

**EXECUTIVE
BOARD
MEETING**

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September 30, 2016

To: Members of the Executive Board

From: The Secretary

Subject: **Vanuatu—Staff Report for the 2016 Article IV Consultation—Informational Annex**

Board Action:	Executive Director's consideration (Formal)
Tentative Board Date:	Friday, October 21, 2016
Publication:	Not yet decided*
Questions:	Mr. Papageorgiou, RES (ext. 37503) Mr. Lee, APD (ext. 37094)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	Tuesday, October 11, 2016—WTO After Board Consideration—Asian Development Bank, European Commission

***At the time of circulation of this paper to the Board, the authorities have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent.**



VANUATU

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION —INFORMATIONAL ANNEX

September 22, 2016

Prepared By

The Asia and Pacific Department
(In consultation with other departments)

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FUND RELATIONS

(As of August 31, 2016)

Membership Status: joined September 28, 1981; Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	23.80	100.00
Fund holdings of currency	28.11	118.09
Reserves tranche position	4.20	17.63

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	16.27	100.00
Holdings	1.37	8.43

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
RCF Loans	8.50	35.71
Emergency Assistance ^{1/}	8.50	35.71

^{1/} Emergency Assistance may include ENDA, EPCA, and RFI.

Latest Financial Arrangements: None

Projected Payments to the Fund ^{2/}

(SDR million; based on existing use of resources and presenting holdings of SDRs);

	Forthcoming				
	2016	2017	2018	2019	2020
Principal			2.13	4.25	2.98
Charges/Interest	0.05	0.10	0.01	0.01	0.01
Total	0.05	0.10	0.01	0.01	0.01

^{2/} When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not applicable

Implementation of Multilateral Debt Relief Initiative: Not applicable

Implementation of Post-Catastrophe Debt Relief: Not applicable

Exchange Arrangements

Since 1988, Vanuatu has officially 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. 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 August 31, 2016 was VT 108.72 per U.S. dollar. The de facto classification is “other managed,” as the composite weights are not disclosed and cannot be confirmed. 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.

Article IV Consultation

Vanuatu is on a 12-month consultation cycle. The previous Article IV consultation mission took place during April 15-28, 2015 and the consultation was concluded on June 5, 2015 (Country Report No. 15/149).

OFC Assessments

The most recent Offshore Financial Center Module II Assessment, conducted by MFD, was concluded in May 2006.

Technical Assistance

LEG, MCM, PFTAC, and STA have provided 11 technical assistance missions between May 2015 and June 2016 on the financial programming framework, national accounts for revenue forecasting, anti-money laundering, post natural disaster banking supervision strategy, reserve management, external sector statistics, public financial management, PEFA self-assessment, and national accounts monitoring and forecasting.

Purpose	Date	Department
Workshop on Practical Applications of the Financial Programming Framework	May 21-Jun. 3, 2015	PFTAC
PEFA Self-Assessment	Jun. 1-12, 2015	PFTAC
Post-Natural Disaster Banking Sector Supervision Strategy	Jun. 9-12, 2015	PFTAC
External Sector Statistics	Jul. 27-Aug. 7, 2015	STA
Government Finance Statistics	Oct. 5-16, 2015	STA
External Sector Statistics	Oct. 26-Nov. 6, 2015	STA
Develop GDP forecasting and Monitoring Methodology	Oct. 26-30, 2015	PFTAC
Reserve Management	Oct. 28-Nov. 10, 2015	MCM
PFM Reform Roadmap	Apr. 1-8, 2016	PFTAC
Vanuatu Financial Programming Framework and a National Framework for Revenue Forecasting	Mar. 7-18, 2016	PFTAC
Empirical Analysis of Tax Reform Options Using the Model of the Vanuatu Economy	May 8-22, 2016	PFTAC

Resident Representative

The resident representative office for the Pacific Islands, including Vanuatu, was opened in September 2010 in Suva, Fiji. Mr. Tubagus Feridhanusetyawan is the Resident Representative.

RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER (PFTAC)

(As of August 2016)

Economic Statistics

During 2010 and 2011 PFTAC assisted with the upgrading of government finance statistics to the 2001 GFS Manual and the authorities have been supplying data regularly to STA. A GFS mission is scheduled for September 2016. The Vanuatu National Statistics Office has benefited from four national accounts TA missions since 2012 (most recently in August 2016) and attendance at annual sub-regional workshops. TA has particularly focused on rebasing GDP to 2010 and the development of quarterly GDP estimates, though both remain incomplete due capacity issues. Rebasing is the priority and work is expected to resume in early 2017.

Public Financial Management

Vanuatu has regularly sent officials to PFTAC-sponsored regional training events. During FY2015 and 2016, missions were conducted to prepare authorities for a review of non-tax revenues; assist with risk-based planning and other business processes for internal audit, including on the use of the audit software TeamMate, a guided PEFA self-assessment and development of a framework for formulating a PFM Reform Roadmap. Follow-up TA is planned in FY17 to continue the internal audit reform and formulation of a PFM Reform Roadmap.

Macroeconomics

In the macroeconomic area, PFTAC has provided assistance to the Reserve Bank of Vanuatu (RBV) in developing a Model Of the Vanuatu Economy (MOVE). The MOVE, which generates medium-term projections within an internally consistent macroeconomic and fiscal framework, is being used by the Ministry of Finance and Economic Management (MFEM) to inform a review of Vanuatu's tax system. In addition, staff members from the Office of the Prime Minister and MFEM participated in regional workshops, co-hosted by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) Pacific Office and the Pacific Islands Tax Administrators Association (PITAA), on government expenditure and revenue forecasting.

Tax Administration

Supported by PFTAC, Vanuatu has made steady progress over the last few years which has included: (a) the development of a new strategic and business plan; (b) a risk-based compliance improvement strategy; (c) implementation of performance standards; and (d) the development of an IT strategy followed by the implementation of an IT system that has facilitated taxpayer compliance. A Revenue Review Governance Committee and Project Team, recently appointed by Vanuatu's MFEM, has been tasked with drafting a framework for modernizing Vanuatu's tax system and includes two main deliverables: (a) a review of the current tax policy regime and exploration of the possibility of introducing an Income Tax (as previously recommended by the IMF); and (b) a review of the current

organizational structure and governance arrangements which PFTAC supported through a recent technical assistance mission.

Financial Supervision

In FY2016 PFTAC conducted a series of technical assistance missions involving on-site examination of banks and revisions of the Credit Union Act and oversight capacity building. The Reserve Bank of Vanuatu indicated that those sectors were a priority for technical support. In addition, in June 2015, the PFTAC Financial Supervision advisor visited Vanuatu to advise on implementation of a post-natural disaster (Cyclone Pam) banking sector recovery strategy, as well as to draw lessons from Vanuatu's experience for other PFTAC members.

BANK–FUND COUNTRY TEAM CONSULTATIONS

(As of August 2016)

Representatives of the World Bank accompanied the IMF team on the Article IV mission to Vanuatu (July 13–26, 2016) and participated in discussions with the Government of Vanuatu. The Bank and Fund country teams also exchanged views on the main macroeconomic issues facing Vanuatu and appropriate policy responses.

Fiscal Issues

The teams agreed that careful fiscal planning will be required to finance necessary development expenditure (including Cyclone Pam-related reconstruction spending) while at the same time ensuring debt sustainability. Where possible, the authorities should seek external financing on grant or highly concessional credit terms. The authorities should also aim to rebuild fiscal buffers over the medium term, including by taking steps to increase domestic revenues through the introduction of income and corporate taxes. The teams agreed that formulating an infrastructure investment plan in line with national priorities, and ensuring discipline and allocative efficiency in public expenditure more generally, will be important in responding to fiscal challenges.

Public Investment

The scaling up of investments in infrastructure should be complemented with broad reforms aimed at enhancing the business environment, promoting tourism (including in newer long-haul markets), and improving the resilience, consistency and quality of agricultural output. The teams welcomed efforts to strengthen institutions for climate change adaptation and disaster risk management, including by strengthening early warning systems. Both teams noted the importance of promoting inclusive growth, which will be supported by government strategies to ensure the widespread provision of basic services and employment opportunities, particularly in the less-populated islands.

Exchange Rate and AML/CFT Issues

The teams agreed that the vatu peg to a basket of currencies has served Vanuatu well and should be maintained, given the importance of exchange rate stability for maintaining confidence. Both the IMF and the Bank welcomed the government commitment to address current deficiencies in controls on anti-money laundering and combating the financing of terrorism.

Collaboration

The teams have the following requests for information and collaboration from their counterparts:

- The Fund team requests to be kept informed of progress in various projects and analytical work undertaken by the Bank in order to use resources efficiently and avoid work overlaps.
- The Bank team requests that the Fund make available to the Bank its latest macroeconomic assessments and macroeconomic data from time to time, as inputs to the Bank's lending and non-lending operations.

Further details on collaboration, as necessary, will be agreed at the technical level as work progresses. Table 1 details the specific activities planned by the two country teams over the next year, along with their expected deliverables.

Table 1 Vanuatu: Bank and Fund Planned Activities in Macro-critical Structural Reform Areas (August 2016–July 2017)		
	Products	Expected Delivery Date
Bank Work Program	<ul style="list-style-type: none"> Support improvements in the operational safety and oversight of international air transport and associated infrastructure in Vanuatu, including rehabilitation and works at Bauerfield International Airport. Support for emergency reconstruction to repair cyclone-related damage to airports. 	Ongoing
	<ul style="list-style-type: none"> Support the reconstruction and improved disaster resilience of selected public sector assets in provinces affected by TC Pam, including roads, schools, and other public buildings. 	From mid-2016
	<ul style="list-style-type: none"> Support increased access to electricity services in and around Port Vila, as well as for rural and lower-income households. Technical assistance on the government's energy sector work program. 	Ongoing
	<ul style="list-style-type: none"> Assist in increasing the resilience of communities in Vanuatu to the impacts of climate change and natural hazards on food and water security, including through strengthened disaster risk management and preparedness. 	Ongoing
	<ul style="list-style-type: none"> Support regulatory reform in telecoms and ICT. 	Ongoing
	<ul style="list-style-type: none"> Technical assistance to improve public financial management and identify the appropriate level and mix of financing in the health sector. 	Ongoing
	<ul style="list-style-type: none"> Technical assistance for public debt management (building on the Debt Management and Performance Assessment conducted in 2014, and the Medium Term Debt Strategy supported in 2015). 	From late-2016
Fund Work Program	<ul style="list-style-type: none"> Surveillance (Article IV consultation mission), including a joint debt sustainability analysis 	October 2016
	<ul style="list-style-type: none"> Technical assistance on improvement of national accounts statistics and rebasing (PFTAC). 	August 2016-2017
	<ul style="list-style-type: none"> Technical assistance on developing comprehensive tax reform strategy, legislation, and implementation. 	Late 2016

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of August 2016)

Operational Strategy

The Asian Development Bank's (ADB's) Country Operations Business Plan for 2016–2018 is aligned with the government's Priorities and Action Agenda and aims to assist the government in (i) transport—by providing support for improved connectivity to markets and social services; (ii) urban development—by improving access to sanitation and drainage facilities and improving urban infrastructure with a particular focus on Port Vila; and (iii) energy—by rural electrification and renewable energy sources. Consistent with the government's strategy of fostering private sector-led growth, ADB also focuses on improving the enabling environment for the private sector through improving access to financial services, reforming business laws, and supporting state-owned enterprise (SOE) reform.

ADB's indicative allocation to Vanuatu of Asian Development Fund loan and grant resources for 2017–2019 has been set at USD37.29 million, including USD9.73 million in disaster risk reduction financing. In addition to this, ADB will also provide on average approximately USD500,000 per annum in technical assistance (TA) grant support. To leverage ADB's impact and reduce borrowing costs, co-financing opportunities will be pursued with other development partners.

Portfolio Status

Since joining ADB in 1981, 14 loans have been provided to Vanuatu for a total amount of USD89.36 million, 9 grants totaling USD66.74 million, and 62 TA projects totaling USD22.45 million. More than 50 percent of the loans and TA projects were for the transport sector. ADB resumed its lending operations in Vanuatu with the approval of two projects in the last quarter of 2011. These were for the Vanuatu Interisland Shipping Project (USD52.12 million), co-financed by the Government of New Zealand, and the Port Vila Urban Development Project (USD39.10 million), co-financed by the Government of Australia.

There are three ongoing TA projects amounting to USD1.13 million: TA 8724-VAN: Supporting the Preparation of the National Sustainable Development Plan; TA 7938-VAN: Establishment of the Maritime Safety Administration; and TA 9073-VAN: Institutional Strengthening for Environmental Safeguards in Vanuatu.

Interisland Shipping Support Project

The aim of this project is to improve the efficiency and effectiveness of interisland shipping services through provision of an integrated package of assistance. It comprises two major components: (i) infrastructure investments in the capital of Port Vila and five outer islands, and (ii) establishment of a shipping support scheme to catalyze the provision of services to remote noncommercial destinations. The project is complemented by associated TA to improve sector governance through institutional strengthening and legal and regulatory reforms, and by project management services. ADB is providing a loan of USD29.30 million, the Government of New Zealand a parallel grant of USD17.25 million, and the Government of Vanuatu USD5.57 million.

Port Vila Urban Development Project

The aim of this project is to improve drainage, roads, and sanitation systems in greater Port Vila municipality and adjacent urban and peri-urban areas in the Shefa province. The project is implementing the recommendations of the drainage and sanitation master plan prepared through a project preparatory TA, which identified priority interventions for improved access to, and delivery of drainage and sanitation services to the residents of Port Vila. It is supporting affordable, sustainable, and effective sanitation, roads, and storm water drainage services, and is contributing to climate resilient and sustainable urban development in and around Port Vila. ADB is providing a loan of USD5.0 million and administering the corresponding grant of USD31.0 million from the Government of Australia. The Government of Vanuatu is providing a contribution of USD3.1 million.

Private Sector Development

Private sector development in Vanuatu is supported through the Pacific Private Sector Development Initiative (PSDI). PSDI is a regional technical assistance facility cofinanced by the Government of Australia, the Government of New Zealand, and ADB. PSDI works with Pacific developing member countries to improve the enabling environment for business and support inclusive, private sector-led economic growth. ADB's support under PSDI focuses on (i) improving access to financial services; (ii) business law reform; and (iii) state-owned enterprise reform.

- **Improving Access to Financial Services.** ADB supported the secured transactions framework reform through the drafting and passage of the Personal Property Securities Act, and the installation, and later upgrade, of an electronic registry to record the filing of security interests.
- **Business Law Reform.** ADB assistance has focused on drafting a new Companies Act, a new Companies (Insolvency and Receiverships) Act, and a new Insolvency (Cross Border) Act. Support was also provided for online companies, business names, and charitable associations registry.
- **State-Owned Enterprise Reform.** ADB supported preparation of an SOE reform policy, approved by Cabinet in October 2013, and the subsequent drafting of SOE legislation. ADB has also been working with several SOEs on reform and rationalization strategies, including recommending liquidation where appropriate.

Cyclone Response

Following Tropical Cyclone Pam in March 2015, ADB's immediate support to the government consisted of (i) the approval of USD1.0 million grant financing from the Asia Pacific Disaster Response Fund, and (ii) deployment of urban and infrastructure specialists to Port Vila to provide assistance. This was followed by the approval of two cyclone recovery projects for the reconstruction of Vanuatu's roads and schools.

Proposed Pipeline Projects

ADB's forward pipeline includes a proposed Energy Access Project that will support increased energy access to households and businesses in the provincial centers of Vanuatu through expansion of existing distribution grids and the development of low-cost renewable energy generation from hydropower.

An urban development project for Luganville and a second phase of the Port Vila Urban Development Project are also proposed. Vanuatu's participation in regional projects for tourism and agribusiness financing are being discussed with the government.

ADB–World Bank Joint Development Coordination Office

An ADB–World Bank joint Development Coordination Office was opened in June 2010 in Port Vila. The shared field presence has improved ADB's responsiveness to the development needs of Vanuatu and supports aid coordination and aid effectiveness. In 2016, the office will be upgraded to become the Vanuatu Extended Mission, strengthening ADB's presence on the ground.

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision has shortcomings, but is broadly adequate for surveillance. In particular, national accounts and external sector statistics need to be further improved, while the coverage of government finance statistics could be expanded. Reporting lags could be shortened.</p>	
<p>National accounts: While there have been improvements in methodology and the development of additional data sources, the accuracy of the recently-released, experimental expenditure-based GDP estimates could be further improved. Data are compiled only on an annual basis. Due to recent staff changes in Vanuatu National Statistics Office, there may be delays in 2015 GDP release. PFTAC is providing technical assistance in national accounts compilation, including rebasing the constant price GDP estimates using 2010 as the new base year, the improvement of the experimental expenditure-based GDP, and the development of estimates of GDP on a quarterly basis.</p> <p>Price statistics: The CPI weights are based on 1998 household surveys, and only cover the two urban centers of Port Vila and Luganville. Rebasing the CPI to a more recent base year may start after a new Household Income and Expenditure Survey in 2017.</p>	
<p>Government finance statistics: Budget classification is broadly consistent with the <i>GFSM2001</i>. Work is underway to migrate budget classification to <i>GFSM2014</i>. Government operations data are compiled for the central government only and exclude public enterprises and operations of provincial governments and the two municipalities, as well as grant bodies and other central government extra-budgetary units. The operations of the budget are recorded on a cash plus invoice basis.</p>	
<p>Monetary statistics: The Reserve Bank of Vanuatu (RBV) reports monthly monetary data, including the accounts of the monetary authorities and commercial banks (only in aggregate), and the distribution of loans by sector in its monthly bulletin posted on its website. The RBV also publishes a quarterly report with wider coverage of financial data including fiscal transactions and key financial soundness indicators. Information on financial access is sparse, and could be usefully expanded to allow for better assessment of financial inclusiveness and monetary policy transmission.</p>	
<p>External sector statistics: The RBV releases quarterly BOP data in its Quarterly Economic Review. A special Debt Unit has been created within the Ministry of Finance for public debt management and recording in 2015; however, the recording and management of public debt needs further improvement. Two external sector statistics missions visited Vanuatu in the second half of 2015 to assist the authorities in improving the collection and reporting of external debt and external sector statistics.</p>	
II. Data Standards and Quality	
Participant in the General Data Dissemination System (GDDS) since April 2004.	No data ROSC is available.

Vanuatu: Table of Common Indicators Required for Surveillance

(As of August 2016)

	Date of latest Observation	Date Received	Frequency of Data¹	Frequency of Reporting¹	Frequency of Publication¹
Exchange Rates	4/2016	8/2016	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary ²	3/2016	6/2016	M	M	M
Reserve/Base Money	3/2016	6/2016	M	M	M
Broad Money	3/2016	6/2016	M	M	M
Central Bank Balance Sheet	3/2016	6/2016	M	M	M
Consolidated Balance Sheet of the Banking System	3/2016	6/2016	M	M	M
Interest Rates ³	3/2016	6/2016	Q	Q	Q
Consumer Price Index	3/2016	5/2016	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ⁴ —General	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing ⁴ —Central	5/2016	7/2016	M	M	M
Stocks of Central Government and Central Government-Guaranteed ⁵	2015	5/2016	A	A	A
External Current Account Balance	3/2016	6/2016	Q	Q	Q
Exports and Imports of Goods and Services	3/2016	6/2016	Q	Q	Q
GDP/GNP	2014	3/2015	A	A	A
Gross External Debt	12/2015	4/2016	Q	Q	Q
International Investment Position	3/2016	6/2016	Q	Q	Q

¹ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I), and Not Available (N/A).² Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.³ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.⁴ Foreign and domestic financing.⁵ Includes external gross financial asset and liability positions vis-à-vis nonresidents.