increasing investment in research and development through this or other institutions.

Agricultural research should also be co-ordinated with international programs. The Consultative Group on International Agricultural Research provides a good balance between global objectives and developing countries' own development agendas.

8.5 The Vanuatu Commodities Marketing Board (VCMB)

The role of the VCMB is contentious. It has been dealt with at length in three recent independent reports commissioned by the DTII and the Department of Agriculture and Rural Development (DARD) and funded by the EU.[69] An ADB review of its operations took place in late 2007.

8.5.1 Legislation

The VCMB was established by the Vanuatu Commodities Marketing Board Act No. 10 of 1981. The key provisions relating to functions, powers and original aims are summarised as follows:

Functions
- To obtain best prices for prescribed commodities;
- To buy and sell prescribed commodities;
- To develop the prescribed industries, including processing;
- To stabilise prices;
- To avoid the need for Government grants or subsidies.

Powers
- To purchase prescribed commodities;
- To control and fix prices;
- To sell prescribed commodities and all things necessary with marketing, cleaning, storing and shipping;
- To appoint agents for purchase, storage and export of prescribed commodity.

Aims
- To ensure 'orderly and efficient marketing' of prescribed commodities;
- To provide producers with fair and reasonable prices;
- To improve the quality of export commodities;
- To stabilise prices.

Since 1981 the VCMB Act has been amended a number of times: in 1986 regarding copra regulations; in 1989 regarding the appointment of a Chief Executive; in 1993 changing the Minister responsible for the Board; in 1994 relative to information required by the Board, internal allocation of costs and surpluses, penalties for non compliance with the Act; in 2003 abolishing the Board's monopoly over prescribed commodities and opening up business to the private sector; and in 2004 prescribing kava as a commodity subject to the Act. The most important legislative act has been the dismantling of VCMB's

[69] Gay (2005); Coulter (2005); Burnett (2005)

monopoly in 2003; however the Board retained control of the commodity business through the issue of licenses to approved operators, and the imposition of penalties for infringements of the Act and its amendments.

The original responsibility for overseeing the VCMB came under the Minister of Finance, subsequently under the 1993 amendment of the Act the responsibility was transferred to the Minister of Trade and Industry. It should be noted that the Minister of Agriculture, Quarantine, Forestry and Fisheries has no direct responsibility regarding VCMB despite the Ministry having specific responsibilities for the prescribed commodities under the Act.

8.5.2 Background and rationale to the establishment of the VCMB

Since the early 1960s it was received wisdom that control by statutory marketing boards would afford both transparency and fair prices to growers. Vanuatu followed this trend on gaining independence in 1980. Widely fluctuating prices for both cocoa and copra and the suspicion that private traders were taking excessive margins seemed to justify the establishment of a statutory body. Furthermore, by the early 1980s Vanuatu copra was regarded as extremely poor quality. Following fifteen months of preparation with assistance from the UNDP, the Board began trading in April 1982.

The VCMB traded initially in copra only, with the emphasis on copra quality improvement, and price stabilisation with support from EU Stabex funds. A copra improvement project was initiated in the early 1980s, comprising an extension campaign and the provision of subsidized materials. VCMB managed the project but worked closely with DARD. This was an undoubted success for the Board as Vanuatu regained its reputation for quality. The Board also encouraged coconut replanting. Although the Board always had regulatory powers over the cocoa sector, these were not applied until 1984. Kava was also added as a prescribed commodity in 1987 and again in 2004.

The copra pricing scheme which had three pricing functions: (i) price stabilisation, (ii) price support, and (iii) a national transport subsidy. Cocoa did not have price stabilisation or a transport subsidy.

In 1982 VCMB charged a very low marketing margin, in order to “emphasise the point that it intended to improve returns to the producers.”[70] However, between 1985 and 1989 the average cost of marketing grew rapidly, ending up at six times the marketing margin in Papua New Guinea. Throughout the 1990s there was little attempt to find new markets or to conserve surplus revenues to provide a cushion for periods of low prices. Following the ending of the EU Stabex funds in 1993 the VCMB accumulated large losses. Beach prices often were higher than FOB prices. The situation came to a head in 1998 when the support mechanism was dropped and a new system of copra pricing was introduced with monthly prices reflecting world market prices.

[70] Fowler (1986)

In the early 2000s price support continued. However, with insufficient funds to support prices, the Board was verging on bankruptcy by 2003. The Government intervened to abolish the VCMB monopoly, opening up the cocoa and copra markets to private competition. However, to fund its regulatory activities, VCMB was permitted to charge a variable levy on all prescribed commodity exports, currently at 6 percent of CIF export value for cocoa; USD880 for copra; and 5 percent on export value for kava. Traders mostly pass these costs on to producers. In effect these levies act as export taxes, discouraging exports.

8.5.3 Recent Trends in the Role of Marketing Boards

The statutory marketing board system of regulating and controlling the commodity trade in developing countries has undergone substantial change. The role of statutory boards has become limited to maintaining standards, enhancing image and ensuring the reliability of their export structure. The private sector has been encouraged to assume an increasing role. Statutory authority control of marketing has been removed in the Ivory Coast, Cameroon, Nigeria, and Samoa. Biggs (2006), in a review of DTIS around the world, shows that crop boards in Tanzania created a significant anti-export bias and were recommended for reform.

Since the initial liberalisation of developing countries' commodity markets a number of lessons have been learned, the most important being:

- A new marketing structure must make allowance for commercial risk and ensure it can be properly and effectively managed;
- Appropriate institutional devices and instruments must be introduced which are suited to the circumstances of a particular country;
- To be successful a free market system must have an effective quality control system;
- Contract reliability of exporting companies is essential for long-term relationships between buyer and seller.

8.5.4 Government Intervention in Agricultural Markets

Governments usually justify intervention in agricultural markets through statutory boards for the following reasons:

- To reduce in marketing margins;
- To stabilise prices;
- To facilitate trade;
- To achieve economies of scale ;
- To improve regulation.

If it is agreed that all the above criteria are valid, the VCMB's performance is assessed as follows:

(i) The marketing margins being charged by VCMB have always been much higher than other statutory marketing authorities in the Pacific.[71] The ADB agriculture review in 2000[72] summarised the situation thus:

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

The VCMB no longer conducts the reconditioning and grading of beans. Charges of 11 percent of the price paid at the fermentary and dryer are exorbitant for a service which comprises only inspection.

(ii) Price stabilisation was a key function of VCMB at its inception and was undertaken with reasonable success until the early/mid 1990s, assisted through EU Stabex funds. With ending of this support, price stabilisation did not last long and is no longer a function of VCMB. Real prices have deteriorated dramatically. A price stabilisation scheme was never introduced for cocoa but there is evidence of some manipulation of cocoa prices over the years through the VCMB's buying and export sales.

(iii) Trade Facilitation. In its early years the VCMB had some success in facilitating trade. For example, in the 1980s the VCMB through its copra quality improvement program was able to restore the reputation of Vanuatu as a producer of good copra. However, since that era the VCMB's effectiveness as a trade facilitator seems to have declined dramatically.

Cocoa grading has also been a key VCMB trade facilitation activity in the past; however the Board is no longer is involved in grading and reconditioning of cocoa and has leased its facilities to a private exporter.

(iv) The VCMB is no longer directly involved in exporting cocoa or copra, therefore, the economies of scale argument is no longer valid. However, there is a case for limiting the number of licensed exporters to allow them to capture economies of scale in marketing. In the past Vanuatu, the Solomon Islands and PNG jointly negotiated copra freight rates, particularly to Europe. Freight rates for copra remained relatively stable, whereas rates for cocoa (and other commodities) fluctuated widely. The possibility of jointly negotiating freight rates for copra and coconut oil with Papua New Guinea and the Solomon Islands should be reinvestigated.

(v) Regulation relates particularly to quality control and grading. Presently the VCMB is issue inspection reports, but these are only for internal purposes and are not used as part of export documentation. This function is undertaken by the VQIS, which issues the quality assurance certificate as well as the phyto-sanitary certificate, both of which

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[71] Coulter (2005)

[72] ADB Agriculture and Fisheries Sector Review, 2000

facilitate the movement of commodities to the overseas buyer. Therefore the VCMB inspection system has little relevance.

Some recent recommendations of various organisations, advisers and government officials regarding include the following:

- A recent review of the agriculture sector [73](ADB 2002) recommended:

"The status of VCMB should be changed to that of a commercial firm without regulatory responsibilities including statutory provisions prohibiting further political interference."

- A recent trade study[74] was even more critical:

"In sum, the VCMB has become outdated following the ending of Stabex and its role as a vehicle for delivering price supports to farmers. Most countries have now abolished their commodities marketing boards, which had their heyday in the 1980s. The VCMB currently performs only a marginally useful role, one that could better be achieved by existing government departments. The levy on exports is effectively a tax that disincentives a sector the government should be doing everything in its power to promote."

- The Comprehensive Reform Program (CRP) recommended:

"In the long term it may be that the interests of rural producers will be best served by allowing the private sector to provide all the marketing services."
In 2003 CRP took its first step in this regard and dismantled VCMB's monopoly over the prescribed commodities. However, it has so far failed to carry out the second stage of privatising VCMB.

- The Ministry of Agriculture, Quarantine, Forestry and Fisheries has also commented on the excessive charges of VCMB[75]:

"We have received complaints from growers and exporters of cocoa and copra, both prescribed commodities under the (VCMB) Act. Those concerned are challenging the relevance of VCMB's role and the fees being levied. These fees are passed on to farmers by way of lower relative prices for their crops. May I inform you that one of this Ministry's aims is to maximise farmer incomes. The current activities of VCMB, as facilitated by the prescription of products, are a severe constraint to achieving this objective."

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[73] **ADB: Vanuatu, Policy Issues in the Agriculture, Fisheries and Forestry Sectors, 2002**

[74] Gay (2005)
[75] Letter to the Minister of Trade and Industry concerning the prescription of kava under the VCMB Act, 2005

8.5.5 Conclusions on the VCMB

For some years now there has been a loss in confidence in the VCMB, and there is growing discontent regarding its role by a wide range of stakeholders. Little of the original rationale for the VCMB remains. Exporters are willing to take on more responsibility for quality control, while the VQIS continues to provide the final assurance that comes with export documentation. VCMB's inspection process is merely an internal regulatory procedure with no apparent relevance to the trade. It is thus important to reconsider the role of the VCMB.

8.6 Support to rural development

Support in overseas aid funds from bilateral and multilateral agencies over the past 10 years amounts to over VT30 billion. The past duplication, overlapping and cross-cutting amongst donors is being mitigated by more frequent and regular meetings between leading donors.

Table 8.3 Main donor projects implemented by MAQFF since 2002

MAQFF Department	Project Name	Donor	Brief Description
DARD			
	Producers Organisation Project (POP2)	EU/France (until September 2006) (2002/2007) VT143 million	Organisation of farmers into marketing-oriented producers groups
	Development of Sustainable Agriculture Project	EU (Regional) (2003/2006) VT29 million	Identification of soil fertility problems and the recording of crop genetics
	Root Crops	FAO (2004/2008) N/A	Production and processing of root crops
	Agricultural College	China (PRC) - No time/value Details	Training and capacity building
	Oil Palm Development	China (PRC) - No Time /value details	Nucleus estate concept
	Rice Development	China (PRC) - No Time details	Import substitution

	Chinese Vegetable Development	China (PRC) - No Time/value details	Commercial farming
Quarantine			
	Fruit Fly Monitoring and Research	UNDP (ongoing)	Vanuatu-wide monitoring, since 2004
	Vanuatu Organic Certification	AusAID (2003/04) VT2 million	Certification of selected beef farms
	Control of Bovine Venereal Campylobacteriosis (BVC)	AusAID (2003/04) VT2 million	Pilot study on the disease that kills foetuses in cows
	Dairy Project	FAO (2002/04) VT17 million	Training farmers in milking techniques for domestic consumption
	BSE Surveillance	UK (2003/04) VT1.5 million	Surveillance for signs of 'Mad Cow Disease' in herds
	Taro Beetle Control	FAO VT1 million	Management methods of controlling beetle infestation
	Fruit Piercing Moth	FAO VT17 million	Survey of moth control measures
	Survey of *Brassica* Pests	SPC VT0.5 million	Survey of cabbage pests
	Biosafety	UNEP VT25 million	GMO and LMO
	Persistent Organic Pollutants	UNEP VT25 million	Survey and capacity building
Forestry			
	German Technical Cooperation (GTZ)	GTZ VT9 million	Pilot project on community forestry on Santo
	Landowner Extension and Awareness of Reforestation Naturally (LEARN)	EU VT30 million	Study on the post-harvest natural regeneration of major timber species on Santo
	South Pacific Regional Initiative on Genetic Resources (SPRIG)	AusAID VT10 million	Selection of the best timber and fruit tree species through trials and best seed stands for future use
	Forest Health Surveillance	ACIAR VT4 million	Conduct of pest and disease surveys on border control areas and wood lots ; train staff on surveillance techniques

Source: MAQFF/Donors

8.6.1 Donors

EU/France

The EU is committed to supporting the productive sector, including ALF, with its major recent intervention being the Producers Organisation Project II (POP2 – 2002/2007), co-financed until 2006 with France. POP2 has been the main donor-supported rural development project directly assisting the agriculture sector in recent years. POP 2 has operated seven specific product development programs: (1) Coconuts; (2) Cocoa; (3) Coffee; (4) Spices; (5) Root Crops; (6) Beef Cattle; and, (7) Fishing.

The project, which ends on 31st December 2007, has initiated some important development programs in agricultural marketing and trade related activities, including:

- An embryonic market information system including a regular newsletter;
- A beef cattle smallholder program geared to increasing smallholder involvement in the industry;
- Initiation of fair trade certification process for cocoa under the Fair Trade Labelling Organisation (FLO) regulations;
- Standardisation and quality improvement of cocoa grades;
- The promotion of coffee value addition;
- Support to the organic certification process (internal control, traceability and international auditing) of spices.

A case can be made for the IF Trust Fund to support, possibly in conjunction with other donors, some of the above initiatives. Independent consultants[76] have made a number of recommendations regarding the project.

The ACP-EU Centre for the Development of Enterprise has also assisted the sector, particularly in support of cocoa fair trade certification and market research on coffee and sandalwood.

Australia

The natural resources sector is not a key support area for Australian assistance, which focuses mainly on issues concerning institutional strengthening, public and legal sector reform, police force capacity building, health, climate change monitoring and education. AusAID personnel indicated that the main area for possible support in the ALF sector is the beef cattle industry. In this context AusAID is assessing Concept Note 5 (Smallholder Cattle Production and Marketing) of Bazeley and Mullen (2006).

China (PRC)

76 Evaluation of the Producers' Organisation Project POP-II Vanuatu, Marc 2007, ECORYS Nederland BV

Since 2004 the PRC has actively assisted the ALF sector through the provision of agricultural tools, equipment and machinery; the construction of the agricultural college on Santo; two projects to develop the cultivation of Chinese vegetables and dry land and wetland rice; and, a nucleus estate oil palm venture on Santo. The rice, vegetable and oil palm projects are ongoing.

New Zealand

The main elements of the NZAID Vanuatu Development Program Strategy, 2006-2010, relative to the ALF sector are as follows:

- General – To increase economic growth, increase private sector investment, strengthen livelihoods and increase employment opportunities particularly in rural areas.
- Specific – Improve local and international marketing information, including an increased role for Pacific Islands Trade and Investment Commission (PITIC) and other marketing support mechanisms/Review and assist the MAQFF in improving extension services and capacity building/Assist the MAQFF in the formulation of a policy and strategy.
- Ongoing support for Vanuatu Chamber of Commerce (and Vanuatu Investment Promotion Authority).

8.7 Product profiles and issues

8.7.1 Beef cattle

The beef cattle sector in Vanuatu comprises large and medium-size cattle ranches together with smallholders[77]. The largest ranches pasture between 4,000 and 10,000 cattle each. Medium to smaller ranches run around 200 to 4,000 cattle, and, smallholders, on average, graze around three animals but this figure varies widely depending on location. The national beef cattle herd is estimated at 142,910[78].

The beef cattle industry is catered for by two abattoirs; Vanuatu Abattoirs Limited (VAL), (85% Government/15% private-owned), located near Port Vila on Efate; and, Santo Meat Packers located on Santo, and owned by the Japanese company Nitchiku. The industry is geared to export, although there is a growing domestic market for beef and veal due to the growing tourist industry and generally increasing local consumption .

Both abattoirs suffer from under-utilization of capacity due to the insufficient number of animals being presented for slaughter. This situation has been exacerbated by live cattle exports to markets in South East Asia due, in part, to the perceived low prices offered by the abattoirs, particularly on Santo. However in 2006 no live exports were recorded. Despite more aggressive marketing, sustained low prices and the lack of support services over recent years have resulted in the national herd declining until very recently.

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[77] The term smallholder cattle farmer is used to include custom landowner operators, outside the commercial ranch definition, but who can run upward of 50 cattle

[78] Agricultural Census 2006 (First Snapshot - October 2006).

Cattle numbers are now on the increase, as indicated in the 2006 Agricultural Census, and export prices have been rising since the beginning of the decade. But beef export volumes have not increased correspondingly. This situation is accounted for mainly by an increase in local slaughter and consumption. However, it is a major concern of the abattoirs to increase the number of animals available for slaughter at their premises and consequently available for the export market and local butchers.

Despite the problems faced by the beef industry in the past few years, current signs are that the industry is entering a period of expansion and has great potential for a major contribution to both the economy and the livelihoods of the rural poor. Furthermore, interviews conducted during the course of the DTIS Vanuatu study revealed a long-term commitment to beef cattle production and export by all stakeholders, and particularly the VAL management and medium to large-scale ranch owners on Efate, and Santo. This type of stakeholder commitment has created the conditions for a relatively stable and growing export industry.

Providing that export volumes can be increased in face of growing domestic demand the medium-term outlook for the beef cattle sector is good, with diversified markets being developed in Australia, the Solomon Islands, PNG, New Caledonia and Japan. Longer-term prospects include the opening up of EU markets to Vanuatu beef, and steps are underway to meet compliance standards for entry into this market. Organic production certification has recently been attained by several Efate-based cattle farms..

Despite the recent period of expansion, several capacity issues hinder growth, particularly participation of smallholders. Cattle production is limited by unreliable and expensive transport, a lack of credit for rural farmers, and limited Government and private sector support services.

The VQIS recently produced a report on the state of the livestock sector and made a number of comprehensive recommendations for the sustainable development of the sector, particularly of beef cattle. The following priority action areas were identified:

- Various initiatives to meet export market requirements including meat residue testing, improved ability to survey for animal diseases, organic certification, and brand development;
- Addressing abattoir issues of processing and health standards, the high costs of electricity, transport and stevedoring costs, meat processing and improving standards and ensuring the sustainability of meat inspection services;
- Developing regulations to control live cattle exports to provide transparency and ensure that produce destined for export does not exceed sustainable levels;
- Facilitate marketing of smallholder cattle through private sector marketing linkages, road and sea transportation and development of local butcheries;
- Support for improved smallholder production of poultry and pig production; and
- Improved production of smallholder and large commercial ranches through improvement of pastures, animal genetics and production systems.

The beef sector presents the best prospect for rapid sustainable trade growth amongst the major agricultural and forestry export products. Recent studies[79] covering the agriculture and livestock sector identify beef cattle as a key priority for development support and in particular addressing the crucial issue of the increasing the national herd with the full involvement of the smallholder sector.

8.7.2 Copra

Since independence in 1980, production has fluctuated between 47,800 tonnes and 25,000 tonnes. The variations in production have been attributed to the impact of cyclones, fluctuations in the copra price, competition from more profitable crops and cattle, and declining yields. There is now a slow but steady decline in production. Whilst coconuts grow throughout the archipelago, production is now concentrated in the northern geographic zones of Malakula, Santo/Malo, Ambrym, Ambae/Maewo and Banks/Torres. The world market for copra is now very small. Competition from major producers such as Indonesia and the Philippines, where copra is processed domestically, means that opportunities for Vanuatu have been mostly limited to the low-priced markets of Bangladesh and other South East Asian destinations.

Two copra crushing mills operate in Luganville, exporting crude coconut oil and manufacturing oils and soaps. Together the mills have the capacity to handle all the copra produced in Vanuatu. However, copra is still being both exported and imported.

A small mill, Vanuatu Virgin Coconut Oil Ltd (VVCO) has recently opened near Luganville under foreign ownership. It produces high-quality virgin coconut oil and various by-products (semi-activated carbon, pith and coconut flour). The company buys fresh nuts from farmers and processes using a fully-automated process. It is too early to predict the sustainability of this operation. If successful, the premium prices paid for fresh nuts will have aI positive impact on the livelihoods of smallholders.

It is essential for Vanuatu to move away from copra, crude coconut oil (CNO) and copra meal production. It must look toward a future in the high-value and niche coconut product markets, geared to health and nutrition. The development of coconut oil biofuel for domestic use, although used for more industrial purposes, is probably a special case, in view of escalating world mineral fuel prices and the high cost of imports into small island states. This policy is also the stated objective of the Asia Pacific Coconut Community (APCC) for the industry. Such a change of focus is particularly important for Vanuatu in view of its disadvantages in terms of low economies of scale, its small island status, and high transaction costs.

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[79] E.g. Bazeley and Mullen (2006); Uniquest Pty Ltd, Vanuatu Economic Development Strategy – Report to the GoV and NZAID, May 2005.

VCMB reform will have the biggest impact on the copra industry. However, the additional following measures should be prioritised:

- **New Product Development.** VCO, coconut shell charcoal and activated carbon/ pith, for the horticultural sector; coconut wood; and coconut oil biofuel. Organic certification should also be priority in order to take advantage of premium markets for health and nutrition products. It should be noted that the development of desiccated coconut; coir products; soaps and oils as branded products for export probably has little chance of success in Vanuatu due to high labour costs and availability; low economies of scale and high transaction costs.
- **Market Research and Product Promotion.** Regional and global niche and premium (e.g. organic, fair trade etc.) markets should be targeted, with particular emphasis on compliance with international rules and regulations regarding environmentally friendly products and technologies.

8.7.3 Cocoa

Vanuatu is a tiny player in the global cocoa trade. Production in 2006 of around 1800 tonnes represents less than 0.06 percent of global production. However, cocoa grows well in the more northerly islands of the Vanuatu archipelago and has been a valuable cash crop and foreign exchange export earner for many years. Cocoa is overwhelmingly a smallholder crop with the only plantation enterprises being the Government-owned Metenesel Estate, the foreign-owned Plantations Reunies du Vanuatu (PRV), and the Cooperative plantation, MAPBEST.

Cocoa quality standards established in the 1980s are still extant, however compliance amongst producers is erratic and unreliable. Vanuatu's grading specifications are based on the international standard Cocoa Bean Specification ISO-2451-1973. The standards established provide access to the main global cocoa markets including those in Europe and the USA. However, current exports, with the exception of organic cocoa exported to France, are mainly to the low-price cocoa product markets of South East Asia, (for powder, liquor and butter) where prices tend to be much lower than mainstream European markets. The reason given for current export policy is that the quality of Vanuatu cocoa is unacceptable in Europe. As this was not the case in the past, it seems that the industry is experiencing difficulty in conforming in sufficient quantities.

With improved quality and the standardization of grades opportunities exist for Vanuatu to gain access to the so-called premium price niche cocoa markets. Two of the most important developments, organic cocoa and the fair trade movement, are described here.

(i) Organic cocoa is grown and certified in more than 15 countries and the number is growing as demand from consuming countries increases. The aim of organic farming is to support and strengthen biological processes without recourse to technical remedies such as synthetic fertilizers and pesticides and genetically modified organisms (GMOs).

Organic farming is distinguished by the existence of production standards and procedures and involves a third party, i.e. the certifier. For cocoa to be properly certified as organic all operators in the supply chain—farmers, exporters, importers, manufacturers, wholesalers and retailers—must be certified as acting in conformity with the standards and regulations of the certification program concerned. The French company KAOKA started organic cocoa from Vanuatu in 1999 and several producers, including some Cooperatives' supported by POP2 are involved. The key issue in organic cocoa production is whether the premium paid by the organic buyer fully compensates for the loss of crop due to compliance with certification procedures, e.g. non-use of synthetic pesticides, herbicides and fertilizers.

(ii) Fair Trade: Small scale producers of cash crops traded on the international market, such as cocoa, have always been far more vulnerable to falling world prices than big producers. With no power to influence prices their families' livelihoods are at risk. Fair trade organisations try to reduce those risks by ensuring that producers are rewarded fairly for their product. The key benefit to smallholder cocoa farmers of fair trade certification is price. The fair trade guaranteed minimum price is currently based on USD1600/PMT FOB, plus the fair trade premium of USD150/PMT, totalling USD1750/PMT. This is around USD500/PMT over the current conventional open market price of around USD1250/PMT FOB Luganville. Furthermore, if the world market price increases above the fair trade guaranteed minimum price, the fair trade price increases accordingly.

The cocoa sector should be given priority, together with the beef sector, for support. Vanuatu cocoa is an established commodity on world markets. Given improved and standardized quality, policy reform and the removal of the *de facto* buying monopoly, the development prospects appear positive. Furthermore, cocoa is a major cash crop for many of Vanuatu's rural population and increased exports at higher relative prices should have a significant impact on poverty reduction.

8.7.4 Kava

Vanuatu is the centre of botanical diversity for kava (*Piper mythisticum*) and the indigenous varieties are the world's best commercial varieties. This gives Vanuatu a comparative advantage in supplying to the kava-consuming countries of New Caledonia and Fiji. Previously, a considerable volume of kava was sold into the EU, but its sale has recently been banned due to poorly defined and possibly dubious health risks (outlined in the trade facilitation chapter). Despite this, strong domestic demand, in combination with demand from Fiji and New Caledonia, has seen the industry expand to rival copra in terms of export sales. Furthermore, smallholder participation in the industry is extensive. In 1999, 16,700 of Vanuatu's 30,000 rural households were involved in kava production. It is expected that the final results of the 2006 Agricultural Census, due to be available from the government in 2008, will show participation has grown considerably since this time.

A specific proposal for an integrated program on kava research as part of a regional project has been submitted as part of Standards Development Trade Facility STDF grant proposal greed at an UNCTAD Workshop, held in Port Vila in August 2006 on “Costs of Agro-Food Safety and SPS compliance.” Given existing assistance in this area, it is not proposed to recommend additional assistance to the kava industry through the IF. However, the industry will benefit from the more general proposals regarding the VCMB, fair trade, organic certification and the establishment of a marketing trade information system.

8.7.5 Other products

Coffee

Whilst coffee, mainly of the Arabica variety, has been grown and exported from Vanuatu for over a century, the country is a very minor player in the global coffee trade, with only around 23 tonnes of green coffee produced in a season. Coffee grows well in the more southerly islands, particularly Tanna, and has the potential to be a valuable cash crop and foreign exchange export earner in the future, given substantial production increases.

The main donor assistance to the coffee sector in recent years has been the EU-funded POP2 – 2002/2007, which incorporated coffee marketing and trade support as a key component of the project. The essence of POP2’s coffee marketing support involves encouraging the grouping together of producers in order to achieve economies of scale in storage and transportation, standardised quality and grades and hence greater negotiating power in the market place. An umbrella producers’ organisation, the Coffee Organisation of Vanuatu (COV) was formed in 2003 in order to assist the achievement of marketing objective in mind. However, progress in improving marketing efficiency and net prices to farmers is dependent on greatly improved production. At current levels the industry is barely sustainable.

A very positive feature of the Vanuatu coffee industry is the fact that all green coffee produced in the country is currently roasted, blended and packaged into a consumer product at a local factory near Port Vila.

Spices

The main spice crop grown in Vanuatu is vanilla and its production has been popularized by the extension work undertaken in recent years by the DARD, the FSA and the private sector, and in particular the Venui Vanilla Company, based on Santo.

Through training workshops, publications and extension work, the capacity of Vanuatu farmers to grow and cure vanilla has been enhanced. The FSA, with assistance from the POP2 has also undertaken organic certification and annual auditing and traceability activities. Despite the efforts that have been put into developing the vanilla industry the volume of exports have declined from 14 tonnes in 2003 (Value VT34 million) to 1 tonne in 2006 (Value VT8 million)[80].

The explanation for this situation is unclear but may involve a dramatic decline in global prices since the crop was first popularized, coupled with the high levels of labour-intensity. Furthermore, unscrupulous operators, trading around the islands, have disillusioned many farmers by offering inflated and unrealistic prices and failing to pay. Whilst the planting and cultivation of vanilla is relatively straightforward, harvesting and processing the crop to achieve first grade quality is a complicated process.[81]

In addition to vanilla a number of other spices grow well on the islands of Vanuatu, particularly pepper, chillies, turmeric and ginger, and their trade potential needs to be re-examined in the context of niche markets such as the organic sector and fair trade.

Root Crops

The main root crops grown in Vanuatu are taro, cassava, yam and kumala (sweet potato) grown primarily for domestic consumption and trade. Exports to regional markets, either raw or processed (e.g. frozen taro pieces), totalled 147 tonnes, valued at VT19 million in 2006. There is currently an overproduction of root crops in Vanuatu with insufficient markets to absorb surpluses over and above domestic consumption requirements.

The potential for export trade seems limited, given past experience. For example, a company on Santo set up in 2003 to process and export frozen root crops to regional markets recently failed, due to competition in regional markets from more competitive origins (e.g. Fiji) and the low relative value of the product. Therefore, support from the IF to the root crop sector is not recommended.

Fruit and Vegetables

The soils, climate, and terrain of the Vanuatu archipelago are ideally suited to the production of a wide range of fruit and vegetables, grown primarily for home consumption and the domestic trade. Efforts to develop the commercialization of fruit and vegetable farming have included a number of attempts to export produce to regional markets, but with only modest success to date. The major crops identified for commercialization are citrus fruits, pawpaw, pineapple, banana, plantain, grapefruit, breadfruit, green beans, cucumbers, sweet corn and eggplant. Major constraints to success have been poor and inconsistent quality and standards, inconsistent supply and availability, high transaction costs, difficulties in achieving compliance with overseas buyers' phyto-sanitary standards and insufficient suitable infrastructure (e.g. cold storage, transport and packing materials). The constraints to the development of a vibrant Vanuatu horticultural sector apply to both increasing access to the local retail market, e.g. supermarkets, which prefer imported fresh produce; and developing the export market.

[80] Department of Customs Statistics
[81] Welegtabit and Longmore (2006)

The support of fruit and vegetable production in order to stimulate both domestic and regional market access is considered a priority, as it will: (i) encourage import substitution; (ii) diversify export produce; (iii) encourage smallholder involvement and stimulate the development of nucleus farming concept and the private sector provision of extension services

The IF might consider supporting, under a two year program, the export of selected fruit and vegetables. The nature of the support should be in terms of initial subsidy to transaction costs, infrastructure and capacity building. The fruit and vegetable export business should not be based on permanent subsidies. Lloans, through a revolving credit fund, should eventually be phased out completely. The rationale behind the proposal is that, currently, Vanuatu exporters do not have the economies of scale to compete in the export market, and are restricted to transport their products by air. If sufficient volume is built up then a move to containerized sea transport can take place.

High-value products

Opportunities: Vanuatu can produce a number of what can be termed high-value agricultural products with great potential and suitability for value addition, export to niche markets (fair trade and organic sectors). The following products have excellent trade potential:

- Nangae, Navele and Natapoa nuts;
- Tamanu oil;
- Frangipani oil;
- Virgin coconut oil;
- Sandalwood oil.

Current trade in the above products is relatively small, however, a number of private sector companies are exploring processing techniques and investigating overseas markets, including, in some cases online.

8.8 Timber

Timber is one of the few agricultural commodities expected to increase steadily in price. Vanuatu's natural timber reserves are small, as cyclones regularly damage or destroy maturing forests and re-growth is constrained by the strong smothering growth of the exotic vine *Merremia peltata.* Whilst most timber species are cyclone susceptible, one species in particular, whitewood (*Endospermum medullosum*) is cyclone resistant and produces a high-value, low density timber.

The main islands with significant potential identified timber plantation areas are Santo (estimated at 9,000ha), Erromango (4,000ha), Malakula (3,000ha), and Efate (2000ha). Small areas of plantation whitewood have been successfully established on the northern island of Santo, but further planting is needed to establish a sustainable industry. It is estimated that 3,000-5,000ha of plantation whitewood harvested on a 20-25 year rotation would produce around 50,000m^3 of timber annually with an export value of USD35 million annually.

Unfortunately, international investors have been reluctant to become involved in plantation forestry in Vanuatu because of the small size of the industry and the insecurity of land tenure. However, there is considerable potential for smallholder farmers in north-east Santo to become involved in whitewood production. Woodlots with as few as 50 stems will be valuable for both farmers and timber cutters in the coming years. Facilitation is required now if a sustainable industry, largely based on smallholder agro-forestry systems, is to be established.

Further opportunities exist in production of sandalwood; the centre of sandalwood production currently is the island of Santo where most current harvesting is undertaken. Replacement planting will be required on Santo as harvesting currently exceeds the sustainable yield. Opportunities for development need to be identified in collaboration with private sector operators who have established a long-term commitment to the sector. This will necessarily require a shift in the adversarial relationships that have characterised Department of Forestry and logging/sandalwood industry interaction. Community forestry initiatives have been successfully developed in the Solomon Islands and could be used as a model.

IF support should focus on agriculture over the forestry industry for the following reasons:

- Agriculture, including livestock, is the most significant sector of the economy in terms of the livelihood of the poor with over 80 percent of the population being involved directly or indirectly in some form of agricultural enterprise;
- The export of agricultural products, excluding timber, represent the main source of export earnings accounting for 71 percent of the total in 2006 (see table above). However, as a percentage of foreign exchange earnings, including services and aid, agriculture will account for much less;
- A number of development initiatives in the agriculture sector, with direct or indirect influence on the development of trade, are planned, or have already been put in place by donors;
- The forestry sector, whilst a contributor to foreign exchange earnings, with timber exports accounting for VT306 million, in 2006, is not a major source of income (or food security) for the rural poor compared to agriculture. Furthermore, principles of environmental sustainability warrant caution in this area.

This is not to suggest that support for the forestry industry is not warranted, simply that the scarce resources of the IF should not initially be used for forestry development.

8.9 Conclusions

Within the ALF sector, priority should be given to the following specific products, in order of ranking:

- (1) Beef; (2) cocoa; (3) fruit and vegetables for the following reasons:

    - In the **beef** industry, conditions already exist for rapid expansion through increasing the national herd and by encouraging more smallholder farmers to produce and sell cattle. Furthermore, the recommended support initiatives should have an early impact on rural incomes and foreign exchange earnings through the expansion of trade. Donors such as AusAID, NZAID and the ACP-EU CDE, are already involved in some aspects of industry development, e.g. market access, compliance with importers regulations and smallholder cattle production.
    - In the **cocoa** industry, as indicated above, initiatives have already been introduced by the EU funded POP2 Cocoa Development Program, to involve smallholders more directly in overseas trade through umbrella organisations, to improve quality standards and grades and access niche markets such as the fair trade and organic sectors. Momentum in these developments may be lost as POP2 finishes at end 2007, and the continuity of EU support may be interrupted.
    - The support of **fruit and vegetable** production in order to stimulate both domestic and regional market access is considered a priority, as it will: (i) encourage import substitution; (ii) diversify export produce; (iii) encourage smallholder involvement.

(iii) Support should be given to initiatives of a more general, cross-cutting nature applicable to a number of products, such as:

- Support to access to the fair trade and organic markets;
- Market research on groups of commodities, e.g. essential oils/health products;
- Studies on policy change, e.g. reform of the VCMB/ Cocoa Acts.

(iv) A Proactive Trade and Market Information system (PTMIS) should be established, because stakeholders along the value chain require easily accessible, accurate and regular marketing information in order to initiate, develop and sustain both domestic and export trade in agricultural, livestock and forestry products. Marketing and trade information is increasingly recognized as essential for trade development.

Despite past efforts and sporadic availability of trade and marketing information in the media and through organisations such as the CCI, an effective, sustainable and useful PTMIS still does not exist in Vanuatu. Furthermore, it is essential that the establishment of a PTMIS must, in the long term, be sustainable and owned and managed by ni-Vanuatu.

The original intention was to make the establishment of a PTMIS a priority; however, in view of the lack of enthusiasm and belief in the sustainability in Vanuatu, we have reduced both the scope and priority of this initiative.

9. FISHERIES

9.1 Introduction

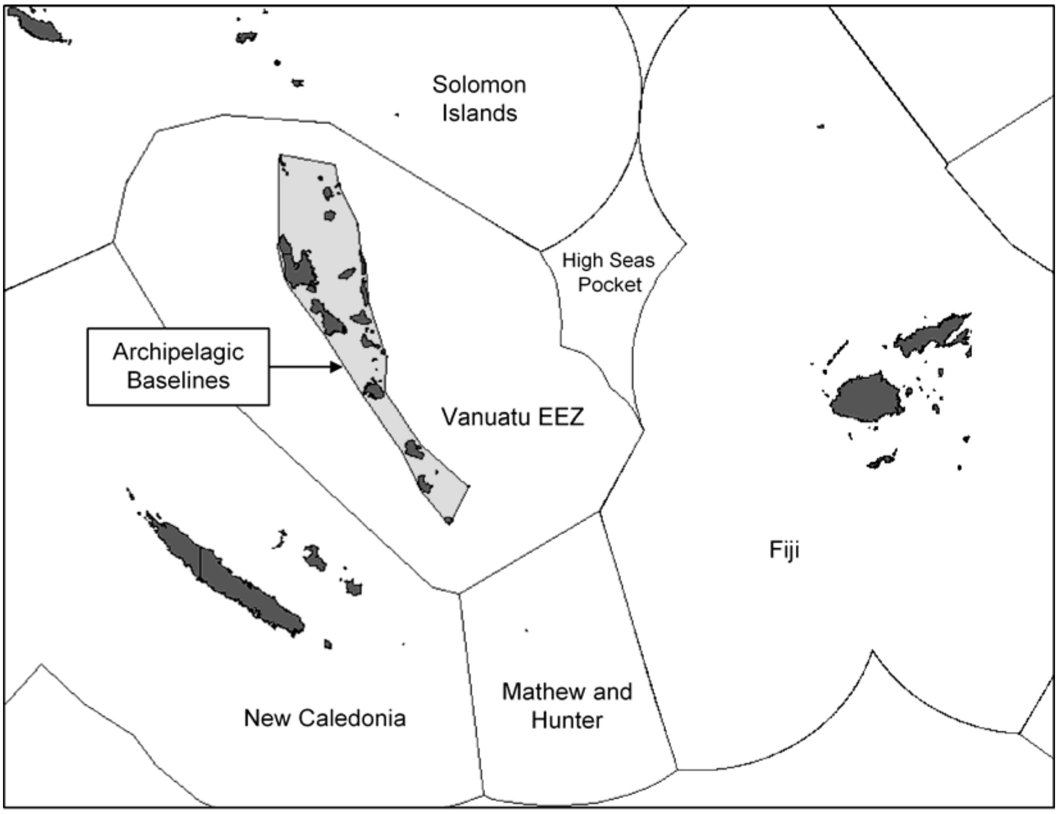
Vanuatu fisheries can be divided into three sub-sectors: offshore, coastal and nearshore. Offshore fishing consists mainly of tuna, the sport boat industry and overseas vessels registered on Vanuatu's shipping register Coastal fishing is conducted by small local boats, mostly in deep water. Nearshore activity mostly comprises subsistence fishing, but with a growing aquaculture industry. This chapter examines ways to increase the contribution of fisheries to development whilst preserving the natural environment and cultural practices. The offshore industry has particular potential to be developed in such a way that it adds more value and increases the potential for innovation.

9.2 Offshore resources

Vanuatu's Exclusive Economic Zone (EEZ) is very large, at approximately 680,000 km^2.[82] An additional area of 230,000 km^2 surrounding the small-uninhabited southern islands of Matthew and Hunter is currently disputed with France (see figure).

Figure 9.1. Vanuatu's EEZ

[82] An important outstanding activity for Vanuatu to undertake is the formal delimitation and ratification of its EEZ to resolve the boundaries with its neighbours including Solomons, Fiji and France. France has recently lodged a formal claim to the UN for the area surrounding Matthew and Hunter.



Under the Maritime Zones Act, Vanuatu also has a 12-mile territorial limit (measured outward from the baseline) and a 12-24-mile Contiguous Zone used for customs regulation purposes.

9.2.1 Tuna

Vanuatu's involvement in commercial tuna fishing began in 1957 with the establishment of the South Pacific Fishing Company (SPFC) trans-shipment, cold storage and support base at Palekula Bay on Espiritu Santo island. Between 1957 and 1986 commercial tuna fishing accounted for 26% of total export earnings, second only to copra (Cillaurren et al. 2001). Annual tuna landings from surrounding nations were as high as 16,000 tonnes before 1973. Ice production and the two slipways continued to serve local needs until the mid-to-late 1990s. Production has now declined substantially.

The primary economic benefit is now resource rental through fisheries access. By 2005 the fleet included 127 mostly Chinese, Taiwanese and Fijian longliners, as shown in Table 9.1. It yielded around USD1 million (MAQFF Report 2006, unpublished).

Table 9.1 Longline vessels fishing in Vanuatu's EEZ, 2001-2005

FLAG/YEAR	**2001**	**2002**	**2003**	**2004**	**2005**
Belize	3	3	3	3	3
Cambodia	0	7	0	0	1

China	8	18	35	57	57
Equatorial Guinea	1	0	0	0	0
Fiji	3	13	31	17	28
Korea	0	5	29	10	11
New Zealand	0	2	0	0	0
Panama	2	2	0	0	0
Chinese Taipei	30	34	29	23	16
US	0	2	0	0	0
Vanuatu	1	19	12	8	11
Total	**48**	**105**	**139**	**118**	**127**

Source: Naviti and Taleo 2006

The current license rate schedule varies with vessel tonnage; vessels greater than 100 Gross Registered Tonnes (GRT) pay USD11,000, while the rate for less than 100 GRT is USD 9,000. Most longline vessels are bigger than 100 GRT (Naviti and Taleo 2006).

The following table shows longline revenues (MAQFF Report 2006, unpublished).

Table 9.2 Revenue from longline fishing licenses, 2002-2006

Year	Total (Vatu)
2002	111,832,036
2003	105,556,760
2004	70,790,968
2005	81,230,022
2006	121,299,188

Due to local oceanographic and climatological conditions influencing productivity, Vanuatu's EEZ lies outside the main 'hotspot' areas for the main species caught by longline fleets operating in the Pacific. It is therefore not a major tuna fishery. The main species targeted in Vanuatu's EEZ is albacore, which at this latitude is said to be of higher oil content and is increasingly being sold to the high value sashimi market. The other main tuna species caught are yellowfin and bigeye.

Data collection, compliance and management issues

The longlining fleet has historically under-reported its catch in order to reduce fees. As catches are offloaded in Fiji, the logsheets are submitted there for forwarding directly to the Secretariat of the Pacific Community (SPC) for data entry and analysis. Vanuatu does not receive copies of the logsheets nor has the opportunity to develop the capacity to assess and analyse them. In addition, Vanuatu does not have an observer program to monitor and record fishing activity on-board foreign fishing vessels.

As only species retained on board are recorded on logsheets (i.e., discarded bycatches go unrecorded), their management remains an important outstanding issue. Discards may include non-commercial species, damaged or low quality fish such as skipjack and protected species due to their endangered status such as marine mammals (primarily dolphins and small, toothed whales), seabirds and marine turtles. Overfishing impacts to these bycatches on ocean ecology and biodiversity is of increasing concern. Additionally, data may be pooled for some groups (e.g. sharks or billfish), making their management by species more difficult.

Longliners are reported to illegally fish inside the 12-mile limit. Unlicensed fishing vessels also enter Vanuatu's EEZ to fish illegally. The Vanuatu Police vessel 'RVS Tukoro' undertakes regular monthly patrols (depending on weather conditions, vessel repair and budget constraints). It is also available to respond to any infractions reported, however its effectiveness in apprehending offenders is limited in such a large area. In addition, aerial surveillance patrols are conducted by New Zealand and the French military..

Without accurate information, fisheries managers are unable to implement appropriate management measures to ensure the sustainabilty of the fisheries and protect the ocean's ecological balance. Accurate reporting is also important to ensure a fair return for access to resources.

Vanuatu Tuna Management Plan

A Tuna Management Plan was developed by the Department of Fisheries in 2000 with donor assistance, and includes specifying a Total Allowable Catch (TAC). It makes environmental concerns central.

Over the last decade increasing attention has been placed on more holistic approaches to resource management and for marine ecosystems. This is often expressed as the Ecosystem Approach to Fisheries Management (EAFM). Not only should there be management of target stocks, but impacts on the broader ecosystem need to be considered, and importantly, social and economic outcomes.

The Convention on the Conservation and management of highly migratory fish stock in the Western Central Pacific Ocean (WCPO) Convention specifically covers these issues, in accordance with the United Nations Convention on the Law of the Sea of 1982.

Vanuatu is the first Forum Fisheries Agency (FFA) member country to introduce EAFM as a more sophisticated and comprehensive approach to fisheries management and promote the WCPO Convention. The following management objectives and principles are derived from these efforts (Fletcher 2007).

Objectives

1. To ensure that the exploitation of the tuna resources that are found in and pass through Vanuatu waters is compatible with the sustainability of the stocks throughout their range.
2. Within the limits of the sustainability objective, to ensure the harvest is taken in a way that maximizes the long-term economic and social benefits received by the peoples of Vanuatu.
3. To contribute to the food security of ni-Vanuatu.
4. To meet regional and international responsibilities for tuna management.

Principles

Principles provide guidance to the development of goals and strategies and also to routine decision-making. Five key principles that are all consistent with an EAFM approach have been considered in the development of this report and the review of the Tuna Management Plan:

1. Equitable distribution of benefits	Benefits from the tuna fishery will be distributed equitably among the people of Vanuatu with consideration given to rural/urban and geographic distinctions. In the short and medium term, an important focus for tuna management will be on the maximization of net revenues and other benefits to the people of Vanuatu from foreign vessels fishing in Vanuatu waters and from vessels fishing for tuna in other waters while under the Vanuatu flag. Vanuatu intends to develop a sustainable locally-owned and based fleet that can extract a significant proportion of the available tuna resources from the EEZ with as much local processing and value-adding as possible. Wherever possible management will support the utilization of tuna resources by small scale/artisanal fishermen and in rural areas.
2. Use of the precautionary principle in management	The use of the precautionary principle in the management of fisheries emphasizes prudent foresight to avoid unacceptable or undesirable situations. In support of precautionary management at the regional level Vanuatu will ensure that: 1. Appropriate information is collected from tuna fisheries in its waters and from Vanuatu-flagged tuna fishing vessels in other waters and provided to appropriate regional organisations for stock assessment purposes;

	2. The necessary management, legal and enforcement tools are in place to enforce limitations on catch should this become necessary; 3. The management system is regularly reviewed to ensure that it can be responsive to changing situations.
3. Cost recovery	The level of management of the tuna fisheries that will result from the implementation of this Tuna Management Plan will require financial resources. Fishermen who benefit commercially from the tuna resource are expected to contribute to these costs of management.
4. Public accountability and transparency	The Government will be accountable to the people of Vanuatu for its management of the tuna fishery and will consult with stakeholders before making major policy decisions.
5. Limitation of adverse social and environmental impacts	Careful attention will be paid to any adverse environmental and social impacts resulting from the tuna fishery and these will be limited to acceptable levels.

The Tuna Management Plan aims to make value-adding central. To this end, two shore-based fish processing facilities are planned for the Port Vila area.

1) The Government has reached agreement with China for the construction of a tuna longlining base. The facility will be managed by the China National Fisheries Corporation (CNFC) and will process (loin) and pack for export the catches of 40 Chinese longline vessels. Although details of this scheme are not widely available, the CNFC and Vanuatu Government (with CFNC the majority shareholder) will jointly own the 'SinoVan' Company. The processing facility will be located at the Blacksands area within Mele Bay. It is anticipated that longliners will offload their catch at the main wharf and the catch will be transported to the Blacksands facility for processing. Land clearing has begun at this site.

2) A local business (Tuna Fishing Co Ltd., with vessels licensed to fish in Vanuatu) has recently initiated the construction of a processing plant for loining of its tuna catches within Port Vila Harbour. Although details of this operation are not well known, this operation appears to be in partnership with a Chinese fishing company based in Fiji. Longliners will offload their catch directly at the facility for processing.

Vanuatu-based fishing operations have a number of advantages for management, the economy and human development:

- Improved data and resource management as monitoring becomes easier;
- Improved fisheries observation;
- Increased fiscal revenues;
- Increased employment in the Port Vila area;
- Spin-offs in the form of refuelling, servicing and provisioning of ships;
- Increased capacity and training for seamen and fishermen, engineers/ship maintenance, fish processing, catering;
- If sashimi-grade tuna is produced and exported by air this would add value and create revenue for Air Vanuatu.

Clearly the policy of value-adding may conflict with environmental concerns, making the EAFM all the more important. The loining facilities will generate biological waste in the form of fish blood, frames, tails, skin and heads. It is not clear how or where this waste will be disposed of but in light of the significant tourism development in this area it will be important to avoid contaminating the marine or terrestrial environment. The area within the inner harbour is already polluted (high organic loading and bacterial coliforms), partly a result of restricted water circulation and flushing.

In addition, care must be taken with the refuelling of vessels while in port to minimize and contain spillage and contamination of the marine environs. The pumping of bilge water and domestic waste are additional potential threats to the harbour and the tourism value of the area. This is especially important in light of the poor water circulation within the harbour. Long-term damage to the tourism industry from pollution or unsightly facilities is likely to outweigh any benefits from the fishing industry.

To date, the Government has chosen not to undertake an Environmental Impact Assessment (EIA) for either of these developments (a preliminary assessment funded by FFA for the Chinese facility in Blacksands recommended that the proposed facility does not require an EIA). As these two projects represent the first fish-processing facility on Efate, it is recommended that a full EIA be carried out to ensure that adequate environmental protection measures are put in place. This is best done during the initial planning and development phase to protect the environment as well as tourism industry of the most populous and developed island in Vanuatu.

A further socio-economic concern is the impact of the local-based fleet offloading their bycatch in Port Vila for sale locally. While reduced prices would be welcomed, it may have a major impact on local artisanal and commercial fishers.

9.2.2 The sport fishing charter boat industry

The sport fishing industry has steadily grown from two to three charter boats a decade ago to a current level of eight[83]. Vanuatu currently holds blue marlin world records and is increasingly being recognized as an international game-fishing destination. Each boat lands approximately six to eight tonnes of pelagic fish annually[84]. This equates to some 48 to 64 tonnes of fresh pelagic fish supplying the hotel, resort and restaurant trade.

The Vanuatu Game Boat Operators Association (VGBOA), established in 2004, indicate that 1,120 people came to Vanuatu with pre-booked fishing charters and spent over VT270 million in-country (on average approximately VT240,000 each). Three quarters of this was spent on airfares, accommodation, food and drinks, entertainment, transport, sightseeing and outer island travel. The other quarter went towards boat rental. VAT paid to the Government on these goods and services was calculated to be approximately VT22,666,000. In addition, another 300 tourists selected game fishing as an activity while in-country, bringing the total to 1,420 people utilizing this sub-sector in 2005.

The VGBOA funds, deploys and maintains three Fish Aggregating Devices (FADs)[85] off Efate although all fishers normally make use of them. Each FAD costs roughly VT240,000 to deploy and last a year or two, depending on the number and severity of cyclones.

Based on the figures above, the sport boat industry generates significant direct and indirect revenue within the tourism sector and to Government. It will be increasingly important for the DoF to work closely with the VGBOA in maintaining effective fisheries management and enforcement strategies to allow the continued growth of this industry. It would be useful for the VGBOA to collate all members' fish catch data and provide copies to the DoF[86] on an annual basis.

Currently, the Tourism Office grants a tourism license for Sport Fishing boats while the DoF grants a fishing license. There is a need to establish improved coordination between the two Government bodies to ensure better management and promotion of this industry.

9.2.3 Fishing vessels on the Vanuatu shipping registry

The Vanuatu International Shipping Registry (VISR), under contract to Vanuatu Maritime Services, has some 500 ships registered through an office in New York. The VISR also allows foreign fishing companies to register as Vanuatu flagged vessels. The

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[83] The fleet had grown to 12 but in March 2007 four boats owned by one company dropped out due to external factors.
[84] Fish landed by game boats remain the property of the boat, not the game fisher and the sale of these fish are used to offset fuel and operating costs.
[85] These floating devices are anchored along known tuna migration paths and influence tuna to aggregate in their vicinity thereby concentrating them for more efficient fishing.
[86] The submission of catch data to the DoF is a condition of fishing licenses.

number registered as fishing vessels in 2005 was 86 (up from 33 in 2002) with 11 of these being longliners licensed to operate within Vanuatu waters.

Vanuatu now has the second largest fishing fleet operating in the Eastern Pacific and has the fastest growing fleet in the Indian Ocean. In the recent past, some of these vessels were implicated in illegal, unregulated and unreported (IUU) fishing activities and a number of international tuna commissions expressed their concerns to the DoF. The DoF has taken steps to regulate Vanuatu's fishing fleet through a variety of measures including background checks on vessels, ensuring the timely submission of catch data, introducing Certificates of Origin (COs) and limiting fleet size to 116 vessels.

A Vessel Monitoring System has also been introduced in order to satellite track and monitor the Vanuatu fishing fleet across the globe. The DoF plans to introduce an observer program in the near future (this has been constrained by a lack of funds) and through these efforts Vanuatu-flagged vessels have increasingly complied with most international standards and considerably improved its reputation as a fishing nation.

The DoF intends to phase in fishing licenses for all vessels on the VISR once approved by parliament. The DoF estimates fishing licenses would cost USD5,000 each. With the current number of vessels fishing, this would generate an additional USD430,000 annually for the Government.

9.2.4 International agreements

Given the migratory nature of tuna, it serves the interests of Pacific Island nations to negotiate a multilateral agreement. A multilateral fishing treaty would carry the advantage of avoiding the potential mismanagement that may result from bilateral deals. Additionally, negotiating with the other Pacific nations would enhance transparency and hopefully lead to a more equitable distribution of fishing revenues.

The Pacific has argued that the best way to reap greater benefits from the region's fisheries resources is to act in concert through the provision of a Multilateral Fisheries Partnership Agreements (MFPA), not only for management purposes, but also to further the development of fishing and processing industries[87]. To assist negotiations towards a MFPA, the Pacific Islands Forum Secretariat has drafted an agreement on behalf of member countries not already covered under bilateral agreements. It was agreed by the Pacific ACP (PACP) Group to pursue a multilateral fisheries agreement within the EPA that will contain the current bilateral agreements but with additional components, such as simplified Rules of Origin (ROO).

ROO are often too complicated to enable exporters to qualify for trade preferences. The PACP have argued for a simplification in the definition of a national fish to anything caught within the EEZ of a country, regardless of the flag of the vessel. The PACP also

[87] In the tuna sector one or two PACP countries have the potential to become the Pacific hub for processing. For this to happen, however, both reforms of ROO and clearer national strategy are needed (as canneries policies remain uncertain in concerned PACP countries).

want to abandon the idea of a value-added rule of origin and push for a “change in tariff heading” (CTH) criteria. This has the advantage of having a low administrative cost, as companies are not required to keep tabs on all of the costs of their imported goods.

Vanuatu should not accept any ROO that reduces its current level of market access as specified in the Cotonou Agreement. Also, ideally a ROO should be designed to maximise the incentive for vessels to land their ships in the country fished (rather than go to elsewhere) in order to assist the local development of the fisheries sector and provide for value added potential.

Rampa (2007) notes that the EU has so far refused to simplified ROO. The EU has suggested that this might set a precedent for other regions. This position, however, does not fit with the stated aim of the EPA to promote regional cooperation, investment and economic development.[88]

9.2.5 Conclusions and recommendations for offshore fisheries

While revenue from offshore pelagic resources more than quadrupled over the past decade by raising fees and number of licenses, it currently accounts for less than 2% of the value of goods exported. Establishing shore facilities would add value, create jobs and may potentially stimulate the development of a domestic fishing fleet.

Further, a number of management issues remain outstanding, including monitoring, compliance and surveillance of offshore fishing vessels. Landing catches onshore would have the additional potential of addressing these management issues through Vanuatu based catch-data collection and observer and port sampling programs. Environmental concerns, however, remain paramount. Proper planning and environmental protection measures in the establishment of shore-based facilities will help safeguard the environment so important to local people and tourists.

9.3 Coastal commercial and artisanal fisheries

The annual commercial coastal catch of Vanuatu was valued in the mid-1990s at USD1,514,364 (Dalzell *et al*, 1996). This was approximately 1.5 times the value of offshore tuna fisheries. Local vessels used for deepwater fishing are outboard-powered fishing skiffs fitted with deepwater fishing reels. Trips are usually less than 12 hours during day or night. As deepwater reefs are often relatively close to shore (a characteristic of steep volcanic islands), in many areas local outrigger canoes can be used in quiet weather. The catch is generally traded and consumed locally.

9.3.1 Village Fisheries Development Project (VFDP)

The VDFP, launched in 1982, was the earliest initiative at developing the artisanal deepwater and pelagic fisheries, which were not traditionally harvested. The main objectives were to reduce imports of tinned fish; improve the diet of local inhabitants

[88] This is apparent by the fact that the EU has negotiated fisheries access deals with three Pacific nations bilaterally and the most recent negotiations for renewal of the agreement with Kiribati were concluded as recently as July 2006. This was done despite Pacific trade negotiators making repeated requests for a regional agreement.

with limited access to commercial products; and to create employment. Equipment and onshore facilities were provided, and markets established.

Because deepwater fish stocks in most areas were virtually virgin, catch rates were very high and the VFDP became extremely popular amongst rural islanders. By 1987, over 100 enterprises were established despite the project's initial aim to establish only 25 (Kenneth 1991).

However, towards the end of the project catch rates declined and profitability fell. The project suffered from:

- A lack of understanding of the non-specialist and predominantly agricultural orientation of rural households;

- Poor design and technical appraisal. Initial catch rates were not sustained after virgin stocks began to be depleted;

- A part-time approach to fishing; high price of fuel and spare parts; expensive and unpredictable airfreight; and volatile weather patterns;

- Lack of strategic planning. No short-term targets were set or indicators agreed against which to measure the performance of the project;

- Lack of clearly defined objectives. Some of the VFDP objectives were conflicting and ambiguous. For example, fish production for local consumption as well as for export each required different strategies.

It was also apparent that there was a critical shortage of the necessary mechanical and small business management skills to maintain the introduced technology to remote villages.

Taking account of these shortcomings, the VFDP was extended into its second phase, the Vanuatu Fisheries Training Centre and Extension Services (VFTC and ES) for a further five years (1987-1991) with EU funding. This involved the establishment of the Fisheries Training Centre, the rural Fisheries Extension Centres in each Local Government Region, the Fisheries Mechanical Workshop and a DoF jetty in Santo.

When the EU stopped funding the VFTC and EC Project in 1996, the supply of deepwater fish to Port Vila and Santo dropped significantly. Fish production declined from the 72.3 tonnes achieved in 1996 to about 28 tonnes in 2000. Many of the urban fish markets also closed during this time.

Despite their shortcomings, the projects were the beginning of what is now an established coastal commercial/artisanal deepwater and pelagic fisheries industry. Many of the obstacles were a product of poor design rather than inherent problems with coastal fisheries.

9.3.2 Urban fish marketing developments

The DoF has observed that the inconsistency in fish supply is related to the instability in fish price. Fishers are not motivated sufficiently unless the price remains stable, a finding which fits with the observation on coffee prices in the chapter on human development. As a result, much of the fish currently marketed in Port Vila is through the two large fish retailers. These companies also have vessels equipped for longlining that fish in Shefa and Malampa waters and drop ice to rural villages and later purchase their catch. While this is also a useful service to rural areas that otherwise have limited means to market their fish, they consequently control much of the transport, price and marketing of fish from the rural areas.

The DoF intends to facilitate the development of a public market in Port Vila and elsewhere. Rural Fisheries Marketing Centres have been established in a number of islands, as have training courses.

Further innovations are necessary to promote value-adding other than simply selling whole fish to retailers at wholesale prices, as is currently the practice. Local innovations with minimal capital investments are possible at the household level through the production of niche-market fisheries products. Smoked fish has successfully been produced for urban markets. Additional value-addition includes flour rolled fish sticks, Tahitian salad (fish pieces and vegetables in coconut milk) and fried reef fish, tuna and sardines sold at local shops and at popular kava bars.

While deepwater fish resources are known to be slow-growing and vulnerable to over-fishing and are likely to be limited in stock, they provide a quality fish in high demand from the restaurant-tourism trade as well as for high-income earners around the urban centres. The local production and sale of these fish thus provide opportunities for commercial/artisanal fishers while reducing the amount of fisheries products imported. Given the uncertainty in stock size, annual catches or the impact from years of longlining from larger vessels it is important for the DoF to improve data collection and analysis as well as clarify the development potential of the deepwater stocks.

To promote greater opportunities for local fishers and ensure the sustainability of the deepwater fisheries resource it is recommended that**:**

i) Development and management plans be developed for the deepwater and coastal pelagic commercial and artisanal fisheries need be formalized including objectives, strategies and activities. This should include FAD deployment, distribution and management of ice plants, marketing strategies and quality standards, value adding to products and training for extension personnel;

ii) Revision of strategies for the establishment and training of Fishers Associations and a new Action Plan for implementation by the DoF;

iii) Require a stock assessment of the deepwater demersal fisheries resource and an updated estimation of the Maximum Sustainable Yield (MSY) by island to determine the status and economic potential of this fishery and to underpin the management plan;

9.4 Nearshore resources

9.4.1 Marine resources

While most ni-Vanuatu people are considered farmers, nearly two-thirds of the population also regularly relies on marine resources as a source of nutrition and as an additional option to generate revenue. Most of the traditional fisheries historically practiced in Vanuatu were from nearshore reefs (Hickey 2007). Nearshore catches are generally made with minimal capital investments, often on foot from shore over reef flats or along reef drop-offs or lagoons from outrigger canoes.

Preliminary results from the 2007 agricultural survey indicate that 75% of households now engage in some form of fishing activities (Ipalawatte and Willie 2006), an increase since 1999. In Malampa province the proportion is as high as 90%

The 1999 agricultural census estimated that some 61% of rural households regularly access nearshore resources for consumption or informal trading. Of this proportion, 89.5% fished for subsistence, 10.2% fished for subsistence and to sell their catch and 0.4% fished exclusively to sell their catch. It is clear that although they engage in fishing, very few people consider fishing as an exclusive full-time activity, in keeping with the tradition of spreading risk through non-specialization (Rodman 1989).

The economic value of the subsistence catch to the national economy in terms of informal trading as well as import substitution is often overlooked. It was estimated that the nominal value[89] of the subsistence catch totalled USD1,953,360, about half a million dollars higher than the commercial coastal catch. Each of these figures exceed the value from the resource rental from foreign-flagged vessels to access the offshore EEZ for tuna resources. The total nominal value of subsistence and commercial nearshore catches is estimated at USD3,467,724.

In addition, Vanuatu has a small but important nearshore export industry. Trochus, green snail and beche-de-mer exports peaked in the 1990s but have since declined. In the late to mid 1990s when trochus stocks remained healthy, the value of exports was over VT100 million and accounted for some 3.5% of total commodity exports (ADB 2001).

Table 9.3 Total annual export production for trochus, green snail and sea cucumber (tonnes)

Year	Trochus	Green snail	Sea cucumber
1990	170	10	50

[89] Their monetary value for the purposes of this study was calculated based on their estimated cash value.

1991	130	44	50
1992	150	7.35	39
1993	160	51	40
1994	107	1.1	40
1995	100	0.35	50
1996	100	2.7	50
1997	100	3.9	50
1998	100	1.1	50
1999	90	0.6	50
2000	90	0	26
2001	73	0	38
2002	67	0	8
2003	53	0.7	25
2004	35	0	13
2005	36	0	9

Source: FAO, 2006 and Vanuatu Fisheries Department Database, 2006

9.4.2 Aquaculture

The development of aquaculture in Vanuatu is a new and promising industry. Species include Trochus, Green snail, Giant clams, Sea cucumbers, Corals, Marine Shrimp, native freshwater prawn and tilapia. Government and the private sector have drafted a five year aquaculture development plan. The plan identifies aquatic species from marine, brackish and freshwater environments that have potential for development. However, regulatory mechanisms and legislation to ensure the sustainability of these initiatives, and to protect biodiversity from the impact of introduced species, remains to be included. VQIS has been performing this latter function on an *ad-hoc* basis.

Presently, aquaculture development is not covered under any specific legislation other than quarantine restrictions placed on the import of exotic species. The Government's support to the newly established aquaculture companies so far is through the provision of duty exemptions on fuel, materials and equipment. There is an urgent need to start developing appropriate aquaculture policies and legislation to ensure that this sub-sector is developed in an environmentally sustainable manner.

Donors may wish to support research into identifying local species suitable for aquaculture and promoting (perhaps through micro-credit schemes) small-scale community aquaculture using local species. Donors should also consider funding an assessment of the current status of aquatic diseases, pests and invasive species and their impacts on the environment. Management plans that provide a regulatory framework for aquaculture development including for private sector involvement should be a priority for this sub-sector.

Nearshore marine resources have a number of additional, non-financial benefits:

- Subsistence fishing represents a significant asset in providing access to fresh nutritious seafood. It is therefore a source of import substitution. While coastal and offshore waters are normally restricted to males, access to the nearshore by foot or local canoe is also widely available to women (and children) who are often responsible for providing daily meals. The nearshore reefs thus provide significant and widely accessible food security, income generation potential and human development value.

- Barter systems associated with subsistence fishing also allow for the redistribution of food resources during times of seasonal abundance, while strengthening kinship alliances, maintaining peaceful relations and enhancing food security (Hickey 2007).

- Nearshore areas have an intrinsic environmental value in the form of coastal protection from storm surges, hurricanes and sea level rise. Protection from seasonal threats, global warming and sea level rise are additional reasons to ensure sustainable, non-destructive use of nearshore areas.

9.4.3 Management and conservation strategies

Customary marine tenure is legally recognized in Vanuatu. Chapter 12 of the Constitution states:

> *Article 73: 'All land in the Republic of Vanuatu belongs to the indigenous custom owners and their descendants.'*
>
> *'Land' is further defined in the Land Reform Act to include…land under water including land extending to the sea side of any offshore reef but no further.*
>
> *Article 74: 'The rules of custom shall form the basis of ownership and use of land in the Republic of Vanuatu.'*

These articles provide the customary owners rights to manage their land and reefs as they have traditionally done for centuries through the use of taboos and other fisheries behaviour restrictions. Research into traditional resource management and the use of traditional knowledge in Vanuatu reveals a strong heritage of managing resources through customary marine tenure. A combination of traditional beliefs and practices includes privileged user's rights, species specific prohibitions, seasonal closures, food avoidance and closed areas (Hickey 2007).

While compliance with these measures is generally very good, internal community conflicts sometimes undermines management. Data-less management techniques (Johannes 1998), including the use of popular theatre, that provide culturally appropriate awareness on marine resource lifecycle and ecology used in conjunction with villager's traditional knowledge can have a positive impact on resource management. The application of these cooperative management techniques began in Vanuatu in the early

1990s with the DoF trochus enhancement program (Amos 1993) and quickly spread to cover other nearshore resources (Johannes 1998, Johannes and Hickey 2004).

Most communities also have a well-defined social system with a generally high respect for traditional leader's authority. Where leadership is found to be faltering, traditional leadership and community governance can be strengthened (Hickey 2007). Most areas have elders with a range of traditional knowledge of their resources including their spatial temporal distribution, preferred habitats, spawning migration and aggregation times, traditional fishing calendars and environmental cues and other management relevant knowledge. This knowledge and capacity need be recognized as valuable for fisheries management and mobilized in community-based nearshore reef management plans.

At the level of the state, there is an urgent need for the DoF to maintain an up to date database system for commercial nearshore resources and to enforce license holders to comply with the conditions of their licenses. Better coordination with the growing tourism sector would assist to prevent growing conflicts between these two sectors dependant on the same geographical areas. It is also important to ensure that stock assessment surveys are adopted as a core activity so that surveys to determine status of a fishery can be conducted at a minimum every three years. Regular monitoring of marine products exported for compliance with existing fisheries regulations such as size limits and prohibited species needs to be a regular activity of the DoF. All of these points should be incorporated in formalized management plans for the beche-de-mer, trochus and green snail fisheries.

9.4.4 Conclusions and recommendations on nearshore resources

Nearshore resources remain a significant asset to Vanuatu. They provide an important source of nutrition and serve as a form of import substitution. They also provide alternative revenue generation opportunities for many villages. Commercialized resources, however, are showing signs of over-harvesting. Traditional management practices under CMT remain widely practised and are found to be increasing to respond to continued harvest pressure. Communities need continued support in strengthening their traditional community-based management regimes. This includes the strengthening of traditional leadership and governance systems, use of traditional knowledge and cooperative management strategies.

It will also be useful for communities and fishers to be provided appropriate awareness to improve their understanding of current market trends and value of nearshore marine resources to ensure they are receiving fair value for their resources. To this end, the DoF could consider establishing a community/public resource centre based on its premises in Vila for promoting the fisheries development activities it is conducting as well as being accessible to the general public for research and information purposes. This could also be tied in with the Proactive Trade and Market Information System (PTMIS) proposed in the agriculture chapter.

Management and development plans, with management plans for the aquarium trade being a priority, need be developed for the various nearshore fisheries to provide clear regulatory and monitoring guidelines. Further efforts should be made to routinely collect nearshore fisheries data, especially for commercial species and centrally collated at DoF for analysis and management purposes. The new Fisheries Act and regulations passed in 2005, as well as their underlying rational need to be widely promoted to the public throughout the rural areas such that they will be supported and monitored by communities and their leaders on behalf of the DoF.

9.5 Conclusions

Government and donors have under-prioritised fisheries development over the last decade. Vanuatu has a sizeable EEZ but the financial returns from it currently come only from resource-rental, totalling just over USD1 million, barely 2% of the value of current exports.[90] In contrast, when tuna catches were landed to onshore facilities at Santo between 1957 and 1986, commercial tuna fishing accounted for 26% of total export earnings. The decline in fisheries exports is not due to a reduction in demand or a shortfall of supply. Onshore processing facilities would add value; boost export revenue; potentially help develop a domestic tuna fleet; and increase direct and indirect employment.

Significant improvements in tuna fisheries compliance, monitoring and surveillance would also be made possible if all or most tuna was landed to onshore facilities where catches could be monitored. These changes would help address the significant constraints currently found with tuna management. Protection of the environment must remain paramount in the development of onshore facilities. Social and cultural impacts must also be accorded the utmost priority.

Coastal commercial/artisanal fishing for deepwater and pelagic fish in the form of small-scale fishing initiatives contributes significantly to food security and economic diversification. Further innovations in value addition, including of artisanal fisheries products from the nearshore, will further enhance economic returns. Improved management of this sub-sector in the form of a deepwater stock assessment and refined data collection, analysis and reporting of fisheries catches is necessary to support and underpin further development.

The nearshore coral reefs provide one of the most widely accessible national fisheries assets in the form of fresh fish products for household food security, diversifying income generation, promoting import substitution and contributing to human development with little or no capital investment. Increasingly the nearshore coral reefs are also becoming important in tourism development. Traditional-based management systems need to be strengthened, since they are a cost-effective and decentralized system of resource management. Further research into the impact of introducing exotic aquaculture species is required in order to maintain environmental sustainability.

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[90] Although license fees are clearly recorded as government revenue, not exports.

ANNEX 1: HOUSEHOLD SURVEY

Location	Name	Occupation	Age	Dependents	Income	Source of Income	Source of Investment	Asset		Expenditure		
								Land	Garden	School fee	Health	Savings
SW Tanna	Dick Mana	Kava Farmer	32	7	192,000	Kava	None	2 ha	4 ha	47,000	300	None
SW Tanna	John Basua	Kava Farmer	47	6	48,000	Kava, Taro	None	1 ha	4 ha	18,000	100	None
SW Tanna	Mark Yoma	Cattle, Kava	65	4	196,000	Cattle, Kava,	None	43 ha	3 ha	60,000	5000	None
SW Tanna	Chief Nasse Tamer	Kava Farmer	59	8	96,000	Kava, Taro	None	2 ha	4 ha	47,000	1000	None
SW Tanna	Yau Kopitena	Taro	38	8	--	Kava, Taro	None	2 ha	4ha	47,000	500	None
West Tanna	Kapalu Raysen	Yam	39	4	67,000	Coffee, Pig, Cattle	None	4 ha	5 ha	45,000	600	30,000
West Tanna	Tom Soute	Sandalwood	45	6	400,000	Sandalwood	None	6 ha	7 ha	3,000	2000	
West Tanna	Nako Nafuman	Yam	31	4	45,000	Yam	None	--	6 ha	15,000	200	Yes
West Tanna	Willie Johnnie	Coffee	41	6	53,000	Coffee, Sandalwood	None	--	5ha	60,000	100	4000
West Tanna	Andrew	Yam	31	6	60,000	Yam, Sandalwood	None	2 ha	2ha	47,000	200	Yes/Hom e
West Tanna	Iauchnam	Yam	37	8	64,000	Yam, Carrot, Tomatoes	None	3 ha	6 ha	34,000	100	None
West Tanna	Jack Kisel	Coffee	66	9	100,000	Coffee	None	1/4ha	1ha	32,000	4000	None
Middle Bush	Bob Nateang	Taro	39	7	60,000	Yam, Peanuts	None	10ha	3 ha	47,000	400	60,000py NBV
Middle Bush	John Basua	Coffee	63	8	80,000	Cattle, Kava, Coffee	None	--	6 ha	47,000	6800	Yes/NBV
Middle Bush	Jimmy Iaput	Taro	45	4	200,000	Yam, Taro, Coffee	None	1ha	--	100,000	600	Yes/NBV
Middle Bush	Yala Joe	Coffee	57	6	10,000	Coffee	None	1/4ha	6ha	3,000	100	None
Middle Bush	Jacob Yala	Coffee	50	7	60,000	Coffee, Taro, Banana	None	Coffee Plantati	--	35,000	300	10,000/H ouse

								on - 3hc				
Middle Bush	Jimmy Nowahit	Coffee	67	5	204,000	Coffee, Cattle	None	96 ha	6 ha	47,000	6000	Yes/NBV
Middle Bush	Sam Iatiktaio	Coffee	22	4	50,000	Coffee, Cattle, Kava	None	7ha	6 ha	5,000	1500	50000/home
Middle Bush	Numake Somak	Coffee	36	5	300,000	Coffee, Cattle, Sandalwood	None	20ha	--	68,000	400	
Gaua –East	Mark	Timber	32	2	1,200,000	Cattle, Copra, Vanilla	None	--	--	--	1300	Yes/Home
Gaua –East	Lornoa Sarle/F	Copra, Cattle	32	1	60,000	Cattle, Copra, Vanilla	None	--	2ha	--	2600	20,000/NBV
Gaua –East	Stanley Reginald	Politician, Copra	-	7	450,000	Trochus, Kava, Cattle	None	--	20ha	250,000	-	Yes/House
Gaua –East	David	Peanut, Kava	55	5	110,000	Copra, Peanuts	None	7ha	--	--	300	None
Gaua –East	Jack Springel	Peanuts, Kava, Copra	44	7	441,000	Peanuts, Copra , Kava	None	--	7ha	9000	1000	Yes/Investment
Gaua –East	John Ham	Peanut Farmer	31	7	108,000	Peanuts, Kava	None	2ha	--	2500	1000	None
Gaua –East	Masten Aris	Timber, Cocoa	65	11	38,780	Kava, Peanuts	None	20ha	--	1500	--	None
Gaua –East	Vuti	Kava Nakamal	24	7	360,000	Kava	None	--	--	2500	100	Yes/Home
Gaua –East	Kamuel Vayak	Copra Collector	38	5	360,000	Copra	None	--	--	4500	600	None
Gaua –East	Morris	Kava	43	5	720,000	Kava	None	--	--	1500	500	None
Gaua –East	Madlen Rong	Poultry	--	2	60,000	Poultry, Copra	None	--	--	--	100	None
Gaua –East	Charles Bice	Tourism	--	6	600,000	Allowance from Air Vanuatu Board, Tourism Board	Loan from NBV	4ha	3ha	5000	500	Yes/NBV
Gaua –East	Tony Francis	Copra, Vanilla	62	3	8,400	Copra, Cattle, Vanilla	None	7 ha	2 ha	45,000	300	Yes/Home
Gaua –East	Victor	Kava, Taro	42	7	108,000	Boat Hire, Copra, Kava	None	--	11 ha	72,000	500	None
Gaua -East	Roy Adam	Retail Shop	49	12	120,000	Retail Shop, Copra,	None	--	5 ha	49,000	300	None

						Cattle						
Gaua –East	Simeon Vavak	Copra	50	17	20,000	Cattle, Fruits, Store	None	--	--	2,000	2000	None
Gaua –East	Nelson Doroman	Copra	59	4	108,000	Kava, Root Crops	None	--	--	1,500	600	None
Average			**45**	**6.216**	**198,811**					**37,970**	**1197**	

ANNEX 2: REMIT OF NATIONAL TRADE FACILITATION COMMITTEE

Purpose:
The main purpose of the NTFC is to create a sustainable, transparent and formal consultative mechanism to serve as an inter-institutional national forum where all parties interested in the nation's international trade (notably from both the public and private sectors), work together to identify their respective trade facilitation problems, and priorities, coordinate and implement mutually agreeable solutions through formulating recommendations to the Government as to how to reduce practical impediments to the nations trade.

Background:
Vanuatu's membership and signatory to a number of trade agreements including the Melanesian Spearhead Group Trade Agreement (MSG-TA), Pacific Island Countries Trade Agreement (PICTA), Pacific Agreement on Closer Economic Relations (PACER), the Cotonou Agreement and its European Union Economic Partnership Agreement (EU-EPA) negotiations and our proposed World Trade Organisation (WTO) accession does indeed set the conduit for increasing trade preferences as well as challenges to Vanuatu's growing industries, local businesses and exporting sectors.

Hence a need for all relevant stakeholders to collaborate in formulating an effective trade policy machinery to facilitate and advise on national and regional trade facilitation programs and issues.

The Scope and Objective of the NTFC:
- Improving the effectiveness of national trade facilitation
- Establishing and maintaining a genuine partnership with all relevant stakeholders
- Identifying and prioritizing national trade facilitation related problems affecting the nation's current and potential trade.
- Assisting the Government in formulation and implementing a national trade facilitation policy.
- Enabling an active participation in regional and international trade facilitation fora.
- Providing a national forum for information collection and dissemination, and knowledge sharing on trade facilitation issues (national, regional, and international).
- Facilitating awareness raising of trade facilitation issues.
- Increasing the priority of trade facilitation within the Government.

Responsibilities:
The NTFC will have the following responsibilities:

<u>National Trade Facilitation:</u>
- Identify and prioritize national trade facilitation problems, and suggest measures to overcome them.

- Present recommendations on the formulation and implementation of national trade facilitation policies to the Government.
- Produce recommendations of measures/actions to be voluntarily implemented.
- Propose measures to ensure/enhance the implementation of existing trade facilitation instruments.
- Review any existing trade facilitation related legislation, procedures and institutions and recommend revisions/eliminations as necessary.
- Recommend measures to simplify and harmonize procedures that would facilitate and promote inter-island trade including outside trade
- Identify persons/agencies to undertake relevant studies/research
- Facilitate communication between all relevant trade facilitation stakeholders – maintaining the NTFC as a fully consultative mechanism
- Identify capacity building/technical assistance/training needs and coordinate these initiatives at the national level.
- Identify relevant awareness raising for public sector, private sector and general public
- Periodic review and evaluation of the NTFC function.

Regional and National Coordination:
- Develop an integrated approach to national trade facilitation policy.
- Represent and participate in the Regional Trade Facilitation Forum (RTFF)
- Cooperate and share of experiences with the other FIC NTFCs.

Coordinate and intensify the effort to obtain trade facilitation related technical assistance from relevant regional and international organisations.

ANNEX 3: COMPETITIVENESS INDICATORS FOR VANUATU AND SELECTED COUNTRIES

Average Factor Cost	Fiji	Papua New Guinea	Solomon Islands	Australia	New Zealand	Vanuatu
Cost of vacant land for industrial use (USD/m^2)	77 [1]	14 [C]	143 [14]	420 [F]	237 [19]	70 [15]
Construction costs for an office building (USD/m^2)	336 [1]	377 [17]	580 [A]	721 [18]	853 [G]	995 [16]
Minimum wage (USD/month)	113	48	36 [6]	1,597	1,104	198
Social security contribution (%) [13]	8	5.5	5	NA	NA	4
Employer's contribution (%) [13]	8	7.7	7.5	9	NA	4
Interest rate on short term bank loans (%)[2]	0.90	18.68 *	5.85 *	5.25	5.77	5.50
Cost of electricity (USD/kWh) [5]	0.16	0.05 [I]	0.16	0.03 [8]	0.05 [7]	0.26
Cost of water (USD/m^3)	0.36 [1]	0.38 [5]	0.35 [B]	1.00 [E]	1.42 [H]	0.40 [5]
Cost of a local call (USD/3 minutes) [3]	0.05	0.06	0.09	0.11	0.12 [4]	0.21
Cost of diesel fuel (USD/litre)	0.61 [9]	0.71 [9]	0.28 [10]	0.94 [11]	0.66 [12]	0.90 [9]
Cost of air freight to Europe (USD/kg) [J]	13.00	12.47	10.04	12.74	16.70	16.00
Cost of maritime freight from Europe (USD/TEU)	4150			1297	1597	4000

Notes:
TEU = twenty-foot equivalent units, equivalent to one 20 foot-sized container or 32 m^3.
Exchange rate: USD 1 = Vatu 105

Sources:
1. Fiji Islands Trade and Investment Bureau, author's calculations.
2. Money market rates are for 2004 and treasury bill rates (*) are for 2003. United Nations Department of Economic and Social Affairs (2005). Statistical Yearbook 49th Issue, 2002-2004, New York.
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5. Pacific Infrastructure Review Final Report for the East Asia Pacific Infrastructure Flagship Project 26 November 2004.
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9. Forum Fisheries Agency. DevFish Trip Report #2, November 2006.
10. Solomon Star, 27 September 2006.
11. Australian Institute of Petroleum
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13. US Government Social Security Programs Throughout the World: Asia and the Pacific 2006. www.ssa.gov.
14. http://pidp.eastwestcenter.org/pireport/2007/April/04-18-09.htm

15. Author's calculations based on vacant rural land in property listings. See
http://www.ck.com.vu/default.asp?pg=1&cat=land_location_choix19
16. http://www.assai.com.au/default.asp?d=110537&p=110535
17.
http://www.pm.gov.pg/pmsoffice/PMsoffice.nsf/pages/55E3F7E6AAE7C0ED4A256C3D002DC2A5?OpenDocument
18. http://www.reedconstructiondata.com.au/news/news02.html
19. http://www.joneslanglasalle.co.nz/NR/rdonlyres/BAB7759A-38B9-4C0A-B61D-070BE0CCF3D9/0/AucklandsIndustrialMarketPlanningForFutureGrowth_Final.pdf
A. http://www.archivenet.gov.au/ARCHIVES/parbica/Documents/PARBICALowCostAchivesBuildingsReport.pdf
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D. www. ci-online.co.uk and UNCTAD
E. NUS Consulting (2006). 2005-2006 International Water Report and Cost Survey.
F. http://www.cbre.co.nz/research/marketview/australia_and_new_zealand/AUNZIndustrialMarketView2Q2006.pdf
G. www.dbh.govt.nz Department of Building and Housing
H. http://www.covec.co.nz/pdf/WaterEfficiencyLabelling.pdf
I. http://www.adb.org/Documents/Reports/PSA/SOL/SolomonIslands.pdf
J. http://www.tact-online.org/iata/welcome_nt/start.html. Destination is London, United Kingdom.
K. http://www.btre.gov.au/docs/staffpapers/%20freight_rates_dgargett.pdf

ANNEX 4. MAIN INTERNATIONAL SHIPPING SERVICES TO VANUATU

Service	Operator	Frequency	Vessels Employed	Service Type Vessel Size
Kaohsiung/Hong Kong/Busan/Kobe/Nagoya/ Yokohama/Majuro Atoll/Tarawa/Port Vila/Noumea/Lautoka/Suva/ Apia/Pago Pago/Papeete/Nuku'alofa/Santo/Honiara/Kaohsiung	Greater Bali Hai	Twice monthly	*Kyowa Cattleya Kyowa Hibiscus Coral Islander II Pacific Islander II MP*	Ro-ro: 400-900 TEU (plus car deck for 500 vehicles); 8000-7000GT
Lyttleton/Napier/Tauranga/ Auckland/Brisbane/Port Moresby/Lae/Rabaul/Lihir I/Honiara/Port Vila/Lyttleton	Sofrana Unilines	Every 18 days	*Sofrana Magellan, Sofrana Kermadec*	Multipurpose: 550-600 TEU
Algeciras/Hamburg/Hull/Antwerp/Dunkirk/Le Havre/Papeete/Auckland/Noumea/Suva/Lautoka/Port Vila/Santo/Lae/Madang/Kimbe/Rabaul/Jakarta/Singapore (PSA)/Algeciras	Bank Line	Once monthly	*Boularibank Gazellebank Mahinabank Tikeibank*	Multipurpose: 700 TEU; 18,600 GT
Melbourne/Sydney/Brisbane /Noumea/Port Vila/Santo/Suva/Tarawa/Majuro/Santo Port Vila/Noumea/Melbourne	Chief Container Line (Swire)	Every 33 days	*Kiribati Chief*	Container: 876 TEU, 7900 GT

Source: ADB (2007) Pacific Regional Transport Analysis – Maritime
Key: TEU = Twenty Feet Equivalent Unit, GT = Gross Tonnage, Ro-ro = roll on, roll off

ANNEX 5. SPS AND ENVIRONMENTAL STANDARDS POTENTIALLY APPLIED TO VANUATU AGRICULTURAL AND FOOD EXPORTS

Product Group	**Food Safety Standards**	**Animal/Plant Health Requirements**	**Environmental Requirements**
Traditional Exports			
Copra	Foreign matter and contaminants limits		
Coconut oil	Microbiological standards, free fatty acids		Codes for organic practices and 'fair trade' certification
Coconut meal	Foreign matter and contaminants limits		Codes for organic practices
Cocoa	Pesticide residue standards Mycotoxin tolerance levels		Codes for organic practices and 'fair trade' certification
Live Animals and Meat Products	Vet. drug residue limits Microbiological standards	Disease-free areas Disease surveillance Restrictions on veterinary drugs Animal traceability	Codes for organic practices and certification Regulations on animal waste effluent
Hides and Skins		Animal health status for raw hides/skins	Water effluent regulations Chemical use restrictions
Kava	Human health concerns		
Coffee	Microbiological standards Mycotoxin tolerance levels	Fumigation requirements	Codes for organic practices and 'fair trade' certification Codes for ‘shade grown’
Prawns	Microbiological standards, and fish processing factory requirements		
Trochus			Sustainability
Giant clams			Sustainability
Green snail			Sustainability
Beche-de-mer			Sustainability
Aquatrade			Sustainability, competition with eco-tourism
Non-Traditional Exports			
Fresh Fruits and Vegetables	Pesticide residue limits Microbiological standards Produce traceability requirements Pack house hygiene requirements	Plant material quarantine Pest risk analysis HTFA treatment requirements Phyto-sanitary certificates	Pesticide use restrictions Water/soil contamination regulations. Codes for organic practices and 'fair trade' certification
Fish	Microbiological and mercury standards, fishing boat and fish processing factory requirements		Sustainability, water and soil contamination regulations

Source: UNCTAD (2006) Study on the SPS Cost of Compliance for Pacific LDCs

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LIST OF ACRONYMS

ADB	Asian Development Bank
ALF	Agriculture, Livestock and Forestry sector
APCC	Asia Pacific Coconut Community
APTC	Australia-Pacific Technical College
ASI	Annual Statistical Indicator
ASMP	ASYCUDA Support Mechanism for the Pacific
ASYCUDA	Automated System for Customs Data
AusAID	Australian Agency for International Development
AVL	Airports Vanuatu Ltd
AVL	Airports Vanuatu Limited
Bdm	Beche-de-mer
BFM	Business Forum Matrix
CCDP	Cocoa Development Program
CCI	Chamber of Commerce and Industry
CDC	Commonwealth Development Corporation
CDS	Capture and Development Section
CEDAW	Convention on the Elimination of all forms of Discrimination Against Women
CGA	Cocoa Growers Association
CIF	Customs, Insurance and Freight
CITES	Convention on Trade of Endangered Species
CMT	Customary Marine Tenure
CNFC	China National Fisheries Corporation
CO	Certificate of Origin
COPV	Coconut Oil Products Vanuatu
COV	Coffee Organisation of Vanuatu
CP	Corporate Plan
CPDP	Copra Development Program
CPUE	Catch per Unit of Effort
CRP	Comprehensive Reform Program
CTH	Change in Tariff Heading
DARD	Department of Agriculture and Rural Development
DCBD	Department of Cooperatives and Business Development
DCIR	Department of Customs and Inland Revenue
DESP	Department of Economic and Social Planning
DoF	Department of Fisheries
DTF	Department of Forestry
DTII	Department of Trade, Industry and Investment
DTIS	Diagnostic Trade Integration Study
DTIT	Department of Trade, Industry and Tourism
DWA	Department of Women's Affairs
EAFM	Ecological Approach to Fisheries Management
EC	Extension Centres
EEZ	Exclusive Economic Zone

EIA	Environmental Impact Assessment
EPA	ACP-EU Economic Partnership Agreement
EU	European Union
FAD	Fish Aggregating Device
WCPOFC	Western Central Pacific Ocean Fisheries Commission
FAO	Fisheries and Agriculture Organisation
FAs	Fishermen's Associations
FFA	Forum Fisheries Agency
FFV	Foreign Flagged Vessel
FLO	Fair-trade Labelling Organisation
FOB	Free on Board
FSA	Farmers Support Association
FSec	Forum Secretariat
FTC	Fisheries Training Centre
FTDC	Food Technology Development Centre
GATS	General Agreement on Trade in Services
GBEU	Government Business Enterprise Unit
GDP	Gross Domestic Product
GIFT	Genetically improved farmed tilapia
GMO	Genetically Modified Organism
GNP	Gross National Product
GoV	Government of Vanuatu
GRT	Gross Registered Tonnes
HDI	Human Development Index
HDR	Human Development Report
HIES	Household Income and Expenditure Survey
HTLTC	Hospitality Tourism and Leisure Training Centre
ICA	International Cocoa Agreement
IF	Integrated Framework for Trade Related Technical Assistance to LDCs
IFC	International Finance Corporation
IRA	Import Risk Assessment
IRD	Institut de recherche pour le developpement
ISPS	International Ship and Port Facility Security Code
ITC	International Trade Centre
IUU	Illegal, Unregulated and Unreported
IWS	Ifira Wharf and Stevedoring Limited
JICA	Japan International Cooperation Agency
LAR	Liquid Asset Ratio
LDC	Least Developed Country
LTP	La Toque Poisson
M and E	Monitoring and Evaluation
MAQFF	Ministry of Agriculture, Quarantine, Forestry and Fisheries
MCA	Millennium Challenge Account
MDGs	Millennium Development Goals
MEL	Metenesel Estate Limited
MFA	Ministry of Foreign Affairs

MFPA	Multilateral Fisheries Partnership Agreements
MoLNR	Ministry of Lands and Natural Resources
MSG	Melanesian Spearhead Group
MSY	Maximum Sustainable Yield
MTIT	Ministry of Trade, Investment and Tourism
MTSF	Medium Term Strategic Framework
NBV	National Bank of Vanuatu
NGO	Non-Government Organisation
NISCOL	Northern Islands Stevedoring Company Limited
NSO	National Statistics Office
NTDO	National Tourism Development Office (Vanuatu)
NTFC	National Trade Facilitation Committee
NVHSA	Ni-Vanuatu Hospitality Staff Association
NZAID	New Zealand Aid
OCO	Oceania Customs Organisation
ODA	Official Development Assistance
OFP	Oceanic Fisheries Program
p.a	Per annum
PAA	Priorities and Action Agenda
PACER	Pacific Agreement on Closer Economic Relations
PACP	Pacific ACP
PEFA	Public Expenditure and Financial Accountability
PIC	Pacific Island Country
PICTA	Pacific Island Countries Trade Agreement
PIFS	Pacific Island Forum Secretariat
POP2	Producers Organisation Project II
PRC	Peoples Republic of China
PRTDP	Pacific Region Tourism Development program
PSC	Public Service Commission
PSI	Pre-Shipment Inspection
PSNDP	Private Sector National Development Program
PVFL	Port Vila Fishing Ltd.
RCF	Revolving Credit Fund
REDI	Rural Economic Development Initiative
RFDP	Rural Fisheries Development Program
RFMO	Regional Fisheries Management Organisations
ROO	Rules of Origin
RSE	Regional Seasonal Employer Scheme
RTFP	Regional Trade Facilitation Program
SFCBI	Sport Fishing Charter Boat Industry
SME	Small and Medium size Enterprise
SPC	Secretariat of the Pacific Community
SPFC	South Pacific Fishing Company
SPS	Sanitary and Phyto-sanitary
SPTIM	South Pacific Tourism Investment Marketplace
SPTO	South Pacific Tourism Organisation

SRS	Sustainable Reef Supplies
STA	Santo Tourism Association
STABEX	Stabilisation of Export Earnings Scheme
STDF	Standards and Trade Development Facility
SWAp	Sector Wide Approach
TA	Technical Assistance
TAC	Total Allowable Catch
TCSP	Tourism Council of the South Pacific
TMP	Tuna Management Plan
ToR	Terms of Reference
TVET	Technical and Vocational Education and Training
UNCLOS	United Nations Law of the Sea
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
VARTC	Vanuatu Agricultural Research and Training Centre
VAT	Value Added Tax
VATET	Vanuatu Tourism Education and Training Project
VCCE	Vanuatu Copra and Cocoa Exports
VCMB	Vanuatu Commodities Marketing Board
VFDP	Village Fisheries Development Project
VFIC	Vanuatu Fish Investment Company
VFSC	Vanuatu Financial Services Commission
VFTCES	Vanuatu Fisheries Training Centre and Extension Services
VGBOA	Vanuatu Game Boat Operators Association
VHRA	Vanuatu Hotels and Resorts Association
VIBA	Vanuatu Islands Bungalow Association
VIPA	Vanuatu Investment Promotion Authority
VISR	Vanuatu International Shipping Registry
VIT	Vanuatu Institute of Technology
VITUS	Vanuatu IT Users Society
VMA	Vanuatu Maritime Authority
VNCW	Vanuatu National Council of Women
VNTC	Vanuatu National Training Council
VQIS	Vanuatu Quarantine Inspection Service
VQLD	Vanuatu Quarantine and Livestock Department
VRDTCA	Vanuatu Rural Development Training Centres Association
VSOA	Vanuatu Scuba Operators Association
VT	Vatu, currency of Vanuatu
VTO	Vanuatu Tourism Office
VTOA	Vanuatu Tour Operators Association
WB	World Bank
WCO	World Customs Organisation
WCPFC	Western Central Pacific Fisheries Commission
WCPO	Western Central Pacific Ocean
WCPOFC	Commission for the Conservation and Management of Highly Migratory Fish Stocks in the Western and Central Pacific Ocean

WTO	World Trade Organisation