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Vanuatu: 2004 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Vanuatu

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Vanuatu, the following documents have been released and are included in this package:

- the staff report for the Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 19, 2004, with the officials of Vanuatu on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 9, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 25, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Vanuatu.

The document listed below have been or will be separately released.

Selected Issues Paper and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

VANUATU

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation with Vanuatu

Approved by Masahiko Takeda and Anthony Boote

February 9, 2005

- Discussions were held in Port Vila during November 8–19, 2004. The staff team comprised Ms. Creane (head), Mr. Marciniak, and Ms. Fujita (all APD). Mr. Reddell (OED) joined the discussions.

- The team met with President Mataskelekele, the Minister of Finance and Economic Management, the Governor of the Reserve Bank, other senior officials, and representatives of financial institutions, public enterprises, tourism and other private sector enterprises, labor unions, and the donor community.

- In concluding the 2002 Article IV consultation on November 22, 2002 (IMF Country Report No. 02/265), Executive Directors commended the authorities for macroeconomic stability and progress on structural reform. However, they noted that growth was lackluster as persistent fiscal weaknesses had led to inadequate basic infrastructure and a high-cost production structure. For more rapid growth and lasting fiscal consolidation, Directors emphasized that more needed to be done to strengthen revenue and redirect spending toward infrastructure and social services, along with additional measures to improve the environment for private investment. Directors also called for stronger regulation and supervision of offshore banks.

- Vanuatu has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. Data quality and coverage improvements have been made since the last consultation and Vanuatu now participates in the GDDS. The authorities plan to again publish the Staff Report and related documents.

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Executive Summary

Economic Setting

- **An improved external environment provided a boost to economic growth in 2003–04, after two years of decline**. Exports and tourism showed sharp improvement in both years in volume terms. The recovery was supported by strong macroeconomic policies. The authorities strengthened the fiscal accounts by improving revenue collection and introducing expenditure controls, and as a result maintained total public debt at a manageable level. A cautious monetary and exchange rate policy has succeeded in keeping inflation low.

- **However, growth prospects are not bright without a reinvigorated policy commitment to reform**. Relative to comparator countries in the Pacific and Caribbean, per capita GDP growth performance over the last decade has been poor due to structural weaknesses, and rapid population growth. Underlying structural problems include poor infrastructure, a weak public enterprise sector, high business costs and the need for strengthening the environment for foreign investment.

Key Policy Issues

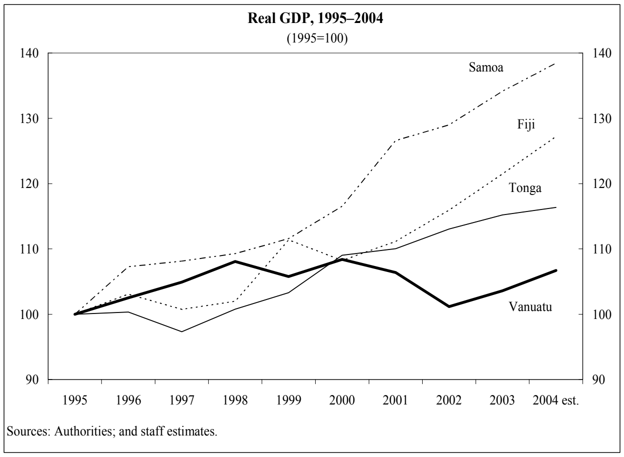
- **With appropriate policies in place, Vanuatu has growth potential over the medium term, especially in agriculture and tourism**. The current improved economy provides an appropriate environment for proceeding with these needed measures. However, political instability during 2004, until the change in government in December, has distracted the government from focusing on economic policy priorities for the economy.

- **Fiscal expenditure reorientation is required to raise economic growth over the medium term, given still pressing development needs**. The resources for infrastructure outlays could be generated under the current fiscal envelope, through a reduction in current spending, particularly the wage bill, and further improvement in tax compliance. Development needs could be then met within the ongoing plans for fiscal consolidation, allowing room for social spending and for public debt to be reduced gradually over the medium term.

- **Further efforts are needed on structural reforms to reduce the high-cost structure and improve the environment for private activity**. Good progress has been made in strengthening banking supervision, but additional measures are required. An overhaul of the weak public enterprise sector is needed. Further action is required to regulate monopoly utilities, pass a competition law, and streamline steps required for investment approval.

I. Background

1. **Vanuatu achieved positive real growth in 2003-04, after two years of decline.**[1] Macroeconomic stability was maintained and some progress made in addressing structural weaknesses (Figure 1). However, a weak environment for private activity, including poor infrastructure and political instability, and rapid population growth have compounded the difficulties that come from a narrow output and export base, and contributed to low per capita GDP growth relative to comparator Pacific and Caribbean island countries over the past decade. As a result, the outlook for the faster economic growth needed to lift living standards is not bright without a deepening of reform. Human development indicators are among the lowest of the Pacific island countries. About 40 percent of the population lives below the poverty line and 80 percent of the labor force is employed in subsistence activities in rural areas.



Gross Domestic Product (GDP) Per Capita and Human Development Index (HDI) in Vanuatu and Comparator Countries	HDI Rank 1/	GDP Per Capita in US$ (2003)	Real GDP Per Capita Annual Growth Average 1994-2003
Caribbean Average 2/	73	5614	1.8
Samoa	75	1672	3.6
Fiji	81	2088	2.1
Solomon Islands	124	498	-2.6
Vanuatu	**129**	**1361**	**-0.8**
Papua New Guinea	133	614	-2.6

Sources: UN Human Development Report, 2004, and IMF.

1/ Rank out of 177 countries.

2/ Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

2. **Political instability has hindered implementation of needed reforms during much of 2004** (Box 1). The coalition government which took office in July 2004 was followed by a new period of uncertainty, including a deterioration in relations with the donor community, delays in pending economic and financial legislation, and proposed policies which would reverse previous economic reforms. Following a motion of no confidence in

[1] Vanuatu is an archipelago of about 80 islands in the south Pacific ocean.

BOX 1. POLITICAL ENVIRONMENT IN VANUATU

Background. The current political environment has its roots in the Anglo-French condominium where France and Britain shared control over Vanuatu (then New Hebrides). The two parties dominating politics at independence in 1980, one identified with Anglophone voters and one identified with Francophone voters, have since splintered into more than ten political parties plus independents. With 52 parliamentary seats, elected by universal adult suffrage, no party regularly earns a majority of the vote. The resulting coalition governments survive only for short periods as political unions are created and dissolved with frequency.

Since the early 1990s, there has been a high degree of political instability in Vanuatu.

- Although not subject to the unrest seen in some of the neighboring Pacific island countries, the political instability distracts from needed action on reforms.

- At the same time, increasing political fractionalization further complicates progress on reforms, due to the need to accommodate a growing number of political constituencies.

- The private sector regularly lists political instability among its major concerns inhibiting investment.

2004 was a year of particularly intense political uncertainty.

- Following increasing parliamentary discord in the early part of the year, in May then Prime Minister Natapei called an election to avoid a possible no-confidence vote. None of the major parties won a majority in the early July elections (the largest number of seats held by any party was 10), and after a long period of negotiations, a fragile coalition government was formed at end-July under Prime Minister Vohor. Almost immediately negotiations resumed among the parties along with talk of a new no-confidence vote. In September a no-confidence motion was put before Parliament but defeated by the Vohor government.

- At the same time, relations between the Vohor government and donors were deteriorating, particularly following the expulsion of Australian law enforcement advisors in August together with public statements questioning the role of all foreign advisors. The government also disregarded court decisions and planned an expansion in the number of ministries to accommodate the diverse factions in the coalition. Donors expressed concern over developments, and Australia, a major donor, warned of reductions in its aid program.

- Prime Minister Vohor's controversial attempts to grant diplomatic recognition to Taiwan Province of China led to his coalition's defeat by a no-confidence motion in December 2004. Prime Minister Ham Lini formed a new government, which maintains Mr. Moana Carcasses as Minister for Finance and Economic Management. Relations with donors have since improved, as seen in the subsequent visit to Port Vila by Australian Prime Minister Downing.

December 2004, a new government under Prime Minister Ham Lini was formed (Finance Minister Carcasses and Governor Tevi have remained in their positions). The initial public statements of the Lini government point to an improved budget outlook, a resumption of financial sector reforms, and strengthened dialogue with donors. At the same time, the comprehensive economic policy of the new government has not yet been announced and its commitment to pursuing needed deep reform is still uncertain.

3. **Some progress has been made in beginning to address issues identified at the last Article IV consultation, despite the unstable political environment**. Executive Directors emphasized the need to ensure lasting fiscal consolidation, strengthen the regulation and supervision of offshore banks, and implement structural reforms. Since then, fiscal balances have improved with strengthened tax revenue, including the introduction of the recommended excise tax on alcohol and tobacco, and new expenditure controls. However, spending is still not well prioritized and capital expenditure is sharply lower, despite development needs. The financial supervision of offshore banks has been significantly improved. Additional reform, such as restructuring public enterprises and improving infrastructure, remains crucial for establishing the sound private sector environment needed to raise economic growth over the medium term. During the November discussions, the authorities noted that they found missions' views during Article IV consultations useful, and welcomed the initiation of interim-year staff visits.

II. Recent Economic Developments

4. **The Vanuatu economy recovered in 2003–04 following two years of decline** (Table 1 and Figures 2–4). Real GDP growth rebounded to 2.4 percent in 2003 and the recovery continued in 2004 with growth of an estimated 3 percent, notwithstanding the crop damage caused by Cyclone Ivy early in the year.[2] The improvement was bolstered by a strong supply response to a recovery in export prices and the liberalization of trading in two key exports (cocoa and copra), the discovery of new markets for kava following the ban by several EU countries in 2002, and higher tourist arrivals with an expansion in airline capacity to Vanuatu (Figure 5).[3] [4]

5. **Fiscal consolidation continued over the past two years** (Table 2). Although in large part reflecting sharply reduced development expenditure, new controls on current spending and improved tax collection also contributed to the outcome. However, the wage bill remained high, while service delivery to the outer islands continued to be poor. Following the completion of large development projects, capital outlays fell to an average 1.6 percent of GDP in 2003–04 from an average 4.5 percent of GDP in 1999–2002, despite continued

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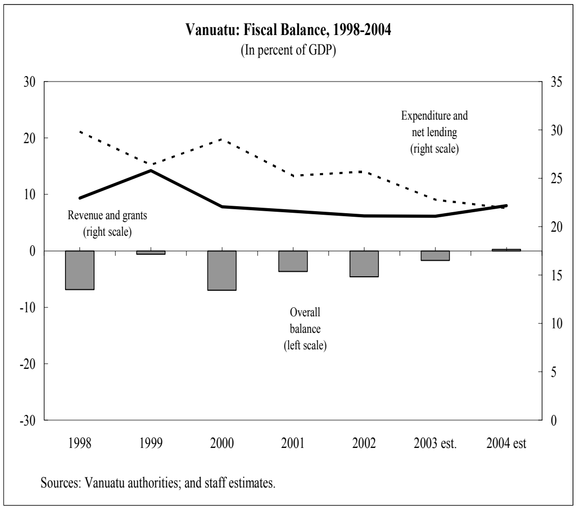
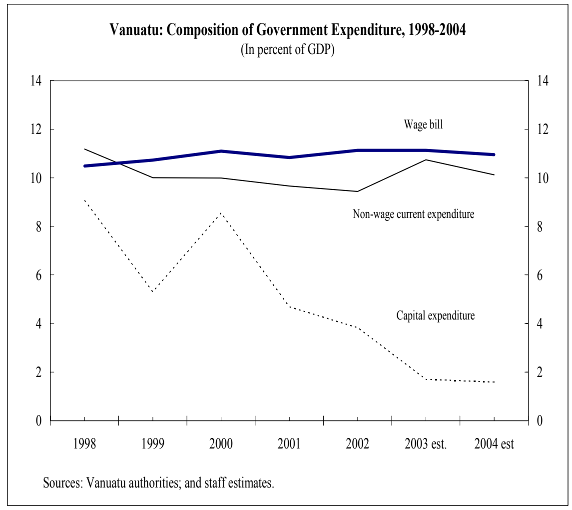
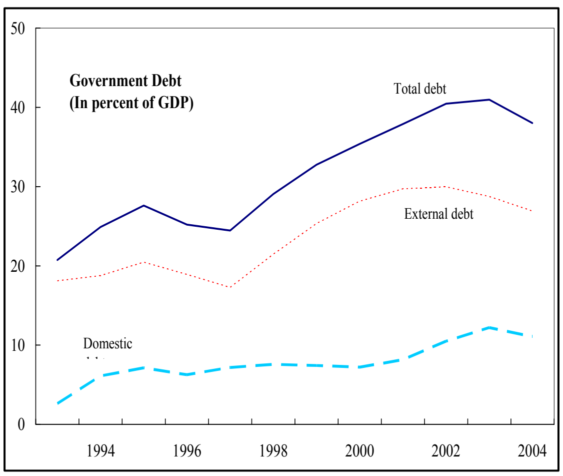
[2] Cyclone Ivy was the second largest natural disaster in Vanuatu (as measured by population affected), since records have been kept.

[3] Kava, an herbal remedy taken to reduce stress, was banned for alleged health reasons.

[4] In the second half of 2004, Pacific Blue began operations from Australia.







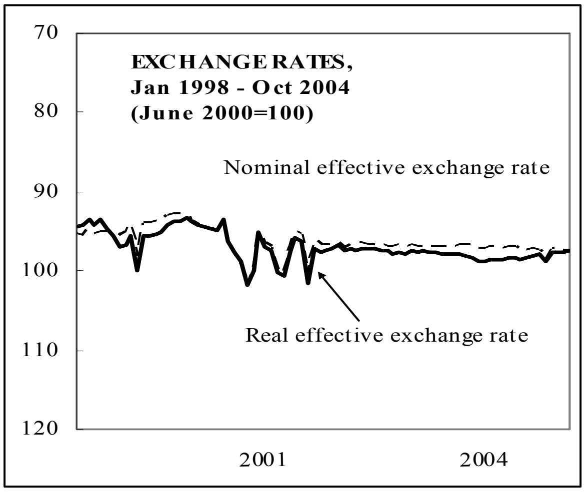
pressing development needs. Reflecting the government's cautious approach to incurring new public debt, total public debt, including external debt, fell below 40 percent of GDP.[5]

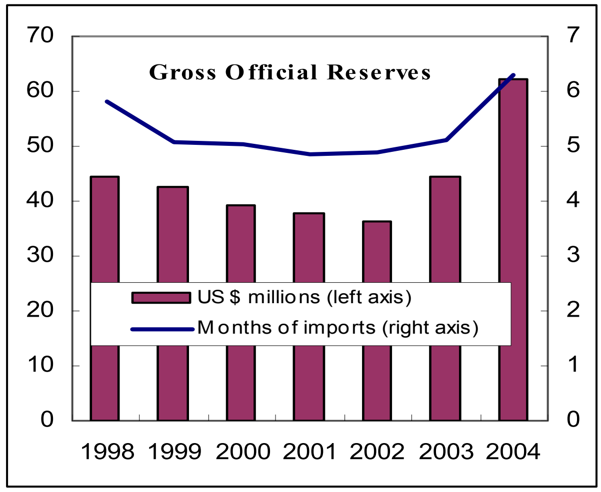
6. **Against the background of a basket-peg exchange rate regime, inflation has remained subdued at just under 3 percent in 2004.**[6] The mid-year appreciation of the Vatu against the Australian dollar offset price pressures from cyclone-related agricultural shortages. Broad money growth picked up in 2004, as deposits with the banking sector rose and the net foreign assets position of commercial banks strengthened (Table 3). Commercial banks' liquidity positions improved in 2004, allowing for lower lending rates, which resulted in a slight narrowing of the interest rate spread.

7. **The external current account deficit narrowed in 2004 with the stronger performance in tourism and exports** (Table 4). In real effective terms, the vatu remained broadly stable over the past five years, while official reserves have recovered since 2002.

[5] The Public Financial and Economic Management Act (1998) sets limits on the total stock of debt at 40 percent of GDP and annual debt service payments to 8 percent of government revenue.

[6] Monetary policy is conducted in the context of an adjustable peg exchange rate arrangement with the vatu linked to a transaction-weighted (trade and tourism receipts) basket of currencies.





8. **The outlook is for a softening of the macroeconomic environment in 2005**. Real GDP growth is expected to taper off closer to trend as global commodity prices for many of Vanuatu's exports again ease, notwithstanding the expected full year impact on tourism of the increased airline capacity. Inflation is likely to edge higher with the delayed impact of higher world oil prices. The current account deficit should widen slightly, as a boost in imports related to tourism investment offset an increase in tourism revenue. Official foreign reserve levels should remain roughly unchanged in U.S. dollars. Based on early reports of the revised 2005 budget expected to be submitted for Parliamentary consideration in February, the fiscal accounts should be near balance, as higher current spending, including an increase in parliamentarians' salaries and higher spending on education, are accompanied by additional donor funding.

III. Policy Discussions

A. Overview

9. **The discussions focused on the policy priorities needed to raise Vanuatu's economic growth rate sustainably above that of its population growth rate**.[7] The consultation took place in November during the last month of the previous government's tenure. Some of the concerns raised during the discussions have now been eased, including the previous government's plans to expand the size of government and to possibly reverse gains made in financial sector supervision. However, the main themes of the consultation discussion—namely the need to broaden the economic base to strengthen resiliency to external and natural shocks—remain valid. The mission's recommendations included the following key components:

(i) Continuing the responsible fiscal and monetary policies followed in recent years;

[7] Real GDP growth averaged about 1.5 percent on an annual basis over the past decade, against average population growth of about 2.5 percent.

(ii) Reorienting government spending toward more productive capital outlays through both revenue and expenditure measures, while maintaining needed social spending;

(iii) Further strengthening of the financial sector to improve availability and lower costs of domestic credit, and

(iv) Structural reforms to improve the environment for private sector activity.

B. Outlook and Risks

10. **Growth prospects over the medium term are not bright without a stronger policy commitment for deeper reform** (Table 5, Figure 6, and Box 2). On the current trajectory, without an active reform effort that addresses weak infrastructure and other sources of high business costs, real GDP growth could fall below even the current moderate level of 2.5–3.0 percent. Pressures to raise current spending would likely continue to be difficult to resist, leading to a return to fiscal deficits. In contrast, with a stronger reform effort (Table 7) than that currently contemplated, growth could rise to allow an improvement in per capita GDP over the medium term. Vanuatu has growth potential, especially in agriculture and tourism. By reorienting fiscal spending to well-targeted social and infrastructure needs, introducing further financial sector reform, and creating an investment-friendly environment, growth prospects could improve considerably, along with an improved external balance, further accumulation of foreign reserves, and a gradual reduction in public debt. Areas for increased infrastructure spending include roads, electricity, water, and transportation both in the main and outer islands.

11. **Given its narrow base, the economy will remain vulnerable over the medium term**. Its resilience will depend on the strength of implementation of structural reforms, while the downside risks pointing to a less favorable outlook are sizeable (Table 8). The recent history underscores the importance of political stability and the preservation of good relations with major donors, particularly given the need to fund additional development spending through grants. Other risks include the possible absence of political commitment to reform and continued exposure to natural disasters.[8]

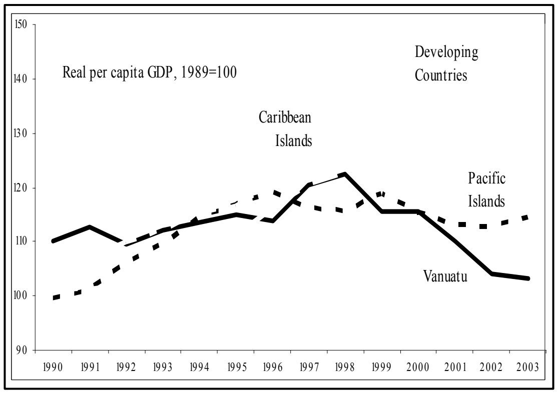
C. Fiscal Policy

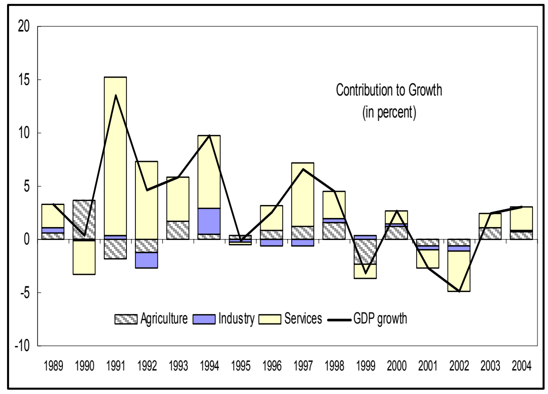
12. **The discussion of fiscal policy focused on the growth implications of continuing to compress needed spending on social services and infrastructure**. In light of continued high development needs and limited financing options for the government, the mission

[8] Based on the Centre for Research on the Epidemiology of Disasters' database and definition of a natural disaster (events due to natural causes that caused 10 or more fatalities, affected 100 or more people, or resulted in a call for international assistance or the declaration of a state of emergency) over the past decade Vanuatu was subject to one natural disaster (earthquake, cyclone, flood or volcano eruption) each year. These data do not include other natural disasters, e.g., a windstorm, that may not meet these criteria but may still cause substantial damage.

BOX 2. ECONOMIC GROWTH IN VANUATU

Vanuatu's growth over the past decade was weak even relative to comparator island economies. Yet, Vanuatu fulfills many of the theoretical requisites for strong economic growth: a relatively sound macroeconomic environment with low public debt, limited inflation, and an open trade regime. Available evidence suggests structural factors leading to low total factor productivity underlie the poor growth performance.





Vanuatu experienced changes in the composition of growth after independence. The importance of services—in particular, tourism—increased significantly, while agriculture showed more moderate growth. Since the early 1990s, developments in the services sector have driven overall real GDP growth. The potential for further growth in these sectors is promising. However, currently tourism remains largely centered in the urban areas on the two larger islands as weak power, transportation and communication limit outward expansion. Similarly, transportation constraints hinder farmers from bringing crops to market. These structural limitations were notably weaker than those of the faster growing comparator island economies.

Structural Indicators 1/

	Fiji	Samoa	Tonga	Vanuatu
Paved roads (in percent of total roads) (2000)	49.2	42.0	27.0	23.9
Aircraft departures (2002)	65,400	12,300	4,300	1,500
Telephone mainlines per 100 residents	12.35	6.53	11.29	3.15
Cost of a three minute local call (in U.S. dollars) (2000)	0.05	0.03	0.08	0.14
Electricity costs (US$/kwh)	0.16	0.18	0.31	0.26
Government wage bill (in percent of total expenditure)	40.6	23.4	42.7	53.0
Government capital expenditure (in percent of total expenditure)	19.9	32.2	5.9	14.2
Adult literacy (in percent) (2002) 2/	92.9	98.7	98.8	34.0
Real GDP per capita growth (average 1990-2004)	2.0	2.1	1.8	0.3

Sources: Vanuatu authorities; World Bank, *World Development Indicators 2003* ; *International Telecommunication Development Report 2003* ; UNDP Human Development Report, 2004; and Fund staff estimates.

1/ Data for 2003, unless otherwise indicated.

2/ Reflects possible bias due to multiple official languages.

Addressing these structural weaknesses should yield considerable gains for medium-term growth. Steps to take include increasing quality investment in human capital and infrastructure by redirecting government expenditure toward development spending and improving the environment for private investment.

argued instead for an increase in capital spending financed by a combination of revenue and expenditure measures. Such a strategy would allow small budget surpluses to be maintained over the medium term, a continuation of critical social spending, and a gradual debt reduction in line with the authorities' own overall objectives (Box 3).

13. **The authorities were in broad agreement with these concerns, and outlined recent measures and plans on the revenue side that would consolidate progress already made in broadening the tax base and strengthening tax administration**. VAT and customs administration have improved with the new automated entry system, which strengthened tax audit and compliance procedures. A new computerized system to be introduced during 2005 will link the two data bases for further improved monitoring. The mission welcomed this step and encouraged introducing additional measures to further strengthen tax audit procedures. In light of the poor dividend collection from public enterprises, the mission recommended reviewing their governance and cost structures. The mission additionally advocated addressing tax concessions which amount to about 1.5 percent of GDP annually. The authorities concurred with the need for tightening tax and duty exemption criteria, and noted plans to remove the full exemption status of statutory authorities and discretionary exemptions for other non-strategic industries. Neither the mission nor the authorities favored introducing new tax measures at this point; Vanuatu's tax burden is in line with those of other similar-income countries and raising taxes could negatively impact economic growth.

Tax Revenue 1/
(in percent of GDP)

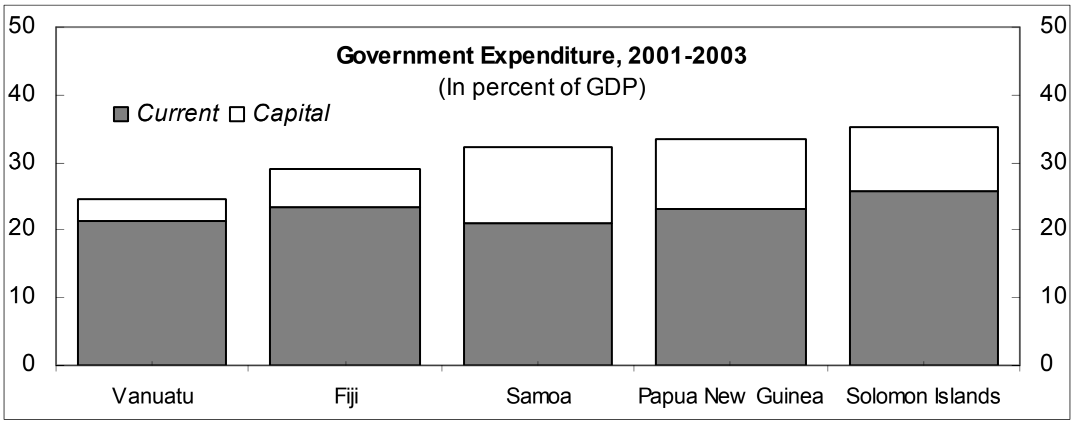
Vanuatu	Asia Pacific	Non-OECD countries	Non-OECD countries 2/
17.7	13.7	18.3	16.2

Source: IMF FAD Tax Revenue Data Base.
1/ Average for 1997-2001.
2/ Excluding Europe.

14. **A reorientation of the pattern of expenditure is needed to reduce less productive spending and redirect outlays toward social and infrastructure expenditure**. Spending prioritization remains weak as capital outlays have been cut back sharply, following the completion of donor-funded projects, while the wage bill remains large by global standards (56 percent of recurrent expenditure or over 11 percent of GDP in 2004). The authorities agreed that compressing spending on infrastructure raised risks for future growth,

BOX 3. FISCAL STRATEGY: DISCIPLINE AND ECONOMIC GROWTH

Under the government's 2004-06 economic and financial policy, the long-term objective is to introduce the fiscal discipline needed to run surpluses over the medium-term to allow for debt repayment and contingencies such as natural disasters. At the same time, development expenditure is to be increased over time to about 25 percent of total expenditure with the goal of achieving a higher level of sustainable economic growth. However, currently development expenditure is declining and about 7 percent of total expenditure in the 2004 budget outcome, the lowest in the region; thus, there is considerable distance yet before realizing this strategy.



Possible areas for realigning expenditure to make room for larger developing spending include:

- Public entities partially or entirely owned by the government currently have net debts to the government of about 1 percent of GDP, while another 0.5 percent of GDP is transferred to them annually through a direct budget grant.

Public Entities in Vanuatu, 2004
(In millions of Vatu unless otherwise indicated)

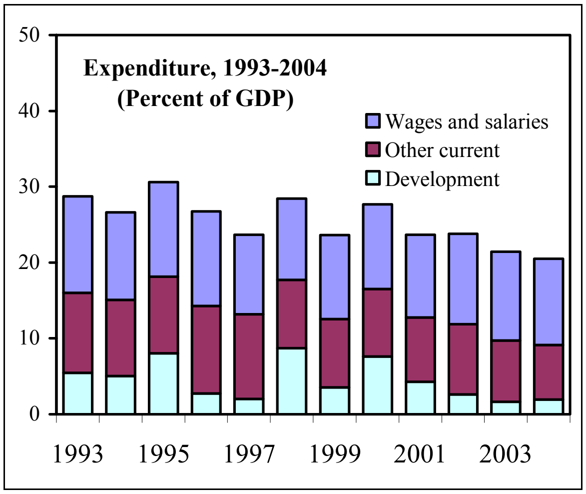
	Net Debt to Government	Direct Budget Grant
Enterprises 1/	114.9	0
Statutory Bodies 2/	143.0	168.6
Total	257.9	168.6
(percent of GDP)	0.8	0.5

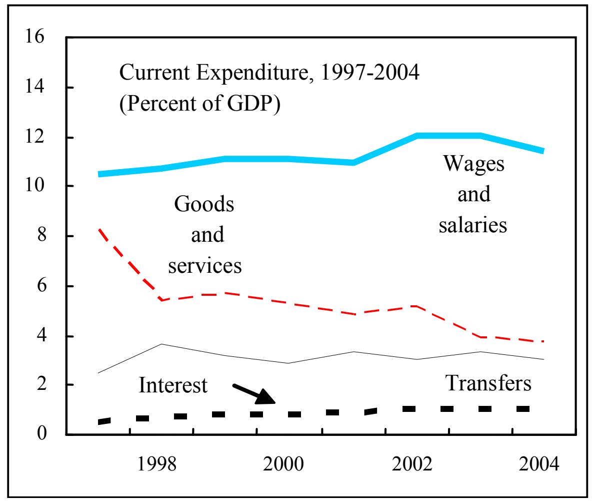
1/ Includes Air Vanuatu, Stevedore and Livestock Companies.
2/ Includes Broadcasting and TV and the Maritime Authority.

- Discretionary tax and duty exemptions to public and private enterprises are growing, and are now about 1.5 percent of GDP.
- The public wage bill is high by regional and global standards.

Public Wages in Vanuatu and Comparator Countries, 2003

	Vanuatu	Papua New Guinea	Samoa	Solomon Islands	Fiji	Asia	Middle-Income
Public wage bill as share of:							
GDP	12.1	9.2	8.3	9.7	11.5	5.3	6.0
Expenditure	53.0	29.4	24.5	24.5	40.6	20.0	22.1





but pointed to financing constraints, noting that they preferred to rely on donor funds for capital spending. In addition, the authorities were eager to introduce a well-considered public investment program before proceeding with further large capital spending plans, so as to avoid using scarce revenue or incurring debt for non-productive projects. A donor-funded macroeconomist is expected to prepare an investment plan by mid-2005. The authorities also argued that the relatively large current spending on wages and education reflected Vanuatu's archipelago geography and the need to provide resources for each remote island. At the same time, the authorities noted expenditure measures that have been taken and are planned in the interests of prioritizing spending. To control the wage bill, in 2004 the government recently extended the Financial Visa System to the education sector and has plans to cut the civil service by 20 percent over the medium term.[9] The mission additionally advocated reversing the proposed 20 percent increase in salaries for parliamentarians, which could eventually stimulate pressure for a general public sector wage increase. While noting this concern, the authorities were of the view that political realities made a reversal unlikely. In light of weaknesses in the education sector (despite relatively high budget allocations, the adult literacy rate remains comparatively low), the mission also recommended reviewing its cost structure relative to social benefit and identifying ways to achieve higher productivity. In addition, further increases in education spending should be deferred pending the outcome of this review. The authorities observed that an audit of the Education Ministry will take place in 2005, with assistance from the EU.

15. **Vanuatu follows a prudent public debt policy**. Vanuatu currently aims to limit the total stock of debt to no more than 40 percent of GDP and requires new external borrowing to deliver a financial rate of return to cover the costs of debt servicing. The rate of return constraint does not bind domestic borrowing, although the authorities are mindful of the dangers of crowding out private activity. The mission cautioned that parallel concerns strongly advise against giving consideration to raising the limit on Reserve Bank of Vanuatu

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[9] The Financial Visa System requires government departments to obtain prior approval from the Ministry of Finance and Economic Planning before hiring new staff.

(RBV) deficit-financing, including the potential consequences for macroeconomic stability.[10] Indeed, the mission noted that continuing with the recent trend toward fiscal consolidation would minimize financing concerns, and allow further reductions in debt and a build-up of a contingency in case of unforeseen natural disasters.

D. Monetary and Exchange Rate Policy

16. **Through use of the basket peg as a nominal anchor, monetary policy has successfully kept inflation low**. The authorities are strongly committed to continue to pursue the restrained monetary stance needed to maintain the peg. The mission noted that monetary policy alone cannot support the peg and that close coordination with the fiscal authorities, to limit government borrowing from the RBV, is also needed.

17. **The exchange rate and the adjustable peg exchange rate regime remain broadly appropriate at this time** (Figure 7). The real effective exchange rate has been broadly stable since the late-1990s, measured on both partner and competitor bases. Export and tourism receipts grew rapidly in 2003–04, in both value and volume terms. Vanuatu's export market share also remained roughly stable over the past ten years, even as the Pacific region's share declined. Pressures on official reserves have eased with the rebuilding of official reserves to 6 months of imports, one of the highest levels in the region. The mission and the authorities were in agreement that maintenance of the current regime would require the continuation of macroeconomic policies consistent with the peg, and that, in parallel, firm action should be taken to reduce underlying fiscal and structural rigidities which raised non-price costs. At the same time, some flexibility in the exchange rate regime has been introduced as the RBV widened its buy and sell margins slightly and started offering to buy foreign exchange within the full range of its published rates; these steps should help to develop the foreign exchange market.

18. **The RBV has made progress in building capacity for discharging its responsibilities**. In particular, the mission supported the RBV's ongoing plans to put in place strengthened internal audit procedures and improved reserve management, including a risk management system. In addition, the mission encouraged the RBV to upgrade the payments system to allow for automated operations. Finally, the mission welcomed the introduction of greater transparency in monetary policy through the Governor's semi-annual monetary policy statements.

E. Structural Reform Policies

19. **Good progress was made in strengthening Vanuatu's financial sector, although further measures remain to be taken**. Vanuatu made impressive gains in financial sector supervision with the passage of the International Banking Act in 2002 and the broadening of the RBV's supervisory responsibilities to the offshore banking sector and the Vanuatu

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[10] RBV deficit financing, included within the 40 percent of GDP debt cap, is limited to 20 percent of the previous three years' government budget current revenue.

National Provident Fund (VNPF).[11] In addition, the necessary measures were taken to allow the OECD to remove Vanuatu from the list of uncooperative tax havens in 2003. The mission urged further enhancement of Vanuatu's reputation in the global financial community through early passage of the AML/CFT amendments to the Financial Transactions Reporting Act (FTRA). The mission also advocated strengthening of the Financial Intelligence Unit (FIU) as it was not yet fully operational nor able to carry out its mandated role. The authorities agreed to recruit the additional needed staff. The mission recommended parallel strengthening of the Vanuatu Financial Service Commission's (VFSC) resources, which is currently tasked with oversight of nonbank offshore institutions (including insurance and fiduciary services) by passing the necessary legislation (including the Insurance Act which is behind schedule) and increasing still limited staff resources. Technical assistance from LEG to strengthen the insurance supervisory framework is planned. An overall cost-benefit assessment of the impact of the offshore sector on the Vanuatu economy, as recommended by MFD, is now underway and should be completed this spring.

20. **The financial sector in Vanuatu is considered to be sound, although there are areas of potential risk** (Box 4). The increase in nonperforming loans (the NPL ratio rose to 18.5 percent in September 2004 from 8.4 percent at end-2003) reflected the downgrading of a small number of loans contracted under previous weak loan management at one private commercial bank (a branch of a major foreign bank). Management of the bank has since been changed by its parent bank and loan approval policies strengthened. The loans are fully provisioned and the RBV expects these will be worked out through the market without need for government intervention. The RBV will continue to monitor the situation closely. The state-owned bank, the National Bank of Vanuatu, is now showing a small profit following restructuring in 2000 and the contracting out of its management to experienced bankers.

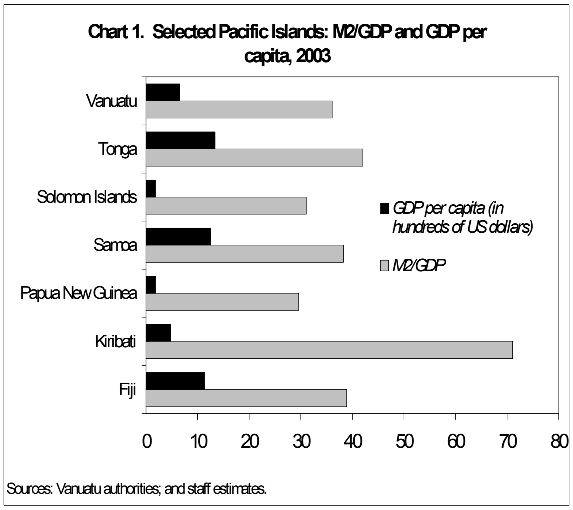
21. **The mission advised against proposals to expand the role of government financial institutions**. In response to concerns about rural access to credit, the authorities are weighing plans for reintroducing a publicly funded development bank and for increasing the lending operations of the VNPF. In light of past experience in Vanuatu and in other countries with both development banks and pension-fund lending activities, the mission strongly urged the authorities to rely instead on market-related mechanisms, such as the collateral loan project proceeding with assistance from the AsDB and the existing microfinance window in the commercial banking sector.

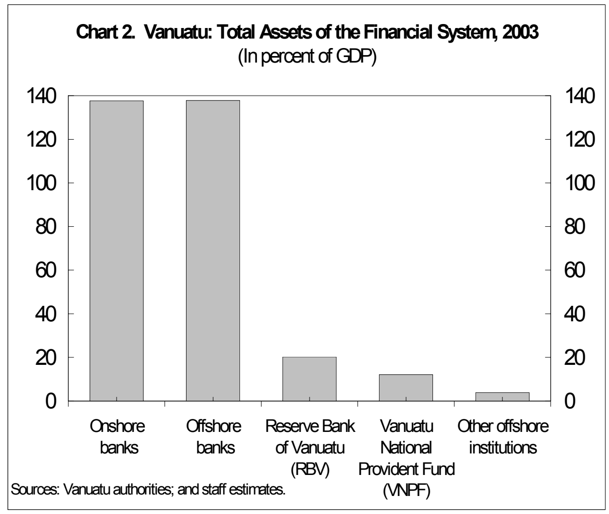
22. **Given the importance of a dynamic private sector in attaining higher economic growth and generating employment, the mission and the authorities agreed that a renewed effort was needed to improve the environment for private activity**. The entry of competitive air service was a tangible illustration of the benefits of liberalization in that it had resulted in increased numbers of tourist arrivals and reduced air fares. In light of the continued high costs for communications and electricity relative to regional comparators

[11] A long-term MFD advisor provided technical assistance on banking supervision during 2002–04. The financial sector, including the offshore banking sector, is described in the accompanying background paper.

BOX 4. FINANCIAL SECTOR DEVELOPMENTS, STRENGTHS AND VULNERABILITIES

The banking system is relatively large, and although it is considered sound it is exposed to a number of potential risks. Deposits with the banking system are more than double GDP, given the offshore banking sector. Although banks are liquid, the level of non-performing loans is now high. At the same time, capital adequacy is solid. Tier 1 capital accounts for nearly 98 percent of total capital, and its growth is largely driven by retained earnings.





Financial Sector Indicators, 2000-04
(In percent)

	2000	2001	2002	2003	2004
Capital adequacy					
Regulatory tier 1 capital to risk-weighted assets	19.5	30.9	31.6	38.7	32.5
Asset quality					
Nonperforming loans to total gross loans 1/	4.5	3.8	3.9	8.4	18.5
Vatu loans to total loans	91.9	91.4	91.0	90.6	90.4
Earnings and profitability					
Return on equity	4.5	4.4	6.0	7.7	7.7
Liquidity					
Liquid assets to total assets	26.5	27.9	21.9	18.1	21.4
Memo items:					
Offshore banks (number of units)	56	51	34	14	9
Trust companies (number of units)	13	13	10	11	10

Source: Reserve Bank of Vanuatu (RBV).
1/ As of September 2004.

A bright spot has been the strides made in strengthening financial sector oversight, especially for offshore banks, in line with recommendations from MFD's 2002 OFC Assessment report. The number of offshore banks was sharply reduced in 2003, as a result of bringing them under the RBV's direct supervision and stricter regulations including the requirement of a physical presence. The authorities are moving forward on the AML/CFT initiative; a financial intelligence unit for monitoring offshore bank activities has been established with Fund technical assistance, although it not yet fully staffed; following delays during 2004, the amended Financial Transactions Reporting Act (FTRA) should be considered by Parliament early in 2005. Similar action will be needed to bring the nonbank offshore sector under an adequate level of supervision (see Box 2), the mission was encouraged by the authorities' planned review of the public utilities' tariff structure, benefits, and inputs, and creation of a small regulatory unit with oversight over the utility monopolies. To improve the incentives for private investors, the mission also strongly encouraged introducing a competition law as well as speeding up establishment of an electronic "one-stop shop" for investment approval.

23. **Progress in reforming public enterprises remains slow**. Public enterprise finances are poor, overall, in part reflecting the absence of market-based management. The mission encouraged reevaluating the financial status of all public entities and considering the options of introducing competition or dismantling them. For example, the remaining licensing responsibilities of the liberalized Vanuatu Commodities Marketing Board (VCMB) could be incorporated within the Ministry of Finance. At a minimum, the mission recommended conditioning existing transfers and tax exemptions for public enterprises on receipt of full financial statements. The authorities agreed with the need to improve the efficiency and transparency of the public enterprises, and plan to begin an intensive review of the sector beginning with the television and radio company.

24. **Vanuatu has an open trade regime and is expanding its regional trade links**. Vanuatu's participation in the Pacific Island Countries Trade Agreement (PICTA) and the Pacific Agreement on Closer Economic Relations (PACER) was ratified by Parliament in 2004. Vanuatu also participates in the Economic Partnership Agreement negotiations with the EU. The mission welcomed the authorities' plan for 2005 to sharply reduce the number of tariff rates to four (including a zero rate) while maintaining revenue neutrality, along with the recent liberalization of trade in copra and cocoa through the reorganization of the VCMB which benefited export receipts. To provide for a more open trade regime, the mission recommended removing existing ministerial discretion in banning imports. In addition, the VCMB's 2 percent fee on copra and cocoa exports appears to effectively amount to an export tax and its removal is recommended. Finally, Vanuatu should safeguard its tourism assets by protecting the environment, including careful management of non-renewable fishing and forestry resources.

25. **Vanuatu's macroeconomic data improved since the last consultation, although further upgrading would allow more comprehensive economic analysis and surveillance**. Vanuatu began participating in the Fund's General Data Dissemination System (GDDS) in 2003. Core economic data are updated in a regular and timely manner, which has enhanced surveillance. Despite some donor technical assistance, however, two of the key statistical areas—national accounts and the balance of payments—remain weak. Data are not available for public enterprise operations and the labor market.

IV. Staff Appraisal

26. **Vanuatu achieved positive real growth over the last two years, following two years of decline, but the outlook for future growth is not bright without a reinvigorated policy commitment to deeper reform**. Despite political instability, growth rebounded in 2003–04 supported by a favorable external environment and macroeconomic policies. Fiscal consolidation continued, albeit in large part reflecting sharply reduced development expenditure, and total public debt remained at a manageable level. Careful monetary and

exchange rate policies have succeeded in keeping inflation low. Vanuatu has growth potential over the medium term, especially in agriculture and tourism. However, continued fiscal and structural weaknesses limit the prospects. The current improved economy is an appropriate environment for proceeding with needed reforms.

27. **A reduction in current spending, particularly the wage bill, and increased tax compliance could finance higher outlays for targeted social and infrastructure expenditure**. The staff welcomes the authorities' plans to introduce a cross-compliance monitoring system between the VAT and custom duties data bases. On the expenditure side, steps should be taken including reducing the wage bill, removing discretionary tax and duty exemptions, and improving efficiency in education spending. With appropriate policies in place, development needs could be met within the ongoing plans for fiscal consolidation, allowing total public debt to be reduced gradually over the medium term.

28. **Monetary and exchange rate policies have been managed successfully in recent years**. The current restrictions on RBV financing of the government sector should be firmly maintained. The staff finds the current level of the exchange rate and the existing adjustable peg exchange rate arrangement to be broadly appropriate for the Vanuatu economy.

29. **Good progress was made in strengthening banking supervision, but additional measures are needed**. A welcome reform was the recent extension of the RBV's supervisory responsibility to cover the offshore sector and the VNPF. However, the lack of adequate staffing and resources in the FIU should be addressed without delay. The authorities are encouraged to pass the Insurance Act promptly, adopt the proposed amendments to the FTRA, and introduce further measures needed for strengthening the AML/CFT legislative framework.

30. **The staff advises against plans for increased lending operations by government financial institutions**. The proposals to raise the limits on VNPF lending and to revive a publicly funded development bank, both of which previously resulted in financial crises in Vanuatu, are of concern. Instead, access to credit in rural areas could be improved by expanding existing market-based microcredit operations in collaboration with commercial banks and donors.

31. **Further efforts are needed on structural reforms to improve the environment for private activity**. Steps should be taken to reduce Vanuatu's high cost structure through introducing regulation over monopoly utilities, passage of a competition law, streamlining steps required for investment approval and upgrading infrastructure. Staff welcomes the authorities' intentions to address these issues. In addition, given the poor performance overall of the public enterprise sector, the authorities are urged to move quickly with the planned review.

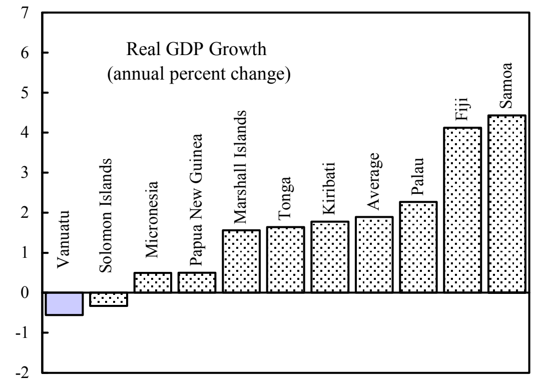
32. **While progress was made in statistical reporting, there remains a need to ensure accurate and timely data are available for policymakers**. The staff welcomes the participation in the Fund's GDDS and the improvement in the quality and availability of government budget and monetary aggregate data. While data provision for surveillance is adequate overall, staff's analysis was affected by shortcomings in certain areas, given

continued weaknesses in data quality and availability for the national accounts, the balance of payments, public enterprises and the labor market.

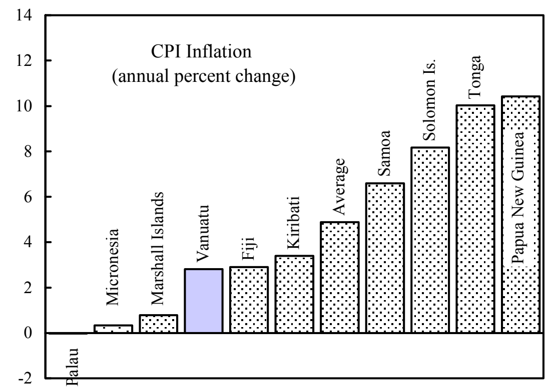
33. **It is proposed that the next Article IV consultation be conducted on the 24-month cycle**. The authorities have expressed interest in a staff visit in 2005.

Figure 1. Vanuatu: Regional Comparators
(Averages, 2000–2004)

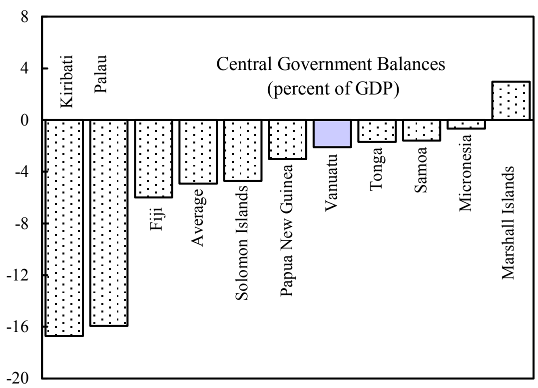
Vanuatu's growth has been low,
despite good macro fundamentals, including...



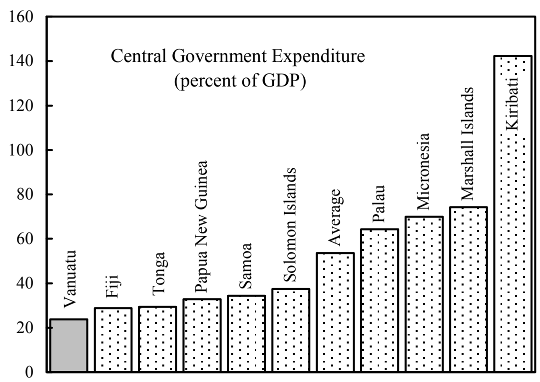
low inflation...



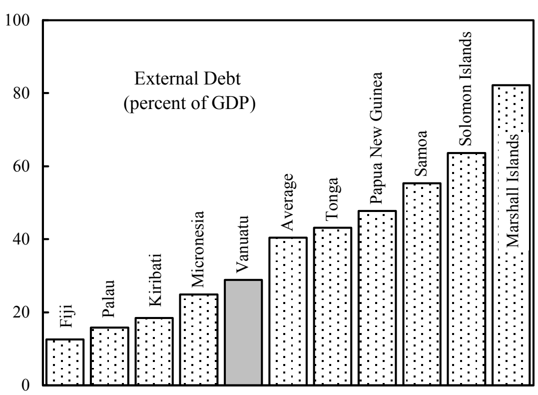
as fiscal deficits are declining and...



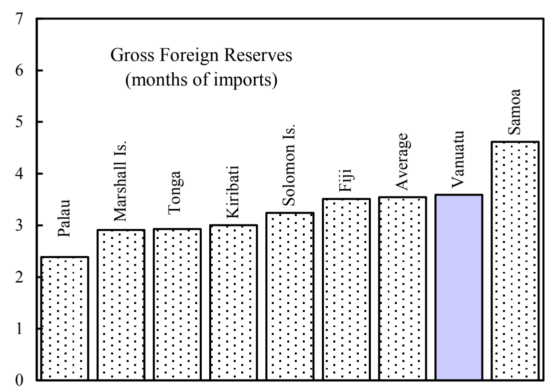
expenditure is low.



External debt is moderate and..

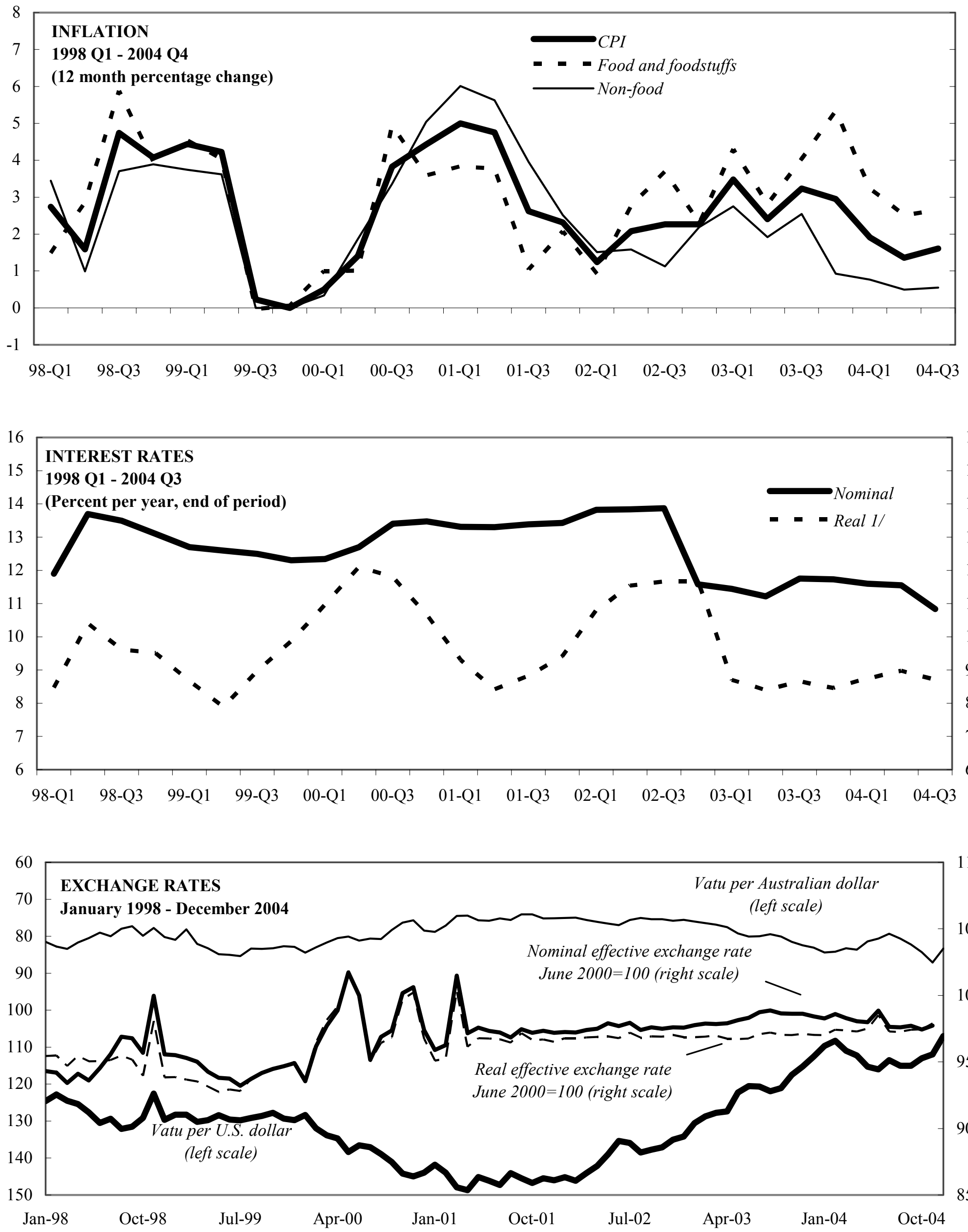


the reserve position is comfortable.



Sources: Vanuatu authorities; and Fund staff estimates.

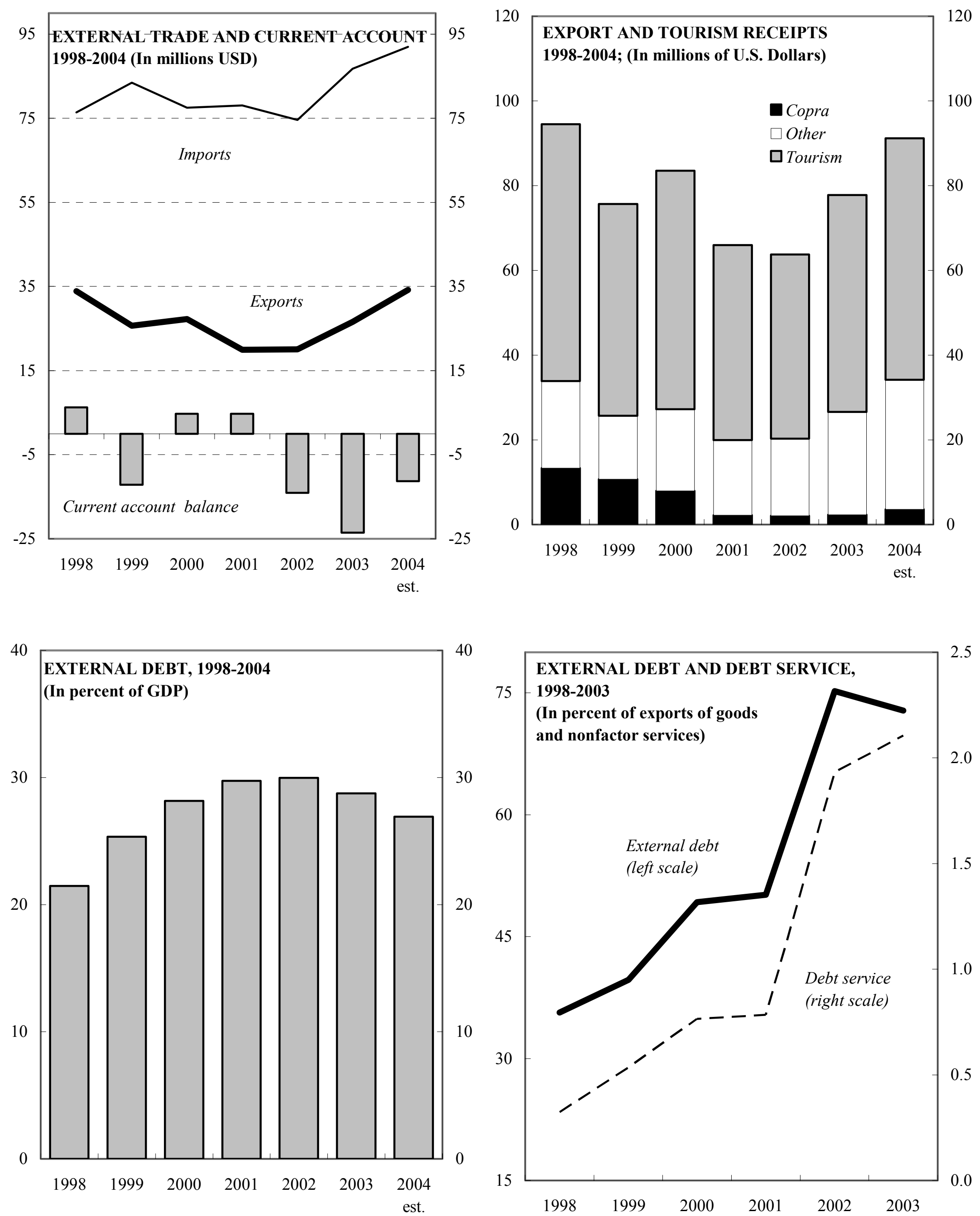
Figure 2. Vanuatu: Selected Economic Indicators, 1998-2004



Sources: Vanuatu authorities, and Fund staf estimates.

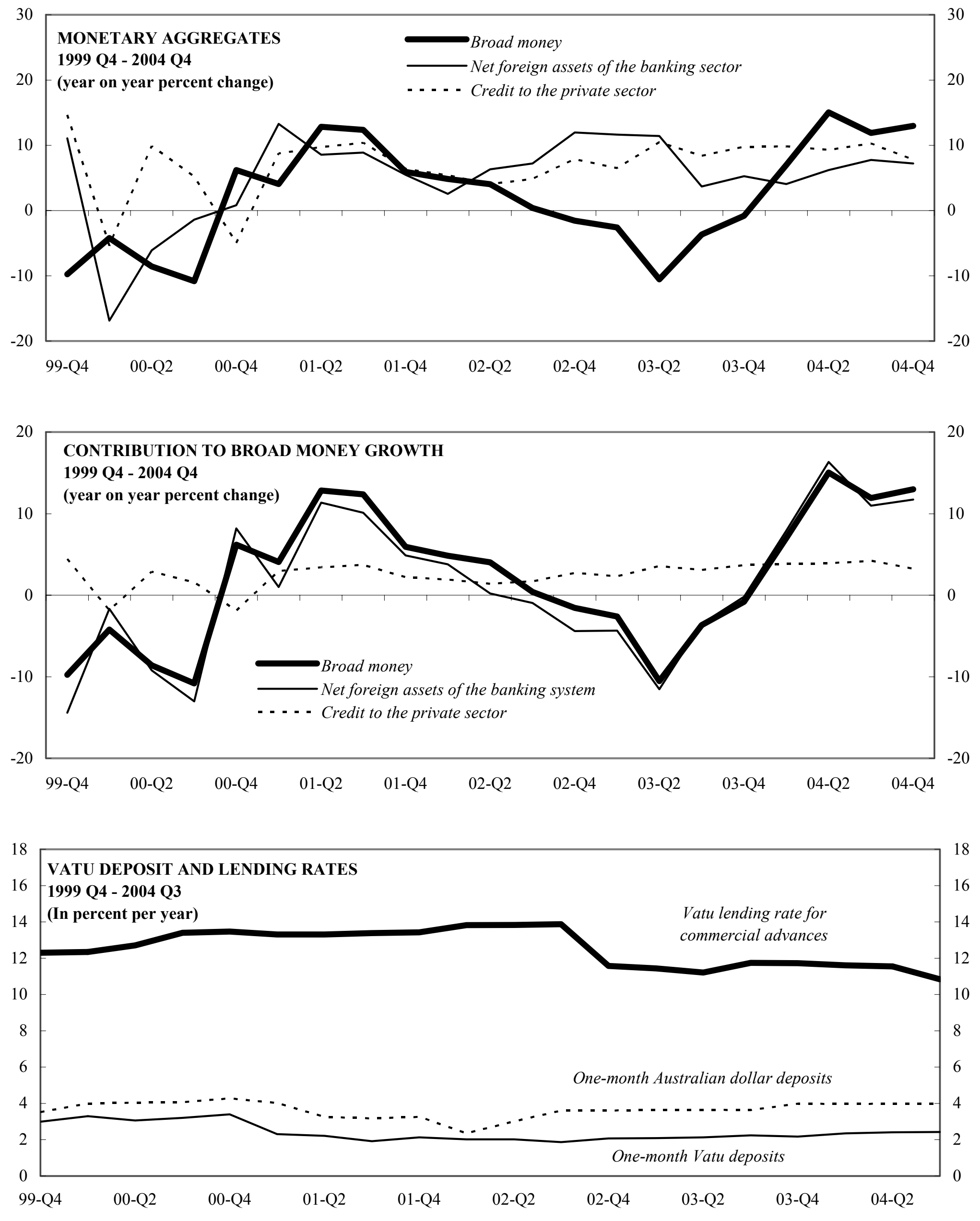
1/ Measured with respect to a weighted average lending rate on bank loans and the four-quarter average inflation rate.

Figure 3. Vanuatu: External Sector Developments, 1998-2004



Sources: Vanuatu authorities, and Fund staff estimates.

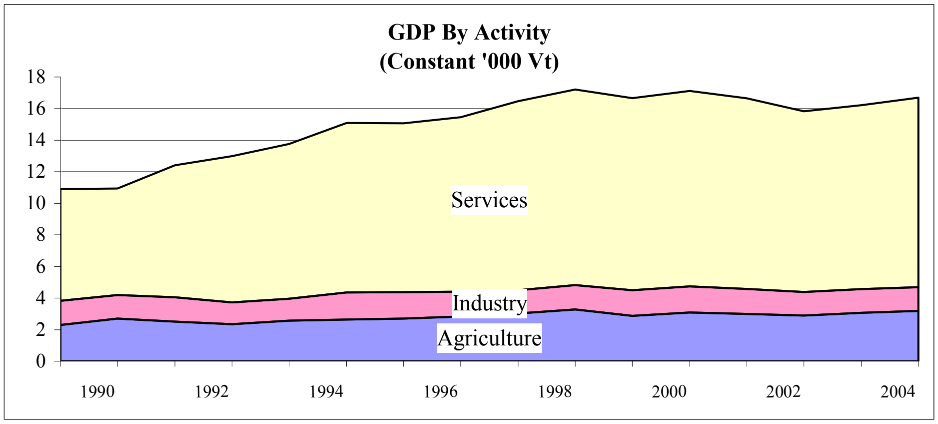
Figure 4. Vanuatu: Monetary and Financial Indicators, 1999-2004



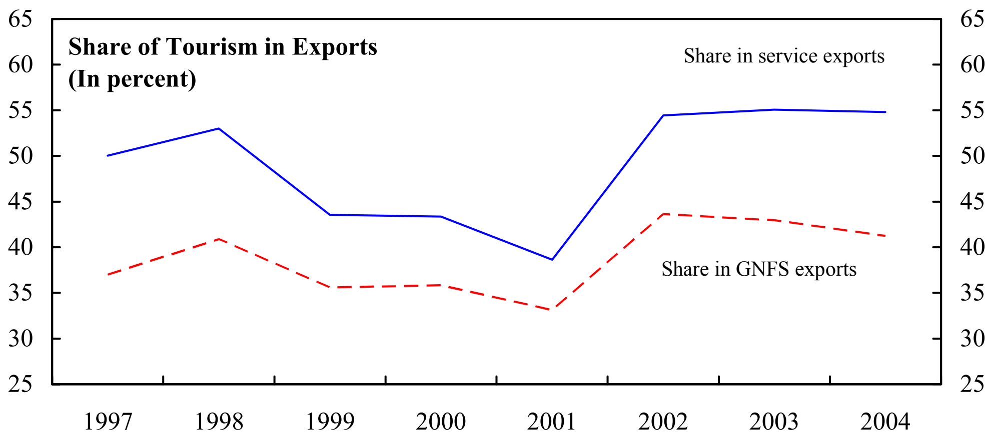
Sources: Vanuatu authorities, and Fund staf estimates.

Figure 5. Tourism and Growth, 1990-2004

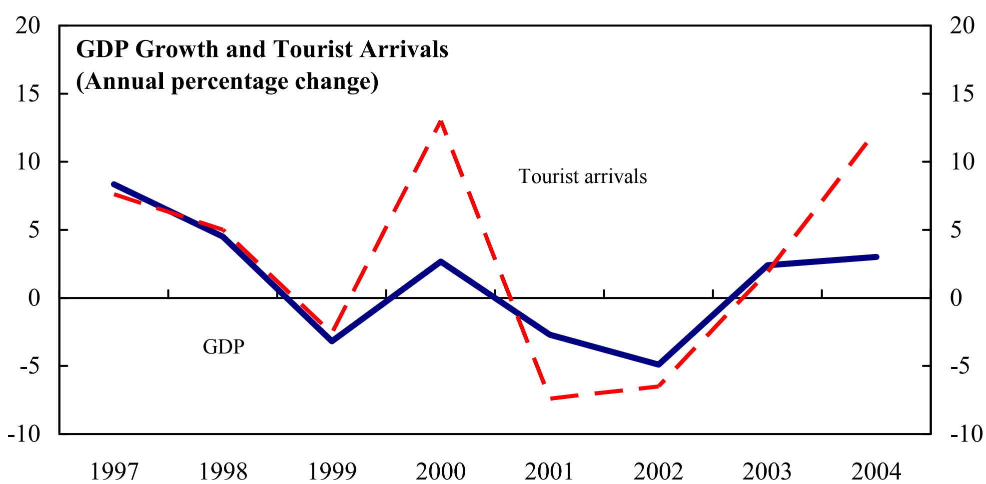
The services sector has become an increasingly important source of economic activity...



... And tourism accounts for a large part of exports in services....



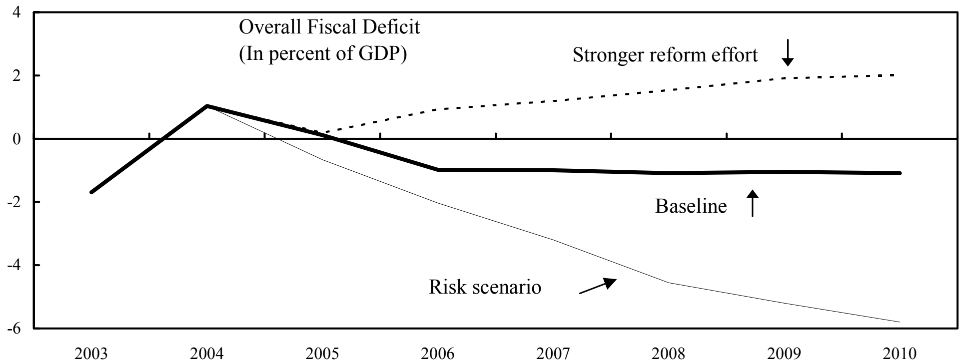
...with the resulting close correlation between tourist activity and GDP growth.



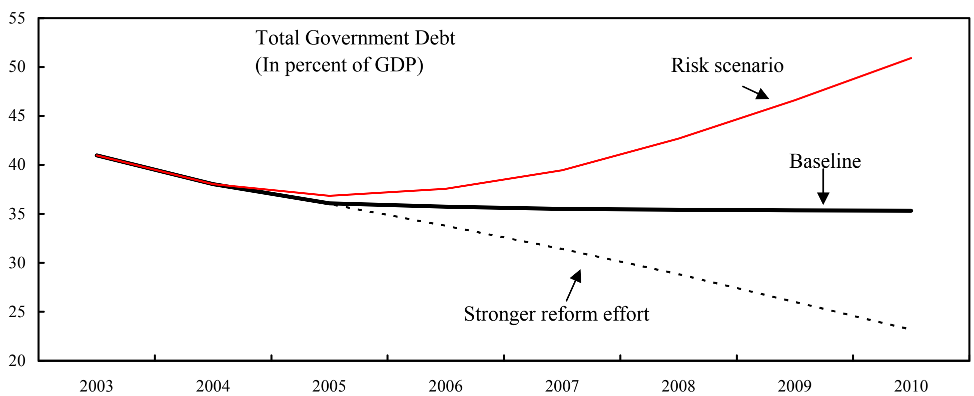
Sources: Vanuatu authorities and Fund staff estimates.

Figure 6. Vanuatu: Medium-Term Macroeconomic Outlook, 2003–10

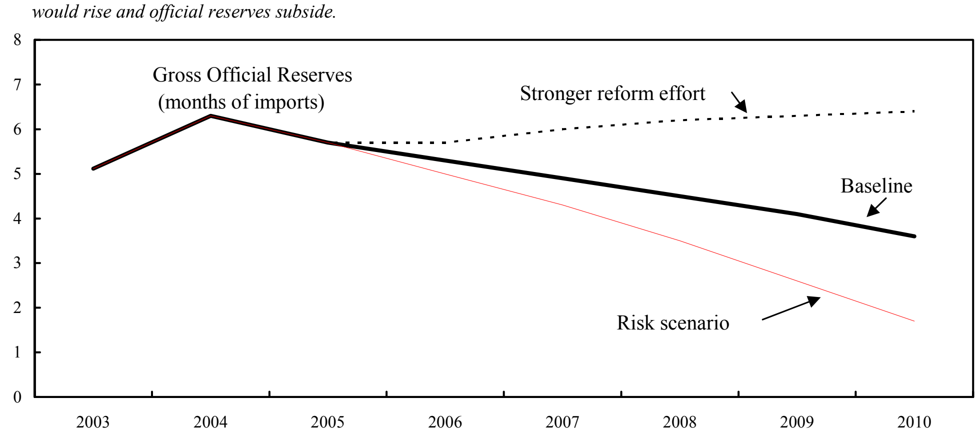
Under the baseline scenario, *without active reform addressing high business costs, improved infrastructure and weak public enterprises, GDP growth would continue at moderate rates below population growth, pressures on wages would lead to larger fiscal deficits and unchanged public debt levels .*



A stronger reform effort *on both macroeconomic and structural policies would create room for greater development spending and reduce costs to the private sector, attracting private investment and donor grants, and result in higher economic growth, positive fiscal balances and a reduction in government debt. The external current account would strengthen with stronger export performance, and, along with higher capital inflows, would boost reserves.*

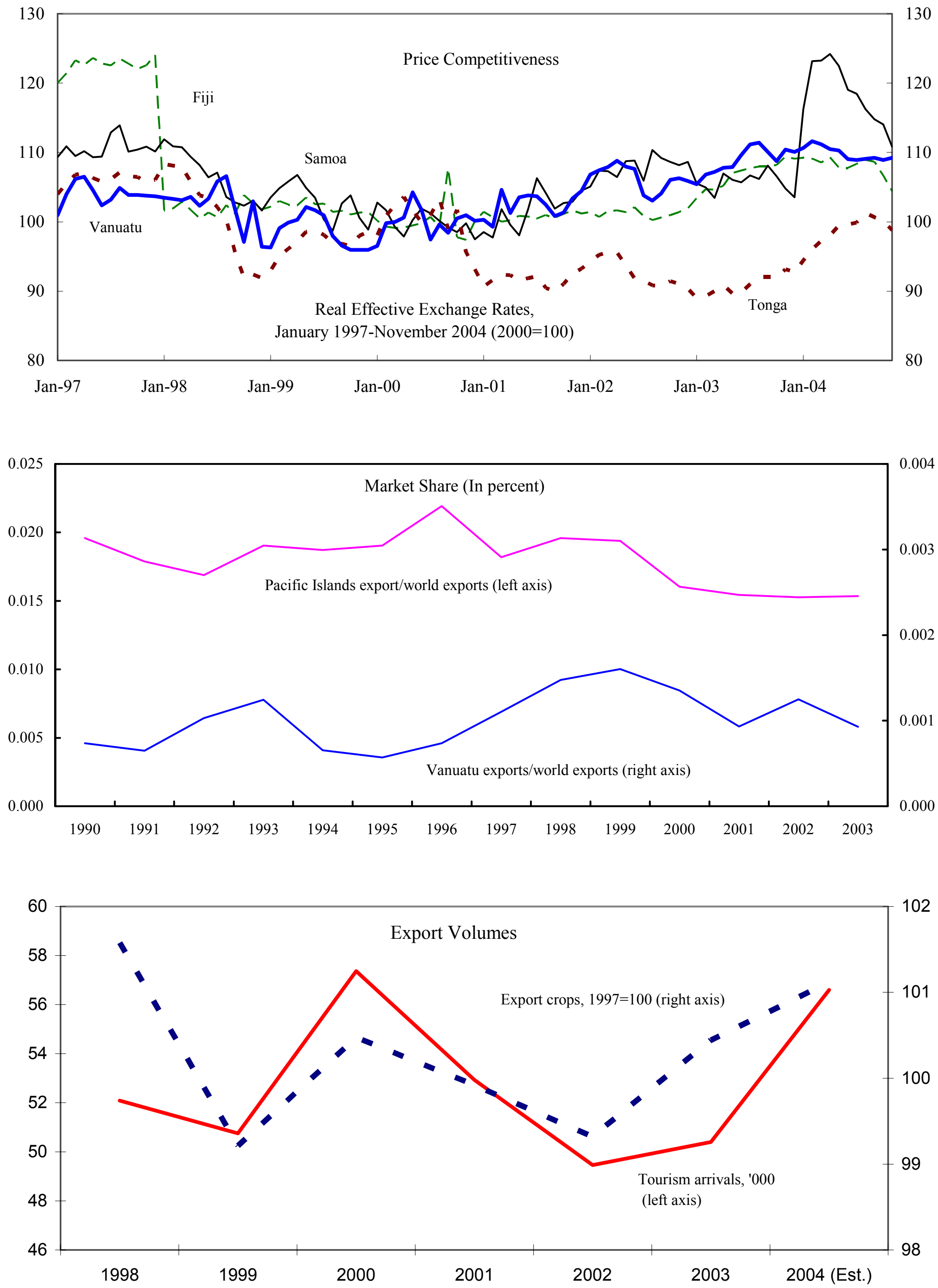


A high risk scenario *, including a reveral of reforms and poor relations with donors, would lead to gradual slowing of GDP growth over time, as development needs are not met and structural problems not addressed. Fiscal and external balances would deteriorate as spending pressures grow while exports of goods and services remain weak. Government debt levels would rise and official reserves subside.*



Source: Vanuatu authorities; and Fund staff estimates and projections.

Figure 7. Competitiveness Indicators, 1990-2004



Sources: Vanuatu authorities, International Financial Statistics, and Fund staff estimates.

Table 1. Vanuatu: Selected Economic and Financial Indicators, 2000-05

Nominal GDP (2003): US$ 284 million
Population (2003): 207,400
GDP per capita (2003): US$ 1,361
Quota: SDR 17.0 million

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Output and prices (annual percentage change)						
Real GDP	2.7	-2.7	-4.9	2.4	3.0	2.8
Nominal GDP	3.9	1.3	-4.0	3.1	4.9	5.1
Consumer prices (period average)	2.5	3.7	2.0	3.0	2.8	3.7
Government finance (in percent of GDP)						
Total revenue and grants	22.1	21.6	21.6	21.1	22.4	22.0
Total expenditure	29.0	25.3	25.7	22.8	21.4	21.9
Overall balance	-7.0	-3.7	-4.1	-1.7	1.0	0.1
Money and credit (annual percentage change)						
Broad money	6.7	5.6	-1.7	-0.8	9.8	6.1
Net foreign assets	11.7	6.6	-6.0	-0.3	11.7	6.1
Domestic credit	0.8	5.4	12.0	5.3	7.9	6.7
Credit to private sector	-4.9	6.4	7.9	9.8	9.6	7.2
Interest rates (in percent, end of period) 1/						
Deposit rate (vatu)	3.4	2.1	2.1	2.2	2.4	...
Lending rate (vatu)	13.5	13.4	11.6	11.7	11.6	...
Current account (in millions of U.S. dollars) 2/	4.8	4.7	-14.1	-23.5	-11.3	-14.7
(in percent of GDP)	2.0	2.0	-6.0	-8.5	-3.6	-4.5
Exports, f.o.b. (in millions of U.S. dollars)	27.2	19.9	20.1	26.6	34.2	39.1
(annual percentage change)	6.2	-26.9	0.8	32.5	28.6	14.3
Imports, f.o.b. (in millions of U.S. dollars)	77.5	78.1	74.6	86.8	92.0	105.0
(annual percentage change)	-8.6	0.8	-5.3	19.6	7.2	14.2
Gross official reserves (end of period)						
In millions of U.S. dollars	39.1	37.7	36.4	44.3	62.1	63.0
In months of imports of goods 3/	5.1	4.8	4.9	5.1	6.3	5.7
In months of prospective imports of goods and services	3.1	3.8	3.1	3.5	4.5	4.2
External debt						
External debt (in percent of GDP) 4/	28.2	29.7	30.0	28.8	26.9	25.9
External debt service 5/	0.9	1.0	1.5	1.5	1.7	1.5
Exchange rates (period average)						
Exchange rate regime: Pegged to an undisclosed basket of currencies						
Vatu per U.S. dollar (period average)	137.6	145.3	139.1	122.2	111.9	…
Real effective exchange rate (12-month average, 2000=100)	100.0	102.4	106.2	104.0	103.9	…
(annual percentage change, - depreciation)	1.4	2.4	3.7	-2.1	-1.3	…
Memorandum item:						
GDP (nominal; in billions of vatu)	33.7	34.1	32.7	33.7	35.4	39.5

Sources: Vanuatu authorities; and Fund staff estimates and projections.

1/ Weighted average rate of interest for total bank deposits and loans.
2/ Significant improvements in data compilation from 2002 onward account for a break in the series through 2001.
3/ Imports values are on c.i.f. basis.
4/ Medium- and long-term public debt only.
5/ In percent of exports of goods and services.

Table 2. Vanuatu: Central Government Fiscal Operations, 2000-05 1/

	2000	2001	2002	2003	2004 Budget	2004 Est.	2005 Proj.
				(In millions of vatu)			
Total revenue and grants	7,423	7,366	7,082	7,111	7,484	7,925	8,180
Total revenue	7,046	6,696	6,354	6,729	7,109	7,244	7,710
Tax 2/	5,902	5,794	5,671	6,022	6,394	6,574	6,912
Taxes on property	76	89	51	75	104	96	110
Goods and services	3,441	3,413	3,344	3,664	4,067	3,957	4,242
of which: VAT	2,465	2,358	2,243	2,359	2,509	2,487	2,569
Import duty	2,385	2,292	2,277	2,283	2,224	2,521	2,560
Nontax	1,123	890	662	692	697	660	796
Capital revenue	22	12	20	16	18	10	3
Grants 3/	378	670	728	382	375	681	470
Total expenditure and net lending	9,773	8,613	8,410	7,683	7,340	7,561	8,136
Current expenditure	6,896	7,015	7,157	7,108	6,927	6,997	7,515
Wages and salaries	3,747	3,734	3,929	4,070	4,064	4,053	4,191
Purchases of goods and services	1,768	1,648	1,666	1,312	1,397	1,312	1,556
Transfers 4/	971	1,141	1,004	1,117	791	1,068	1,114
Interest payments	267	281	319	353	406	356	412
Other	143	210	239	256	269	208	242
Capital expenditure	2,877	1,598	1,253	576	414	563	621
Overall balance	-2,350	-1,247	-1,328	-572	144	364	44
Financing	2,350	1,247	1,328	572	-144	-364	-44
Foreign (net)	1,893	370	98	-114	-165	-171	94
Domestic (net)	457	877	1,231	686	21	-193	-137
				(In percent of GDP)			
Total revenue and grants	22.1	21.6	21.6	21.1	21.2	22.4	22.0
Total revenue	20.9	19.6	19.4	20.0	20.1	20.5	20.7
Tax	17.5	17.0	17.3	17.9	18.1	18.6	18.6
Nontax	3.3	2.6	2.0	2.1	2.0	1.9	2.1
Grants	1.1	2.0	2.2	1.1	1.1	1.9	1.3
Total expenditure and net lending	29.0	25.3	25.7	22.8	20.7	21.4	21.9
Current expenditure	20.5	20.6	21.9	21.1	19.6	19.8	20.2
Capital expenditure	8.5	4.7	3.8	1.7	1.2	1.6	1.7
Overall balance	-7.0	-3.7	-4.1	-1.7	0.4	1.0	0.1
Memoranda items:							
Public debt (in percent of GDP)	35.4	37.9	40.5	41.0	38.6	38.0	36.1
Domestic	7.2	8.2	10.5	12.2	11.7	11.1	10.2
External	28.2	29.7	30.0	28.8	26.9	26.9	25.9
Debt service (in millions of vatu)	371	379	425	466	571	526	583
External debt service	189	207	207	225	266	260	268

Sources: Vanuatu authorities; and Fund staff estimates.

1/ Data for 2005 are preliminary, as the budget has yet to be finalized.
2/ Net of tax concessions for VAT, excise, and import duties, except for those for Unelco.
3/ Cash grants only.
4/ Excludes transfers to the Development Fund.
4/ Based on the current government policy. The scenario assumes deficit is financed through domestic market borrowings instead of additiona
5/ Assumes no increase in number of Ministers and salary for Parliamentarians.

Table 3. Vanuatu: Monetary Survey, 2002-05

	2002	2003	2004				2005
			Mar.	Jun.	Sep.	Dec.	Proj.
	(In millions of vatu; end of period)						
Net foreign assets	24,744	24,679	26,768	27,960	27,891	27,575	29,254
Monetary Authorities 1/	4,703	4,738	4,661	5,049	5,508	6,413	6,939
Commercial banks	20,042	19,942	22,107	22,911	22,383	21,162	22,314
Net domestic assets	10,361	10,049	9,791	9,809	10,106	10,572	11,226
Domestic credit	14,921	15,709	15,929	16,407	16,641	16,943	18,085
Claims on government (net)	1,320	1,129	1,245	1,273	1,174	955	955
Claims on municipalities	2	5	-1	-2	6	6	6
Claims on nonfinancial public enterprises	334	16	31	29	26	29	29
Claims on private sector	13,265	14,558	14,654	15,107	15,435	15,953	17,095
Other items (net)	-4,560	-5,659	-6,138	-6,598	-6,535	-6,371	-6,859
Total broad money	35,009	34,729	36,559	37,768	37,996	38,148	40,480
Narrow money	5,666	5,872	5,649	6,446	6,316	6,557	6,889
Currency outside banks	1,916	2,108	1,984	2,142	2,218	2,490	2,616
Demand deposits (vatu)	3,750	3,764	3,666	4,304	4,098	4,067	4,273
Quasi-money	29,343	28,857	30,910	31,322	31,680	31,590	33,591
Time and savings deposits (vatu)	7,245	7,810	8,094	8,526	8,747	9,261	10,508
Demand deposits in foreign currency	5,859	6,304	6,344	5,766	6,057	6,176	6,384
Time and savings deposits in foreign currency	16,240	14,743	16,473	17,030	16,876	16,153	16,699
	(Annual percentage change)						
Net foreign assets	-6.0	-0.3	11.2	23.7	15.4	11.7	6.1
Net domestic assets	10.7	-3.0	-4.1	-5.1	2.2	5.2	6.2
Domestic credit	12.0	5.3	5.8	6.2	7.7	7.9	6.7
Private sector credit	7.9	9.8	9.8	9.3	10.3	9.6	7.2
Total broad money	-1.7	-0.8	7.0	15.0	11.9	9.8	6.1
Narrow money	11.4	3.6	-9.9	16.1	19.3	11.7	5.1
Quasi-money	-3.9	-1.7	10.8	14.8	10.5	9.5	6.3
Vatu broad money	13.0	6.0	4.6	12.3	13.5	15.6	10.0
Foreign currency deposits	-8.6	-4.8	8.5	16.9	10.8	6.1	3.4
Memoranda items:							
Foreign currency deposits (in millions of vatu)	22,098	21,047	22,816	22,796	22,933	22,329	23,083
(in millions of U.S. dollars)	166	188	214	214	215	210	217
(in percent of total deposits)	66.8	64.5	66.0	64.0	64.1	62.6	61.0
Velocity							
Narrow money	5.8	5.7	...	...	...	5.7	5.4
Vatu broad money	2.5	2.5	...	...	...	2.3	2.1
Total broad money	0.9	1.0	...	...	...	1.0	0.9
Credit to private sector/total credit	88.9	92.7	92.0	92.1	92.8	94.2	94.5
Credit to private sector (in percent of GDP)	40.5	43.2	...	...	...	42.9	46.0

Sources: Vanuatu authorities; and Fund staff estimates and projections.

1/ Reserve Bank of Vanuatu, and foreign exchange held by the Treasury.

Table 4. Vanuatu: Balance of Payments, 2000-05 1/
(In millions of U.S. dollars; unless otherwise indicated)

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Current account balance	4.8	4.7	-14.1	-23.5	-11.3	-14.7
(excluding official transfers)	-13.4	-11.6	-30.0	-38.5	-31.3	-28.1
Trade balance	-50.3	-58.1	-54.6	-60.2	-57.8	-65.9
Exports (f.o.b.)	27.2	19.9	20.1	26.6	34.2	39.1
Domestic exports	24.3	15.8	15.3	21.3	28.8	32.9
Re-exports	3.0	4.1	4.8	5.3	5.4	6.2
Imports (f.o.b.)	-77.5	-78.1	-74.6	-86.8	-92.0	-105.0
Domestic consumption	-75.3	-75.1	-73.4	-85.9	-91.0	-103.9
Imports for re-exports	-2.2	-2.9	-1.2	-0.9	-1.0	-1.1
Services balance	59.1	46.2	36.0	40.3	46.0	57.7
Receipts	129.9	119.3	81.2	94.4	104.0	117.3
of which: travel	56.3	46.1	44.2	52.0	57.0	69.0
Payments	-70.8	-73.0	-45.3	-54.2	-58.0	-59.6
Income	-13.0	-4.0	-6.2	-11.6	-11.0	-10.8
Receipts	18.8	17.2	22.4	24.2	28.0	22.1
Payments	-31.8	-21.2	-28.6	-35.8	-39.0	-33.0
Current transfers (net)	8.9	20.6	10.7	8.0	11.5	4.4
Official current transfers (net)	18.2	16.4	15.9	15.0	20.0	13.3
Private current transfers (net)	-9.3	4.2	-5.2	-7.0	-8.5	-8.9
Capital and financial account	-2.6	-10.5	21.0	34.6	21.0	25.0
Capital account	-20.1	-15.9	-2.2	-4.6	-6.0	-7.8
Official capital transfers (net)	10.7	11.8	6.1	4.8	6.0	4.2
Private capital transfers (net)	-30.8	-27.7	-8.3	-9.5	-12.0	-12.0
Financial account	17.4	5.5	23.2	39.3	27.0	32.9
Foreign direct investment	20.3	18.0	8.2	14.7	16.0	16.8
Portfolio investment	0.7	-4.3	-0.3	2.0	1.0	0.9
Government	16.0	-3.4	3.0	3.5	-1.0	3.9
Disbursements	16.7	3.2	3.4	3.7	0.0	2.3
Amortizations	-0.8	-6.6	-0.4	-0.3	1.5	1.5
Other investment	-19.5	-4.7	12.4	19.0	11.0	11.3
Net errors and omissions	-18.1	-7.2	-10.4	-3.1	0.0	0.0
Overall balance	-16.0	-13.0	-3.5	7.9	9.7	10.3
Financing	16.0	13.0	3.5	-7.9	-9.7	-10.3
Change in net official reserves of the RBV (-, increase)	5.3	1.2	3.5	-7.9	-9.7	-10.3
Debt forgiveness	10.7	11.8	0.0	0.0	0.0	0.0
Memoranda items:						
Gross official reserves (in million U.S. dollars)	39.1	37.7	36.4	44.3	62.1	63.0
(in months of imports of goods) 2/	5.1	4.8	4.9	5.1	6.3	5.7
(in months of prospective imports of goods and services)	3.1	3.8	3.1	3.5	4.5	4.2
Exports (annual percentage change)	6.2	-26.9	0.8	32.5	28.6	14.3
Imports (annual percentage change)	-8.6	0.8	-5.3	19.6	7.2	14.2
Current account balance (in percent of GDP)	2.0	2.0	-6.0	-8.5	-3.6	-4.5
(excluding official transfers)	-5.5	-5.0	-12.8	-14.0	-9.9	-8.5
Exchange rate (vatu per U.S. dollar, period average)	137.6	145.3	139.1	122.2	111.9	...

Sources: Vanuatu authorities; and Fund staff estimates and projections.

1/ Significant improvements in data compilation from 2002 onward account for a break in the series through 2001.

2/ Imports values are on c.i.f. basis.

Table 5. Vanuatu: Medium-Term Non-Adjustment Scenario, 2002-10

				Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Output and prices (annual percentage change)									
Real GDP	-4.9	2.4	3.0	2.8	2.6	2.4	2.4	2.2	2.2
Nominal GDP	-4.0	3.1	4.9	5.1	3.8	3.6	3.5	3.2	3.3
Consumer prices (period average)	2.0	3.0	2.8	3.7	2.7	2.5	2.5	2.5	2.5
Balance of payments (in millions of U.S. dollars)									
Current account balance 1/	-14.1	-23.5	-11.3	-14.7	-14.6	-16.4	-17.5	-18.1	-18.4
(in percent of GDP)	-6.0	-8.5	-3.6	-4.5	-4.3	-4.6	-4.8	-4.8	-4.7
Trade balance	-54.6	-60.2	-57.8	-65.9	-76.0	-81.6	-87.3	-93.6	-100.7
Exports, f.o.b.	20.1	26.6	34.2	39.1	43.9	49.3	55.1	61.2	67.6
(annual percentage change)	0.8	32.5	28.6	14.3	12.3	12.3	11.7	11.1	10.6
Imports, f.o.b.	-74.6	-86.8	-92.0	-105.0	-119.9	-130.9	-142.4	-154.8	-168.3
(annual percentage change)	-5.3	19.6	7.2	14.2	14.1	9.2	8.7	8.7	8.7
Service balance	36.0	40.3	46.0	57.7	61.8	66.6	71.7	77.1	82.8
Gross official reserves (end of period)									
In millions of U.S. dollars	36.4	44.3	62.1	63.0	66.8	68.4	68.3	66.9	64.7
In months of imports of goods 2/	4.9	5.1	6.3	5.7	5.3	4.9	4.5	4.1	3.6
In months of prospective imports of goods and services	3.1	3.5	4.5	4.2	4.1	4.0	3.7	3.4	3.1
Central government budget (in percent of GDP)									
Total revenue and grants	21.6	21.1	22.4	22.0	21.9	22.0	22.1	22.1	22.2
Total revenue	19.4	20.0	20.5	20.7	20.7	20.8	20.9	21.0	21.1
Tax 3/	17.3	17.9	18.6	18.6	18.7	18.8	18.9	19.0	19.1
Nontax	2.0	2.1	1.9	2.1	2.0	2.0	2.0	2.0	2.0
Grants 4/	2.2	1.1	1.9	1.3	1.2	1.2	1.2	1.2	1.1
Total expenditure and net lending	25.7	22.8	21.4	21.9	22.9	23.0	23.1	23.2	23.3
Current expenditure	21.9	21.1	19.8	20.2	21.2	21.3	21.5	21.5	21.6
Wages and salaries	12.0	12.1	11.5	11.3	12.7	12.8	12.8	12.9	12.9
Purchases of goods and services	5.1	3.9	3.7	4.2	3.9	3.9	4.0	4.0	4.0
Transfers 5/	3.1	3.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Interest payments	1.0	1.0	1.0	1.1	0.9	1.0	1.0	1.1	1.2
Capital expenditure	3.8	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Overall balance	-4.1	-1.7	1.0	0.1	-1.0	-1.0	-1.1	-1.1	-1.1
Financing	4.1	1.7	-1.0	-0.1	1.0	1.0	1.1	1.1	1.1
Public debt	40.5	41.0	38.0	36.1	35.7	35.5	35.4	35.4	35.3
Domestic debt (in percent of GDP) 6/	10.5	12.2	11.1	10.2	11.3	12.4	13.7	15.0	16.3
External debt (in percent of GDP) 6/	30.0	28.8	26.9	25.9	24.5	23.1	21.7	20.3	19.0
GDP in current prices (in billions of vatu)	32.7	33.7	35.4	37.2	38.6	40.0	41.3	42.7	44.1

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Including official transfers.
2/ Imports values are on c.i.f. basis.
3/ Net of tax rebate for import duties.
4/ Cash grants only.
5/ Excludes transfers to the Development Fund.
6/ Medium- and long-term public debt only.

Table 6. Vanuatu: Vulnerability Indicators, 2000–05
(In percent of GDP; unless otherwise indicated)

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Financial sector risk indicators						
Public debt	35.4	37.9	40.5	41.0	38.0	36.1
Broad money (percent change, 12-month basis) 1/	6.7	5.6	-1.7	-0.8	9.8	6.1
Private sector credit (percent change, 12-month basis) 1/	-4.9	6.4	7.9	9.8	9.6	7.2
Nonperforming loans (as share of total loans) 2/	4.5	3.8	3.9	8.4	18.5	...
Share of deposits in broad money (percent)	94.6	94.5	94.5	93.9	93.5	93.5
Share of foreign currency deposits in total deposits (percent)	77.8	79.2	75.3	72.9	70.7	68.7
External indicators						
Exports (percent change, 12-month basis in U.S. dollars)	6.2	-26.9	0.8	32.5	28.6	14.3
Imports (percent change, 12-month basis in U.S. dollars)	-8.6	0.8	-5.3	19.6	7.2	14.2
Current account balance (excl. official transfers)	-5.5	-5.0	-12.8	-14.0	-9.9	-8.5
Capital and financial account balance	-1.1	-4.5	8.9	12.5	6.6	7.6
Of which: Inward foreign direct investment	8.3	7.7	3.5	5.3	5.1	5.1
Gross official reserves (in millions of U.S. dollars)	39.1	37.7	36.4	44.3	62.1	63.0
(in months of imports of goods) 4/	5.1	4.8	4.9	5.1	6.3	5.7
(in months of prospective imports of goods and services)	3.1	3.8	3.1	3.5	4.5	4.2
(in percent of broad money)	16.6	15.5	13.9	14.3	17.3	17.6
Foreign liabilities of Reserve Bank of Vanuatu (in millions of U.S. dollars)	1.6	1.9	1.9	1.9	1.9	...
Foreign currency exposure of Reserve Bank of Vanuatu 3/	4.5	5.5	5.8	4.9	3.4	...
Foreign assets of commercial banks (in millions of U.S. dollars)	160.6	171.2	215.7	243.4	263.4	...
Foreign liabilities of commercial banks (in millions of U.S.dollar)	26.2	28.5	65.2	65.0	64.8	...
Foreign currency exposure of commercial banks 3/	16.3	16.6	30.2	26.7	24.6	...
Total external debt 5/	28.2	29.7	30.0	28.8	26.9	25.9
In percent of exports of goods and services	42.3	49.7	72.7	71.7	64.7	54.3
External debt-service (in percent of exports of goods and services)	0.9	1.0	1.5	1.5	1.7	1.5
Exchange rate (vatu per U.S. dollar, end of period)	142.8	146.7	133.2	111.8	106.5	...

Sources: Vanuatu authorities; and Fund staff estimates.

1/ Change in percent of beginning of period broad money.
2/ Through end-September 2004.
3/ Foreign currency exposure is defined to be foreign currency liabilities as a percentage of foreign currency assets.
4/ Imports values are on c.i.f. basis.
5/ Medium- and long-term public debt only.

Table 7. Vanuatu: Medium-Term Reform Scenario, 2002-10

	2002	2003	2004	2005	2006	2007	2008	2009	2010
				Projections					
Output and prices (annual percentage change)									
Real GDP	-4.9	2.4	3.0	2.8	2.8	3.0	3.0	3.2	3.2
Nominal GDP	-4.0	3.1	4.9	5.1	4.0	4.0	4.0	4.0	4.0
Consumer prices (period average)	2.0	3.0	2.8	3.7	2.6	2.4	2.4	2.2	2.2
Balance of payments (in millions of U.S. dollars)									
Current account balance 1/	-14.1	-23.5	-11.3	-13.4	-9.1	-9.3	-9.6	-9.4	-8.9
(in percent of GDP)	-6.0	-8.5	-3.6	-4.1	-2.7	-2.6	-2.6	-2.4	-2.2
Trade balance	-54.6	-60.2	-57.8	-65.9	-76.0	-83.4	-91.8	-101.3	-112.2
Exports, f.o.b.	20.1	26.6	34.2	39.1	43.9	49.3	55.1	61.2	67.6
(annual percentage change)	0.8	32.5	28.6	14.3	12.3	12.3	11.7	11.1	10.5
Imports, f.o.b.	-74.6	-86.8	-92.0	-105.0	-119.9	-132.7	-146.8	-162.5	-179.8
(annual percentage change)	-5.3	19.6	7.2	14.2	14.2	10.6	10.6	10.6	10.6
Service balance	36.0	40.3	46.0	59.0	64.8	71.4	78.5	86.2	94.5
Gross official reserves (end of period)									
In millions of U.S. dollars	36.4	44.3	62.1	63.0	72.8	82.9	92.9	103.1	113.9
In months of imports of goods 2/	4.9	5.1	6.3	5.7	5.7	6.0	6.2	6.3	6.4
In months of prospective imports of goods and services	3.1	3.5	4.5	4.2	4.5	4.7	4.9	5.0	5.1
Central government budget (in percent of GDP)									
Total revenue and grants	21.6	21.1	22.4	22.0	22.4	22.7	23.0	23.3	23.5
Total revenue	19.4	20.0	20.5	20.7	20.9	21.1	21.3	21.5	21.6
Tax 3/	17.3	17.9	18.6	18.6	18.8	19.0	19.2	19.4	19.5
Nontax	2.0	2.1	1.9	2.1	2.1	2.1	2.1	2.1	2.1
Grants 4/	2.2	1.1	1.9	1.3	1.5	1.6	1.7	1.8	1.9
Total expenditure and net lending	25.7	22.8	21.4	21.8	21.5	21.5	21.4	21.4	21.5
Current expenditure	21.9	21.1	19.8	20.0	19.3	19.0	18.8	18.4	18.1
Wages and salaries	12.0	12.1	11.5	11.1	10.9	10.6	10.4	10.2	10.0
Purchases of goods and services	5.1	3.9	3.7	4.2	3.9	3.9	4.0	4.0	4.0
Transfers 5/	3.1	3.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Interest payments	1.0	1.0	1.0	1.1	0.9	0.8	0.8	0.7	0.6
Capital expenditure	3.8	1.7	1.6	1.8	2.1	2.5	2.7	3.0	3.4
Overall balance	-4.1	-1.7	1.0	0.2	0.9	1.2	1.5	1.9	2.0
Financing	4.1	1.7	-1.0	-0.2	-0.9	-1.2	-1.5	-1.9	-2.0
Public debt	40.5	41.0	38.0	36.0	33.8	31.4	28.8	26.0	23.2
Domestic debt (in percent of GDP) 6/	10.5	12.2	11.1	10.1	9.3	8.3	7.1	5.7	4.2
External debt (in percent of GDP) 6/	30.0	28.8	26.9	25.9	24.5	23.1	21.7	20.3	19.0
GDP in current prices (in billions of vatu)	32.7	33.7	35.4	37.2	38.7	40.2	41.8	43.5	45.2

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Including official transfers.
2/ Imports values are on c.i.f. basis.
3/ Net of tax rebate for import duties.
4/ Cash grants only.
5/ Excludes transfers to the Development Fund.
6/ Medium- and long-term public debt only.

Table 8. Vanuatu: Medium-Term Risk Scenario, 2002-10

				Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Output and prices (annual percentage change)									
Real GDP	-4.9	2.4	3.0	2.8	2.3	2.1	2.0	1.8	1.7
Nominal GDP	-4.0	3.1	4.9	5.1	5.1	4.9	4.6	4.4	4.3
Consumer prices (period average)	2.0	3.0	2.8	3.7	4.2	4.2	4.0	4.0	4.0
Balance of payments (in millions of U.S. dollars)									
Current account balance 1/	-14.1	-23.5	-11.3	-16.1	-17.8	-20.7	-22.9	-24.9	-22.0
(in percent of GDP)	-6.0	-8.5	-3.6	-4.9	-5.2	-5.7	-6.1	-6.3	-5.3
Trade balance	-54.6	-60.2	-57.8	-65.9	-76.0	-81.2	-86.3	-92.3	-96.3
Exports, f.o.b.	20.1	26.6	34.2	39.1	43.9	49.3	54.9	60.5	65.9
(annual percentage change)	6.2	-26.9	0.8	32.5	28.6	14.3	12.3	12.3	11.4
Imports, f.o.b.	-77.5	-78.1	-74.6	-86.8	-92.0	-105.0	-119.9	-130.5	-141.2
(annual percentage change)	-5.3	19.6	7.2	14.2	14.1	8.9	8.2	8.2	6.2
Service balance	36.0	40.3	46.0	56.3	59.7	63.6	67.7	72.0	76.5
Gross official reserves (end of period)									
In millions of U.S. dollars	36.4	44.3	62.1	63.0	63.2	59.6	52.8	42.9	35.7
In months of imports of goods 2/	4.9	5.1	6.3	5.7	5.0	4.3	3.5	2.6	2.0
In months of prospective imports of goods and services	3.1	3.5	4.5	4.2	3.9	3.5	2.9	2.2	1.8
Central government budget (in percent of GDP)									
Total revenue and grants	21.6	21.1	22.4	22.0	21.6	21.4	21.3	21.2	21.1
Total revenue	19.4	20.0	20.5	20.7	20.4	20.4	20.3	20.3	20.3
Tax 3/	17.3	17.9	18.6	18.6	18.4	18.3	18.3	18.3	18.3
Nontax	2.0	2.1	1.9	2.1	2.0	2.0	2.0	2.0	2.0
Grants 4/	2.2	1.1	1.9	1.3	1.1	1.0	1.0	0.9	0.8
Total expenditure and net lending	25.7	22.8	21.4	22.7	23.6	24.6	25.8	26.4	26.9
Current expenditure	21.9	21.1	19.8	20.7	22.4	23.5	24.6	25.3	25.9
Wages and salaries	12.0	12.1	11.5	11.6	13.1	13.8	14.4	14.7	14.8
Purchases of goods and services	5.1	3.9	3.7	4.3	4.7	4.9	5.1	5.3	5.3
Transfers 5/	3.1	3.3	3.0	3.0	3.0	3.1	3.1	3.2	3.2
Interest payments	1.0	1.0	1.0	1.1	0.9	1.1	1.3	1.6	2.0
Capital expenditure	3.8	1.7	1.6	2.0	1.3	1.2	1.2	1.1	1.0
Overall balance	-4.1	-1.7	1.0	-0.7	-2.0	-3.2	-4.6	-5.2	-5.8
Financing	4.1	1.7	-1.0	0.7	2.0	3.2	4.6	5.2	5.8
Public debt	40.5	41.0	38.0	36.9	37.6	39.5	42.7	46.6	50.9
Domestic debt (in percent of GDP) 6/	10.5	12.2	11.1	11.0	13.1	16.4	21.0	26.3	31.9
External debt (in percent of GDP) 6/	30.0	28.8	26.9	25.9	24.5	23.1	21.7	20.3	19.0
GDP in current prices (in billions of vatu)	32.7	33.7	35.4	37.2	39.1	41.0	42.9	44.7	46.7

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Including official transfers.
2/ Imports values are on c.i.f. basis.
3/ Net of tax rebate for import duties.
4/ Cash grants only.
5/ Excludes transfers to the Development Fund.
6/ Medium- and long-term public debt only.

VANUATU—FUND RELATIONS
(As of December 31, 2004)

I. Membership Status: Joined 9/28/81; Article VIII

II. General Resources Account:	SDR Million	% Quota
Quota	17.00	100.0
Fund holdings of currency	14.51	85.3
Reserve position in Fund	2.50	14.7

III. SDR Department:	SDR Million	% Allocation
Holdings	0.93	N/A

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Arrangements:

Since 1988, Vanuatu has maintained an adjustable peg exchange rate arrangement. Currently, the exchange rate of the vatu is linked to a transactions-weighted (trade and tourism receipts) basket of currencies. The weights and composition of the basket, which are not publicly disclosed, are adjusted periodically (most recently in June 2004). The Reserve Bank of Vanuatu (RBV) quotes daily buying and selling rates for the vatu against the U.S., Australian, and New Zealand dollars; the euro; the U.K. pound; and the Japanese yen. The rate in terms of the U.S. dollar as of December 31, 2004 was VT 106.5 per U.S. dollar.

Vanuatu has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

VIII. Article IV Consultation:

The last Article IV consultation discussions with the authorities were held in Port Vila during August 2002. The Executive Board discussed the staff report and concluded the consultation on November 22, 2002.

		Department	Date
IX.	**OFC Assessments**:		
	Offshore Financial Center Module II Assessment	MFD	May 2002 (published)
X.	**Technical Assistance from Headquarters (2000–present)**:		
	Short-term:		
	Exchange rate policy and reserve management	MFD	November 2001
	Monetary policy	MFD	February 2003
	Monetary operations	MFD	April 2004
	Balance of Payments	STA	March 2004
	Anti-money laundering	LEG	Nov. 2003, Feb. 2004, and Jul. 2004
	Long-term:		
	General Advisor, RBV	MFD	January 1999–July 2000
	Banking Supervision	MFD	January 2002–January 2005
XI.	**Resident Representative**:	None	

VANUATU—RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER (PFTAC)[1]

Since 1998, the Center's assistance to Vanuatu has included 31 advisory missions, with a primary focus in banking supervision and statistics. In addition, Vanuatu has sent 28 officials to the Center's regional seminars, workshops, and training courses.

Banking Regulation and Supervision

PFTAC works closely with the resident advisor on banking supervision. The Center also organized peripatetic advisors on insurance legislation and insurance supervision, the establishment of a bank reporting database system and a Financial Intelligence Unit. As a result, a number of the May 2002 recommendations of the offshore financial assessments program report have been introduced. The Deputy Governor of the Reserve Bank of Vanuatu is the current Chair of the Association of Financial Supervisors of Pacific Countries for which PFTAC acts as the Secretariat.

Public Financial Management

AusAid has funded an extensive technical assistance program in budget management. PFTAC has complemented that assistance through advice on prioritization and sequencing of needed reforms, and, in 2003, by training of staff on moving budget reporting to a GFS basis (see below).

Tax Administration and Policy

PFTAC assistance has been limited to short diagnostic missions on strengthening customs administration and introducing select excises.

Economic Statistics

Following a PFTAC review, technical assistance provided by STA in the context of the GDDS/ PFTAC project for Pacific Island countries resulted in Vanuatu producing quarterly balance of payments and international investment position statistics consistent with the *BPM5*. The Centre trained staff and developed plans for presenting government finance statistics on the basis of the 2001 GFS Manual and for integration of GFS classifications with the budget and accounting systems. Data based on the new standards is nearing completion. PFTAC also undertook a mid-term review of the statistics element of an AusAID/ADB funded institutional strengthening project.

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[1]The Pacific Financial Technical Assistance Centre (PFTAC) in Suva, Fiji is a multi-donor technical assistance institution, financed by the IMF, AsDB, AusAID, NZODA, and, until 2001, by the UNDP, with the IMF as Executing Agency. The Centre's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

VANUATU—RELATIONS WITH THE WORLD BANK GROUP[1]

(As of January 2005)

Since joining the World Bank Group in 1981, Vanuatu has received five IDA credits totaling $18.9 million (all fully disbursed) in the areas of agricultural extension and training (1983), transportation and education infrastructure (1986), primary and secondary education (1988), affordable housing (1991), and a Learning and Innovation Loan (2001).

The Bank has also supported utilities reform through a series of policy-based workshops, and has recently provided funding through the Public Private Infrastructure Advisory Facility for a performance and regulatory review of the water, power, and telecommunications sectors. In addition, the Bank has provided analytical and advisory services to Pacific Island countries, including Vanuatu, through its biennial Regional Economic Reports. The report for 2002 analyzes trade liberalization and complementary reforms in the Pacific Island economies. The forthcoming 2005 report will assess Human Development issues and progress in the Pacific region and includes a focus on Vanuatu as one of a number of case study countries.

In other areas, the Pacific Enterprise Development Facility has been providing support to individuals and intermediaries to allow them to on-deliver quality services in country. Two initiatives are underway in Vanuatu; one is working with the Melanesian Savings and Loans, and another with a tourism association.

In addition, the Foreign Investment Advisory Service has been assisting the Vanuatu Investment Promotion Authority with the drafting of a National Investment Policy Statement, and follow-on involvement is expected.

Recent reports (since 2002)

Catastrophic Insurance Pilot Study, Port Vila, Vanuatu, 2004.

[1] Prepared on the basis of inputs from the World Bank staff.

VANUATU—RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(As of end-December 2004)

The Asian Development Bank's (AsDB) operations in Vanuatu started in 1981. As of end-December 2004, the AsDB had provided nine loans (a total of US$51.25 million) and 53 technical assistance projects (US$14.96 million).

The loan projects include assistance for agriculture, cyclone damage rehabilitation, port facilities, urban infrastructure development, development financing, and the Comprehensive Reform Program (CRP). The technical assistance projects cover both project preparation and advice in the areas of agricultural and forestry development, agricultural support services, energy, industrial estate development, transport and communications, social infrastructure, population planning, economic and fiscal management, vocational training, CRP support, and access to affordable credit.

No loans were extended in 2004 and none are programmed for 2005 due to the government's reluctance to borrow. In the last quarter of 2004, technical assistance was approved for the preparation of a medium-term strategic framework, and reform of the legal and regulatory framework for collateralized loans. The latter is targeted at creating access to affordable credit for small and medium sized entrepreneurs.

In 2005, advisory technical assistance is programmed for corportization of the Ports Authority, and for rural productive skills development.

The strategic thrust of the AsDB's operations for Vanuatu over the medium term continues to be to build local capacity for sound economic management and good governance and maintain its support for the CRP while (i) stimulating private sector development and GDP growth by dealing with the underlying constraints and policy issues; and (ii) supporting the provision of improved rural infrastructure and social services. There is a strong parallel concern for addressing poverty, employment, environment, and other social issues, particularly in the rural areas.

The indicative lending program is expected to amount to a maximum of US$6.0 million over the next three years. The technical assistance program is estimated to amount to around US$1.5 million.

Loans Commitment and Disbursement During 1998–2004

(In millions of U.S. dollars)

Year	Contract Awards	Disbursements
1998	10.8	11.4
1999	8.0	6.6
2000	9.5	10.6
2001	0.8	2.8
2002	0.0	0.2
2003	0.0	0.1
2004	0.0	0.0

[1] Prepared on the basis of input provided by AsDB staff.

VANUATU—STATISTICAL ISSUES

Improvements have been made in Vanuatu's economic statistics, but deficiencies persist in methods and coverage. The Reserve Bank of Vanuatu (RBV) is responsible for balance of payments (BOP) and monetary statistics; the Ministry of Finance (MoF) for government finance and external debt statistics, and the National Statistics Office (NSO) for most other official statistics (including GDP, consumer prices, external trade, tourism activity, and labor and demographics). Available economic and financial data are published regularly in the RBV's monthly *Financial and Economic News* and *Quarterly Economic Review* and in the NSO's quarterly *Statistics Indicator*s (*SI*). Recent technical assistance on the BOP and national accounts was provided by the Pacific Financial Technical Assistance Centre (PFTAC) in national accounts and, by STA in the context of the Fund's GDDS/PFTAC project for Pacific Island countries, in BOP (see Annex II). Vanuatu began participating in the Fund's General Data Dissemination System (GDDS) in April 2004.

National Accounts and Prices

The NSO has compiled annual estimates of GDP by type of economic activity (in current and constant prices) through 2003. The estimates, prepared with technical assistance from the PFTAC, Asian Development Bank, and AusAID, have been published in the quarterly *SI* and posted on the NSO's website. In support of this work, data from an annual business survey and an informal sector activity survey (last conducted in 2000) are being incorporated into national accounts estimates. A national census was conducted in 1999 and a labor market survey in 2000.

The CPI is compiled on a quarterly basis. The NSO has no plans to improve the frequency, timeliness, or coverage (which is largely urban-based) of the CPI owing to resource constraints.

Government Finance Statistics

Government finance statistics (GFS) are compiled on a monthly basis, but are not officially published. Quarterly GFS data have been included in the RBV's *Quarterly Economic Review* and the NSO's quarterly *Statistics Indicator*s (*SI*) and posted on the website in a timely manner since 2001. The quality and timeliness of data have improved since a GFS mission visited Vanuatu in November 1998. Follow-up assistance on expenditure data has been provided by PFTAC and AusAID as part of ongoing work in strengthening public financial management. As a result, government expenditure data on a functional basis were prepared starting in 1998, and have been released for publication since 2003. However, although GFS annual data are reported for publication in the GFS Yearbook, the data are highly aggregated and not clearly defined. GFS data are not reported for publication in the IFS. Some inconsistencies exist between the fiscal and monetary accounts in terms of reconciling data on domestic financing of the budget by the banking system reported by the RBV and the MoF.

Monetary Statistics

Monetary statistics are compiled on a monthly basis for the RBV and three domestic deposit money banks (DMBs). In reporting these data to the Fund for *IFS*, the RBV submits a breakdown of sundry income that allows STA to properly reclassify these accounts. However, a similar breakdown is not provided for the DMBs. The RBV has developed a standard reporting system for the offshore sector and the data on the activity of offshore banks are published quarterly.

External Sector Statistics

The BOP is compiled on a quarterly basis. As a result of PFTAC technical assistance, in the context of the GDDS/PFTAC project for Pacific Island countries; extensive revisions have been made to annual BOP data, especially to net investment income and current transfers and to the capital and financial accounts and various sub-items. This has reduced the size and variability of net errors and omissions as reported by the RBV. Coverage of private flows has also improved with the adoption of a revised enterprise survey by end-2002. Assistance is ongoing to refine methods for compiling the BOP to ensure its consistency with government budget and commercial bank data and to more fully incorporate activity of the offshore financial sector. The authorities also are working with PFTAC to complete the *Coordinated Portfolio Investment Survey*. Data on external debt and debt service (all official) are compiled annually by the MoF

VANUATU: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of January 31, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	12/31/04	1/6/2005	D	D	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/2004	12/21/2004	M	M	M
Reserve/Base Money	12/2004	1/2005	M	M	M
Broad Money	12/2004	1/2005	M	M	M
Central Bank Balance Sheet	12/2004	1/2005	M	M	M
Consolidated Balance Sheet of the Banking System	12/2004	1/2005	M	M	M
Interest Rates[2]	12/2004	1/2005	M	M	M
Consumer Price Index	2004 Q3	11/2004	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	2004	1/2005	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt	2003	11/2004	A	A	A
External Current Account Balance	2004 Q3	11/2004	Q	Q	Q
Exports and Imports of Goods and Services	2004 Q3	11/2004	Q	Q	Q
GDP/GNP	2003	11/2004	A	I	I
Gross External Debt[5]	2004	1/2005	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Does not include currency and maturity composition. For central government only.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

VANUATU—SOCIAL AND DEMOGRAPHIC INDICATORS

	Latest single year	Same Region/Income Group	
	1995-2001	East Asia and Pacific	Lower-Middle Income
Population			
Total population (in thousands)	200	1,822,500	2,163,500
Growth rate	3.0	1.1	1.0
Urban population (in percent of total)	22.1	37.3	45.6
Public current expenditures			
Health (in percent of GDP)	2.4	1.8	2.6
Education (in percent of GDP)	7.3	2.3	4.6
Safe water			
(in percent of population with access)			
Total	88	76	80
Urban	94	93	95
Rural	63	67	70
Immunization rate			
(in percent under 12 months)			
Measles	94	76	84
Diphtheria/pertussis/tetanus (DPT)	93	77	83
Life expectancy at birth (in years)			
Total	68	69	69
Male	67	67	67
Female	70	71	71
Net primary school enrollment rate			
(in percent of age group)	96	93	92
Infant mortality (live births per thousand)	34	34	33

Source: World Bank.

VANUATU: MILLENNIUM DEVELOPMENT GOALS PROGRESS

	1990	1995	Latest Data 2001-02	Target 2015
Goal 1: Eradicate Extreme Poverty and Hunger				
Prevalence of child malnutrition (percent of children under 5)	...	12.1	...	6.0
Goal 2: Achieve Universal Primary Education				
Net primary enrollment ratio (percent of relevant age group)	...	...	93.2	100.0
Goal 3: Promote Gender Equality				
Ratio of girls to boys in primary and secondary education (percent)	91.0	...	...	100.0
Proportion of seats held by women in national parliament (percent)	...	2.0	...	...
Goal 4: Reduce Child Mortality				
Under 5 mortality rate (per 1,000)	70.0	56.0	42.0	24.0
Goal 5: Improve Maternal Health				
Maternal mortality ratio (per 100,000 live births)	...	...	130.0	32.0
Births attended by skilled health staff	...	89.1	...	
Goal 6: Combat HIV/AIDS, Malaria and Other Diseases				
Incidence of tuberculosis (per 100,000 people)	...	...	90.6	...
Goal 7: Ensure Environmental Sustainability				
Forest area (percent of total land area)	36.2	...	36.7	...
Nationally protected areas (percent of total land area)	...	0.0	0.3	...
CO2 emissions (metric tons per capita)	0.4	0.4	0.4	...
Access to an improved water source (percent of population)	...	...	88.0	94.0
Access to improved sanitation (percent of population)	...	...	100.0	...
Goal 8: Develop a Global Partnership for Development				
Fixed line and mobile telephones (per 1,000 people)	17.8	25.9	56.9	...
Personal computers (per 1,000 people)	...	7.4	14.8	...

Source: World Bank; World Development Indicators Database, April 2004.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 05/31
FOR IMMEDIATE RELEASE
March 11, 2005

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2004 Article IV Consultation with Vanuatu

On February 25, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Vanuatu.[1]

Background

Vanuatu achieved positive real growth in 2003–04, after two years of decline. Macroeconomic stability was maintained and some progress made in addressing structural weaknesses. However, a weak environment for private activity, including poor infrastructure and political instability, and rapid population growth have compounded the difficulties that come from a narrow output and export base, and contributed to low per capita GDP growth relative to comparator Pacific and Caribbean island countries over the past decade. As a result, the outlook for the faster economic growth needed to lift living standards is not bright without a deepening of reform. Human development indicators are low. About 40 percent of the population is below the poverty line and 80 percent of the labor force is employed in subsistence activities in rural areas.

Real GDP growth rebounded to 2.4 percent in 2003 and the recovery continued in 2004 with growth of an estimated 3 percent. The improvement was bolstered by a strong supply response to a recovery in export prices and the liberalization of trading in two key exports (cocoa and copra), the discovery of new markets for kava following the ban by several countries in 2002, and higher tourist arrivals with an expansion in airline capacity to Vanuatu.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Fiscal consolidation continued over the past two years. Although in large part reflecting sharply reduced development expenditure, new controls on current spending and improved tax collection also contributed to the outcome. However, the wage bill remained high, while service delivery to the outer islands continued to be slow due to capacity constraints. Following the completion of large development projects, capital outlays fell to an average 1.6 percent of GDP in 2003–04 from an average 4.5 percent of GDP in 1999–2002, despite continued pressing development needs. Reflecting the government's cautious approach to incurring new public debt, total public debt, including external debt, fell below 40 percent of GDP.

Against the background of a basket-peg exchange rate regime, inflation has remained subdued at just under 3 percent in 2004. Broad money growth picked up in 2004, as deposits with the banking sector rose and the net foreign assets position of commercial banks strengthened. Commercial banks' liquidity positions improved in 2004, allowing for lower lending rates, which resulted in a slight narrowing of the interest rate spread.

The external current account deficit narrowed in 2004 with the stronger performance in tourism and exports. In real effective terms, the vatu remained broadly stable over the past five years, while official reserves have recovered since 2002.

Progress has been made in strengthening Vanuatu's financial sector. Important gains in financial sector supervision took place with the passage of the International Banking Act in 2002 and the broadening of the Reserve Bank of Vanuatu's supervisory responsibilities to the offshore banking sector and the Vanuatu National Provident Fund. The state-owned National Bank of Vanuatu is now showing a small profit following restructuring in 2000. In addition, the OECD removed Vanuatu from the list of uncooperative tax havens in 2003.

The outlook is for a softening of the macroeconomic environment in 2005 and growth prospects over the medium term are not bright without a stronger policy commitment for deeper reform. Real GDP growth is expected to taper off as global commodity prices for many of Vanuatu's exports again ease, notwithstanding the expected full year impact on tourism of the increased airline capacity. Inflation is likely to edge higher with the delayed impact of higher world oil prices. On the current trajectory, without an active reform effort that addresses weak infrastructure and other sources of high business costs, real GDP growth could fall below even the current moderate levels. Given its narrow base, the economy will remain vulnerable over the medium term. Vanuatu has growth potential, especially in agriculture and tourism. Its resilience will depend on the strength of implementation of structural reforms, while the downside risks pointing to a less favorable outlook are sizeable. The recent history underscores the importance of political stability, particularly given the need to fund additional development spending through grants. Other risks include the possible absence of political commitment to reform and continued exposure to natural disasters.

Executive Board Assessment

Executive Directors welcomed the improvement in Vanuatu's macroeconomic performance over the last two years, reflected in positive growth, low inflation, a sustainable debt, and a comfortable international reserves position. Progress has been made in structural reform, especially in the banking sector.

Going forward, Directors stressed that the authorities need to focus their attention on raising per capita income growth and reducing the economy's vulnerability to shocks. Attainment of these goals will require sustained fiscal consolidation and broad-based structural reform to boost private investment and diversify the economy. Directors urged the new government to seize the opportunity provided by the current favorable economic climate to build broad support for a reinvigoration of structural reforms, in order to deliver consistently strong economic policies despite the uncertain political environment. This will, in addition, increase donor confidence in Vanuatu.

Directors welcomed the authorities' efforts to strengthen the fiscal position over the past two years, and in particular the enhanced controls on current spending and improved tax collection. However, they expressed concern that fiscal adjustment has come in part through a reduction in capital outlays that could jeopardize future economic development. Directors encouraged the authorities to maintain revenue growth through both continued strengthening of tax compliance and a reduction of tax and duty exemptions. On expenditure, the most important tasks are to reduce the wage bill, improve efficiency in education spending, and reallocate spending toward infrastructure and basic social services. Directors welcomed the continuation of the prudent public debt policy.

Directors endorsed the Reserve Bank's cautious monetary policy stance, aimed at keeping inflation low and building up international reserves. They advised close cooperation with the fiscal authorities with the aim of limiting government borrowing from the Reserve Bank. Directors considered the adjustable peg exchange rate arrangement to be broadly appropriate, while emphasizing that it demands sound macroeconomic policies and broad-based reforms to improve competitiveness.

Directors commended the strengthening of the oversight of the financial sector in the past two years, including the extension of the Reserve Bank's supervisory responsibilities to the offshore banking sector and the Vanuatu National Provident Fund. They noted that, while the banking system is sound, the level of nonperforming loans is high and should be monitored closely. Directors welcomed the important steps taken to combat money laundering and terrorism financing. They urged the authorities to enact promptly all additional legislation necessary to bring the financial sector into compliance with international AML/CFT standards, to provide adequate staff to the Financial Intelligence Unit, and to reinforce oversight of nonbank financial institutions. In light of Vanuatu's past experience, Directors cautioned against reviving a publicly funded development bank.

Directors called for a stronger effort to promote private sector development, particularly by removing impediments to business activity. Key actions would include streamlining investment procedures and upgrading the infrastructure. In addition, Directors urged the authorities to expand their restructuring efforts to all public enterprises—and to privatize these enterprises where appropriate—in order to improve enterprise efficiency and transparency and to increase competition.

Directors welcomed the improvement in the quality, coverage, and timeliness of key statistics needed for surveillance purposes, and Vanuatu's participation in the Fund's General Data Dissemination System. They encouraged further efforts to upgrade the national accounts and balance of payments statistics.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Vanuatu: Selected Economic and Financial Indicators

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Output and prices (annual percentage change)						
Real GDP	2.7	-2.7	-4.9	2.4	3.0	2.8
Consumer prices (period average)	2.5	3.7	2.0	3.0	2.8	3.7
Government finance (in percent of GDP)						
Total revenue and grants	22.1	21.6	21.6	21.1	22.4	22.0
Total expenditure	29.0	25.3	25.7	22.8	21.4	21.9
Overall balance	-7.0	-3.7	-4.1	-1.7	1.0	0.1
Money and credit (annual percentage change)						
Broad money	6.7	5.6	-1.7	-0.8	9.8	6.1
Net foreign assets	11.7	6.6	-6.0	-0.3	11.7	6.1
Domestic credit	0.8	5.4	12.0	5.3	7.9	6.7
Current account (in millions of U.S. dollars) 1/	4.8	4.7	-14.1	-23.5	-11.3	-14.7
(in percent of GDP)	2.0	2.0	-6.0	-8.5	-3.6	-4.5
Exports, f.o.b. (in millions of U.S. dollars)	27.2	19.9	20.1	26.6	34.2	39.1
(annual percentage change)	6.2	-26.9	0.8	32.5	28.6	14.3
Imports, f.o.b. (in millions of U.S. dollars)	77.5	78.1	74.6	86.8	92.0	105.0
(annual percentage change)	-8.6	0.8	-5.3	19.6	7.2	14.2
Gross official reserves (end of period)						
In millions of U.S. dollars	39.1	37.7	36.4	44.3	62.1	63.0
In months of imports of goods 2/	5.1	4.8	4.9	5.1	6.3	5.7
In months of prospective imports of goods and services	3.1	3.8	3.1	3.5	4.5	4.2
External debt						
External debt (in percent of GDP) 3/	28.2	29.7	30.0	28.8	26.9	25.9
External debt service 4/	0.9	1.0	1.5	1.5	1.7	1.5

Sources: Vanuatu authorities; and Fund staff estimates and projections.

1/ Significant improvements in data compilation from 2002 onward account for a break in the series through 2001.
2/ Imports values are on c.i.f. basis.
3/ Medium- and long-term public debt only.
4/ In percent of exports of goods and services.

Statement by Michael Reddell, Alternate Executive Director for Vanuatu
February 25, 2005

Key Points

- Vanuatu faces many and diverse challenges; some exogenous and others of its own making.
- The country has a strong track record of prudent and cautious macroeconomic management. The level of self-discipline in assuming new debt is particularly impressive.
- Economic reform is needed, although this will take time. In the meantime, the key tourism sector is experiencing strong growth and high levels of new investment.
- Government spending (as a share of GDP) is modest, and although there is scope for reducing the size of the public service, overall expenditure on public sector wages and salaries needs to be considered in light of the small and widely-scattered population.
- The authorities appreciate Fund technical assistance and APD's offer of more frequent policy dialogue.

Vanuatu faces many and diverse challenges. Some of these have to do with size and geography – a little more than 200,000 people, speaking many different languages, are scattered over more than 80 islands in the South Pacific, all at a considerable distance from major population centers and potential markets. The weather also poses challenges. Vanuatu experiences cyclones almost every year and is at constant risk of volcanic eruptions and earthquakes. Indeed, the Commonwealth Secretariat has ranked Vanuatu as the most vulnerable to natural disasters of the 111 developing countries it studied. These are constraints that will always affect Vanuatu's development and growth opportunities and they help to shape its cautious and prudent approach to macroeconomic management.

Other challenges are home-grown. The population is rising rapidly (and unlike many Pacific Island countries, Vanuatu has no natural migration outlet), creating pressures on, inter alia, public spending. A degree of political uncertainty has also become something of a fact of life in Vanuatu, and an irritant for potential investors. Indeed, with seven changes of government since 1998, Vanuatu is rivaling the post-war experiences of one or two European countries. All those changes have been conducted peacefully and in accordance with the provisions of the constitution: the legal system is strong, robust, independent, and widely respected. And as the staff report notes, in the most recent change of government the incumbent Minister of Finance retained his position.

In recent years, Vanuatu has built up a strong track record of prudent and cautious macroeconomic management. The fiscal position has gradually been brought back to balance, inflation has been kept low and stable, foreign reserves have risen to levels that are relatively high by regional standards, and the adjustable peg exchange rate regime has served Vanuatu well. Perhaps most impressively, at a time when this Board is once again discussing debt relief for a large number of other less developed countries, it is worth highlighting that Vanuatu has adopted, and lived within, a self-imposed limit on its public debt – setting out to get, and keep, its total stock of debt at below 40 percent of GDP (and much of that on concessional terms), and requiring any new external borrowing to deliver a financial rate of return to cover the cost of debt servicing. Faced with constant pressures to increase spending, and against a backdrop of poor Human Development Indicators, the ability of successive governments to live within this constraint is a considerable credit to Vanuatu and an example to others.

Notwithstanding the prudent macroeconomic management of recent years, the Vanuatu economy has struggled over the last decade as a whole; per capita GDP has fallen, and Vanuatu has underperformed most of the other Pacific Island economies. My authorities are well aware of the need to address the factors that contributed to this decline, although the pace of reform is constrained by political realities. In recent years, however, economic performance has been more encouraging, with growth last year estimated to have been around 3 percent.

As staff note, a number of factors have been at work, but tourism has grown particularly strongly – airborne visitor arrivals, for example, were up 18 percent last year. New airline capacity, helped by government's new open skies policy, has contributed significantly to the growth. The government is committed to ensuring the viability of Air Vanuatu's business model, to support continued strong growth in the key tourist sector. And extensive private sector investment in new accommodation and resort properties is taking place already and/or expected to begin in the coming year (at least 40,000 new annual room nights are due to come on stream this year, an increase in the stock of more than 10 percent). Meanwhile, high and rapidly rising coastal property prices in and around Port Vila, speak to an ongoing interest by foreigners to participate in Vanuatu. The government has implemented a "one-stop shop" for foreign investors, although the extent of foreign investment, and the continuing need to promote economic development among the indigenous ni-Vanuatu, remains a potent underlying source of political friction. This is likely to be a particular issue in realizing Vanuatu's considerable agricultural potential.

As staff note, central government expenditure in Vanuatu is not high (as a share of GDP) by the standards of the region, and continuing improvements in the revenue collections systems and reviews of the current duty exemptions, might allow some increase on total spending without increasing statutory tax rates or imposing new taxes (Vanuatu has neither corporate nor personal income taxes). Vanuatu's spending is, however, heavily concentrated on wages and salaries for public servants (12 percent of GDP). My authorities fully recognize the need for streamlining the civil service and the Minister of Finance indicated to the mission his hope to be able to cut civil service numbers, in time, by 25 percent. Steps in this direction would enable the authorities to allocate more domestic resources towards much-needed capital projects, and to become less reliant on donor assistance. Nonetheless, Vanuatu's rugged archipelagic geography is likely to mean that the share of GDP devoted to public service salaries is higher than in some other more physically compact countries, given the pressure to provide basic health and education services throughout the country (and it is, for example, considerably lower than the share in several other countries in this constituency, which have small populations thinly scattered over vast areas of ocean).

Public enterprises are a sector where there is likely to be scope to secure significant efficiency gains. At present, only two of the trading enterprises report a profit. Tackling, and streamlining, formal governance structures will be politically difficult, and the authorities expect to focus their efforts on reviewing the basic business models of the various enterprises to help secure efficiency gains. Officials from the Ministry of Finance will be directly involved in this process.

Vanuatu has continued to build on the progress reported at the time of the last Staff Report in strengthening bank supervision and ensuring that its legislative and regulatory environment is consistent with international standards. The onshore banking system is sound, well-regulated, and its credit risks are appropriately provided for. Other initiatives will continue. The FIU and Financial Services Commission are being strengthened, and amendments to the Financial Transactions Reporting Act are expected to be passed by Parliament later this year. My authorities believe that the offshore financial centre, which has done much to shape the character of Vanuatu's business services sector over past decades, is now appropriately regulated and are keen to have this recognized by the international community (business and regulatory). However, as staff note, an overall assessment of the impact of the offshore sector on Vanuatu's economy is underway, using external advisers, and the report will be carefully considered by the government when it is finalized.

My authorities are very grateful for the Fund's technical assistance, both directly and through PFTAC. That assistance has been particularly important in recent years in strengthening the supervisory regime for Vanuatu's banking system. The authorities also note that valuable PFTAC assistance has enabled them to make material improvements in Vanuatu's balance of payments statistics. New balance of payments data and international investment position statistics have been produced and the coverage of the Coordinated Portfolio Investment Survey has been improved. The authorities are determined to continue the program of improvement in the quality of balance of payments statistics.

In closing, we thank the staff for their report and for the dialogue that took place with the mission during their stay in Port Vila. My authorities value the opportunity to consult with the Fund on the macroeconomic picture, and appreciate APD's initiative to offer to undertake a staff visit in the off year of the biennial Article IV cycle to help maintain the dialogue.