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VANUATU GOVERNANCE FOR GROWTH PROGRAM – REVIEW

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ABBREVIATIONS

ADB	Asian Development Bank
AML/CTF	Anti-Money Laundering/Combating the Financing of Terrorism
ANS	Assessment of National Systems
AusAID	Australian Agency for International Development
DFA	Direct Funding Agreement
CRP	Comprehensive Reform Program
DFAT	Department of Foreign Affairs and Trade
DoFT	Department of Treasury and Finance
EU	European Union
FSB	Financial Services Bureau
FMIS	Financial Management and Information System
FRA	Fiduciary Risk Assessment
GfG	Governance for Growth
GDP	Gross Domestic Product
GoV	Government of Vanuatu
ICT	Information and Communications Technology
IFC	International Finance Corporation
LPO	Local Purchasing Order
MFAT	Ministry of Foreign Affairs and Trade
MFEM	Ministry of Finance and Economic Management
MFEM-ISP	Ministry of Finance and Economic Management – Institutional Support Program
NBV	National Bank of Vanuatu
OAG	Office of the Auditor General
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OGCIO	Office of the Government Chief Information Officer
PAC	Parliamentary Accounts Committee

PEFA	Public Expenditure and Financial Accountability
PEM	Public expenditure management
PFM	Public financial management
PFTAC	Pacific Financial Technical Assistance Centre
PHAMA	Pacific Horticultural and Agricultural Market Access
PMO	Prime Minister's Office
PNG	Papua New Guinea
PPSDI	Pacific Private Sector Development Initiative
PSC	Public Service Commission
PSM	Public sector management
SOE	State Owned Enterprise
TA	Technical Assistance
TRR	Telecommunications and Radiocommunication Regulator
UNDP	United Nations Development Program
URA	Utilities Regulatory Authority
VAT	Value Added Tax
VCCI	Vanuatu Chamber of Commerce and Industry
VNSO	Vanuatu National Statistics Office
VTO	Vanuatu Tourism Office
VTSSP	Vanuatu Transport Sector Strengthening Program
WEO	World Economic Outlook

EXECUTIVE SUMMARY

The Government of Vanuatu (GoV) and Department of Foreign Affairs and Trade (DFAT) Governance for Growth (GfG) program commenced in 2007 and has run in two phases. Its primary objectives have been to improve macroeconomic, microeconomic, fiscal and service delivery outcomes in Vanuatu. A third phase is currently being designed.

GFG – the modality and approach

GFG was designed as a facility acting as a broker of activities supporting locally driven reforms. It was expected to benefit from close interaction on policy developments by working closely, and being co-

located, with GoV officials. A core philosophy of the program is that relationships are critical, using the specific modality of Australian High Commission officers to implement the program, rather than a contractor or other intermediary. The intention was that this would provide a responsive and well-informed program that could effectively and quickly address GoV's needs.

GFG objectives and activities

As the table below shows, there was very little change in the higher level specification of the programs objectives between the two phases..

GfG Objectives Phase 1 and 2

Phase 1	
Purpose: To generate economic growth and improve service delivery through good governance	
Result area 1 Vanuatu's policy framework is more supportive of broad-based growth	Result area 2 The quality of Vanuatu's public expenditure is improved
<i>Outcome 1</i> Government develops and implements policy decisions to remove constraints to broad-based growth	<i>Outcome 4</i> The budget increasingly reflects national priorities for service delivery and investment
<i>Outcome 2</i> There is greater dissemination of information, and public debate, about economic growth and the role of government	<i>Outcome 5</i> Public financial management in line ministries and provinces is improved
<i>Outcome 3</i> Policy decisions are increasingly informed by sound research, evidence and analysis	<i>Outcome 6</i> Budget resources are increasingly used for their intended purpose
	<i>Outcome 7</i> There is stronger accountability to Parliament and the people for the results of public expenditure
Phase 2	
Purpose: To generate economic growth and improve service delivery through good governance	
Result area 1 Vanuatu's policy framework is more supportive of durable, equitable and broad-based growth <ul style="list-style-type: none"> <i>Better policy development</i> through better evidence, based on better analysis and better communication of policy options 	Result area 2 The quality of Vanuatu's public expenditure and its management is improved <ul style="list-style-type: none"> <i>Better policy implementation</i> through better public expenditure choices and better public expenditure management

This review covers the period from 2007 until late 2016. Over that time, the program spent a total of \$52.3 million, including \$4.7 million on program management. The activity budget was mainly allocated as grants to a range of GoV agencies, mainly central and regulatory bodies, complemented by directly sourced and managed short and long term advisory inputs. The key activities the GoV and the program undertook have been in economic and regulatory reform, public financial management (PFM), public expenditure management (PEM) and public sector management (PSM).

PFM (including revenue management) has absorbed the largest share of activity funding over the life of the program (29 per cent), followed by energy (21 per cent), telecommunications (20 per cent), ports (8 per cent), support to the Prime

Minister's Office (4 per cent), other infrastructure (4 per cent) and finance (4 per cent). About 23 per cent of activity funding went to support the two regulatory agencies, the Telecommunications and Radiocommunication Regulator (TRR) (13 per cent) and the Utilities Regulatory Authority (URA) (11 per cent). Just over a third of funding was spent on technical assistance (TA), 24 per cent on salaries of specific officials/positions funded by the program, and 7 per cent on studies.

A range of agencies have benefitted from GfG support. About one-third of funding has been directed at two central agencies: the Ministry of Finance and Economic Management (MFEM) and the Prime Minister's Office (PMO). The Department of Energy in the Ministry of Climate Change and Energy, the Ministry of Trade, Tourism and Ni-Vanuatu Business and the National Statistics Office have all been targeted by GfG funding, along with

the Office of the Auditor General and the Office of the Government Chief Information Officer.

Outcomes and key impacts of the program

Economic and regulatory work

The bulk of GfG's work on the growth agenda has been predicated on the view that regulatory reform, better sectoral policies and improved governance are pre-requisites for growth. In this regard, its work has been in line with much of the analysis undertaken by international agencies and researchers. And this work has delivered some impressive consequences for growth.

The reform of the telecommunications sector led to Gross Domestic Product (GDP) being one per cent higher than it would have otherwise been (AusAID, 2012). Very few single reforms can claim this kind of impact, and the large increase in mobile phone usage indicates that the benefits have been very widespread¹. And GfG's support to rural electrification, by increasing access, complements the activities of the Utilities Regulatory Authority in regulating the activities of local monopolies supplying energy in urban areas to deliver significant benefits. GfG has also played an important role in improving connectivity – internal and external – with its work on ports, aviation, trade policy and border processing.

GfG has had less success working in some areas, such as the operation of State Owned Enterprises (SOEs) involved in commodities marketing and aviation, where reform is likely to drive growth in agriculture and tourism, sectors that are important for livelihoods and income growth for a large proportion of the people of Vanuatu. It has also not been involved in land reform – in part because other elements of Australia's aid program have been operating in this sector. But this remains a field where reform will have to be pursued at some stage to improve access to and social returns from

such an economically and culturally important resource.

The thornier questions about GfG's work in growth concern inclusivity and sustainability. For inclusivity, most of GfG's attention has been devoted to economy wide barriers, rather than issues that may affect particular segments of the population. This includes the distribution of growth opportunities in outlying islands, the need to meet the challenge of rural-urban migration and women's economic empowerment. This said, GfG's work with the National Bank of Vanuatu on rural and mobile banking has certainly increased women's access to financial services, and access outside of urban centres.

Given capacity limitations and political volatility, sustaining reforms whose continued efficacy is based on the operation of 'independent' institutions dealing with complex regulatory issues will probably remain challenging. On the aggregate growth front, the nature of political competition in the country, the limited engagement of much of the population in formal market activity, and the lack of a productive engagement between politicians, bureaucrats and the formal private sector act as substantial constraints on mobilising support for the development and implementation of market –based reforms.

In Phase III GfG will have to continue its support to implementation of reforms introduced in earlier phases. It makes good sense to maintain an emphasis on connectivity and the costs and quality of business and infrastructure inputs. Agencies such as the Utilities Regulatory Authority (URA) and the Telecommunications and Radiocommunications Regulator (TRR) will need continued access to expertise – technical and legal – and it may be some time before the transition to local leadership and management can be completed. GfG should continue its work with the Ministry of Tourism, Trade and Ni-Vanuatu Business, supporting formulation and implementation of the new Trade

¹ As a result of the reforms, mobile phone subscriptions increased from 4.8 per cent of the population in 2004 to 71 Per cent in 2010 (PIPP, 2012)

Policy Framework and other areas of micro-economic policy.

Given the importance of tourism to the economy and its prospects for growth GfG should continue to work in areas that can help improve the enabling environment for sustainable development of the sector, and its beneficial consequences for the people of Vanuatu. This could involve continuing to support: reform of the SOEs involved in aviation, improvements in maritime logistics, strengthening the collaboration between government and the industry in areas such as marketing and accreditation. It should also involve building on current work on investment policy.

Public finance and service delivery work

The GfG approach to and style of working with GoV on public finance matters have been effective. GfG's work seems to have been strongly aligned with the priorities of bureaucratic leadership, and, from time to time, of political leadership. It has also generally avoided the problem of being driven by concerns to implement international best practice, and has focused on dealing with specific and well identified problems in the system. And it has been continually aware of the limited capacity of government, and the vagaries of the political economy in which it operates. Work on reforms seems to have been focused on areas where forward progress would be technically and politically feasible. As such, it has been broadly consistent with current thinking on good practice in PFM reform, even before some of that thinking was articulated.

GfG's work on PFM has focused primarily on central agencies, building effectively on the foundation of earlier reforms to strengthen aggregate and specific controls over government finances, to improve the quality of expenditure planning and budgeting, and to improve revenue raising and the administration of internal and customs taxes. The design and roll out of Financial Services Bureaus was a major successful initiative. These improvements have generally been sustained and normalised into the operating behaviour of the GoV at the central level. Also, MFEM's reliance on international TA has reduced substantially over

time and this is a reflection of the substantial investments by GfG and the earlier Ministry of Finance and Economic Management Institutional Strengthening Program. (MFEM-ISP).

GfG has had some positive impact on service delivery – for example improving arrangements for school funding, the Financial Service Bureaus (FSBs) and the fiscal space created by better controls and revenue collection. However, it has arguably not delivered on all of the expectations articulated in the designs for both phases. Opportunities for GfG to leverage better outcomes have been limited. Within GoV, the relationships between the central agencies and line ministries are functional, but do not have a strong service delivery outcome-level focus, or a problem focused approach.

Perhaps reflecting the limited opportunities, there has not always been sustained coordination on common PFM challenges across the DFAT country program. This is not necessarily something GfG can easily push on without a structurally different approach across the DFAT country program to better leverage the collective value of its investments in the centre and in sectors to address public sector wide constraints to service delivery. This will be a key priority for phase 3.

GfG work in some areas was primarily constrained by limited capacity - and sometimes willingness - to progress improvements. Examples include GfG's investments in payroll budgeting and structure, public investment, SOE management, and financial accountability. Phase 3 would need to consider the balance of investments for these challenging reform fronts. We consider some priority areas for phase 3 are in:

- Improving funds flow and the level of discretion exercised outside Port Vila by using the FSBs more intensively (deconcentration). Much of this work will be within line agencies. This includes work on GoV's emerging decentralisation agenda, although the policy objectives of that are as yet unclear. And, as in every country, Vanuatu will have to manage risks from over decentralisation - be it administrative, political or fiscal.
- Revisiting the allocation and management of public servants within and between agencies,

including properly accounting for their costs, such as severances. PMO is currently assessing the machinery of government and may take a policy agenda forward. GfG may be able to assist with this, but support will have to take account of the sensitivity of the issue.

- Strengthening the reach and performance of internal audit functions, including using internal audit to systematically examine generic problem areas.

- Improving the consistency and management of procurement underpinned by external debt arrangements.
- Further work on improving the transparency and governance of SOEs including with the Asian Development Bank (ADB) and other partners.
- Working with line ministries to identify – and find ways of addressing – specific impediments to improving service delivery.

1. INTRODUCTION

This report presents the findings of an independent review of the Governance for Growth (GfG) program, examining progress with respect to its objectives of generating economic growth and improving service delivery through good governance. The review looked at contributions in the two result areas, which have been articulated as:

- Vanuatu's policy framework is more supportive of durable, equitable and broad-based growth; and
- The quality of Vanuatu's public expenditure and its management is improved.

Given the breadth of the terms of reference, the review team focussed on the extent to which GfG activity has been involved in key areas of reform, the effectiveness of its involvement and any constraints, and the broader role it has played in policy development. The key elements of the review involve assessing the activities of the GfG program and their contributions to supporting economic growth and strengthening public financial management. The review also makes some general observations about the GfG modality itself. The review does not address the question of efficiency, but does offer some reflections on sustainability, given the specific characteristics of the Vanuatu

economy, political culture and system of government.

A separate review has been commissioned of the consistency of GfG's approach with current evidence about what works in complex change environments, and how well GfG is situated in current practice and thinking about working politically. The distinction between the two reviews has been characterised in terms of the 'how' and the 'what' elements of the program with this review focusing on what GfG has achieved over the decade since the commencement of the program in 2006, with a particular emphasis on Phase II of the program (2012-16). Both reviews will inform the design of the third phase of the program.

The team undertook a desktop review of GfG design documents, periodic reviews and evaluations, and broader external analyses of economic and public financial management issues. In addition, the review interviewed a number of informants from the Governments of Vanuatu and Australia, multilateral partners, the private sector and civil society.

THE CONTEXT FOR GFG

Geography, history and culture play important roles in shaping the opportunities for and limitations to inclusive growth and improved service delivery in Vanuatu.

Analyses of Vanuatu's economy and prospects all agree that the country has comparative advantages in tourism, forestry, fishing and certain kinds of

agriculture – but exploiting these advantages faces some severe constraints arising from the country's geography, size and location. Table 1 summarises the assessment made in one of the initial reports that helped shape thinking about the GfG program.

1.1 Vanuatu's comparative advantages and inherent disadvantages

<i>Comparative advantages</i>	<i>Inherent disadvantages</i>
<ul style="list-style-type: none">▪ A relatively (to the population) massive and - with proper husbandry - productive land resource.	<ul style="list-style-type: none">▪ Very small size with none of the economies of scale in inputs (including fuel and utilities), processing or markets enjoyed by competitors.
<ul style="list-style-type: none">▪ A generally very favourable climate for agriculture (with some limitations), supporting year-round pasture and crop production (including forestry).	<ul style="list-style-type: none">▪ Geographical fragmentation with high internal transport and communication costs.
<ul style="list-style-type: none">▪ Pre-existing commercial-sector agricultural investment and processing infrastructure.	<ul style="list-style-type: none">▪ Geographical and economic isolation from large markets.
<ul style="list-style-type: none">▪ Relatively low incidence of agricultural pests and disease, naturally quarantined from the neighbouring countries.	<ul style="list-style-type: none">▪ High fixed costs of providing governance and essential services per unit of population.
<ul style="list-style-type: none">▪ A unique natural and cultural environment attractive to tourism.	<ul style="list-style-type: none">▪ Unique economic and social challenges in the interface between the 'traditional economy' and the 'modern economy'.
<ul style="list-style-type: none">▪ A maritime environment with useful (if limited) fish stocks.	<ul style="list-style-type: none">▪ Perennial cyclones, which produce occasional economic and societal shocks and restrict the range of viable crop and tree species.
<ul style="list-style-type: none">▪ Sea ports.	
<ul style="list-style-type: none">▪ A stable, comparatively well-educated society and abundant labour.	

Source: Bazelely and Mullen 2006

A snapshot of the economy

Vanuatu is predominantly rural, but urban migration is growing

- According to the 2009 census, just over three quarters of the population of 243 023 people

lived in rural areas². Only 30 per cent of the working age population received regular paid income, and subsistence agriculture and fishing was the main activity of nearly 40 per cent of the adult population living in rural areas.

- Only a third of Vanuatu's cultivable land is farmed, and productivity is low. Cash crops include coconut (exported as copra and coconut oil), cocoa and kava. Beef is the second largest export by value (after copra) sent mainly to PNG and Solomon Islands. About 40 per cent of households raise pigs. Many rural households grow traditional staples such as yam, taro, plantain and breadfruit.
- The lack of economic opportunity in rural areas, combined with poor delivery of social services' is fuelling a strong drift of people into squatter settlements around urban areas.

Services, especially tourism, play a major role in measured output.

- The national accounts statistics indicate that services account for 65 per cent of measured GDP, agriculture accounts for around a quarter and industry 8 per cent.
- The World Travel and Tourism Council estimates that tourism directly contributes nearly 19 per cent of GDP and 15 per cent of total employment. (It estimates that the total contribution of tourism amounts to nearly 50 per cent of GDP).
- Visitor exports accounted for 69 per cent of the value of total exports.

Real GDP growth has barely kept pace with population growth

- Per capita real GDP has increased by only 10 per cent since independence (Appendix chart C.1), less than 0.3 per cent on an annual basis.

Growth has been quite volatile:

- Since independence year on year growth in real GDP has swung considerably, with the 7 years 2003 to 2009 providing the longest period of growth consistently over 2 per cent a year (Appendix chart C.1). Cyclones and other weather events along with movements in international commodity prices drive some of this volatility.

Services contribute most to growth

- The national accounts statistics from VNSO show that the largest - by far - contribution to the growth in real GDP over the period 2005 to 2014 came from retail trade – 22 per cent of total growth (Appendix chart 2). Crop production, Information and Communication each contributed about 12 per cent, and Real Estate and Food and Accommodation Services, both linked closely to tourism, together contributed 15 per cent.

The story on poverty is confusing

- The application of the concept of poverty to Pacific Island Countries is often disputed, and Vanuatu is no exception.
- Applying a standard expenditure based analysis, the United Nations Development Program (UNDP) Poverty and Hardship report for Vanuatu suggests that the incidence of poverty in Vanuatu has declined slightly between 2006 and 2010 – the proportion of the population people living below the basic needs poverty line is estimated to have decreased from 13.0 to 12.7 per cent (table 2). The same source suggests that the incidence of poverty in urban areas has, however, increased significantly.

² The South Pacific Commission estimates that the population of Vanuatu is now just under 290 000, but the same proportion is estimated to live in rural areas.

1.2 Poverty headcount estimates

<i>Year</i>	<i>Vanuatu average</i>	<i>Port Vila</i>	<i>Luganville</i>	<i>Rural</i>
2006	13.0	20.1	12.2	11.5
2010	12.7	18.4	23.6	10.0

- The methodology for estimating the poverty line in 2006 has been criticised, however, and the conclusions regarding the relative levels of rural and urban poverty strongly disputed (Narsey, 2012).³ Narsey also argues that the estimates of income distribution are likely to understate actual inequality. It would seem likely that the same criticism applies to the 2010 estimates.
- A study of child poverty commissioned by UNICEF suggests that poverty is much higher in rural areas (Appendix chart C.3).

The political and institutional context for GFG

The constitution establishing Vanuatu's system of government reflects the country's colonial legacy. But the practice of government and the pursuit and exercise of political power reflects the way in which custom, geographic fragmentation and ethnic/clan/language group interactions play out within the constitutional and electoral framework. The constitution and its associated legal and judicial system clearly reflects the interplay between western and customary concepts. There is a 52 member unicameral legislature elected by universal suffrage, and an executive comprising the Prime Minister and the Council of Ministers. But the constitution establishes a formal role for traditional leaders, and enshrines a role for custom in the law, stating that 'customary law shall continue to have effect as part of the law of the Republic of

Vanuatu'. Importantly, it specifies that 'rules of custom shall form the basis of ownership and use of land'.⁴

There are in effect a number of sets of institutions (both formal and in terms of accepted 'rules of the game') that shape life in Vanuatu, and tensions between them can create significant areas of uncertainty affecting private investment – indigenous and non-indigenous.

A snapshot

The reach of the state and the formal legal system is limited

- Outside of Port Vila and Luganville, the delivery of public services has been very limited.
- Provincial and Area councils have limited resources and play very little role in service delivery.
- While the formal court system is considered to be independent and impartial, and the judiciary is greatly respected, they are physically inaccessible to large numbers of ni-Vanuatu (Forsyth, op cit).

Instability has become the norm

- Between independence in 1980 until 1991, Vanuatu had one prime minister, serving 3 terms. Since then, there have been 20 Prime Ministerial terms, with the position rotating among 10 people.

³ Narsey 2012, Poverty Analysis in Vanuatu: A Critical Analysis and Alternative Formulation, South Pacific Studies Vol.33, No.1, 2012

[http://cpi.kagoshima-u.ac.jp/publications/southpacificstudies/sps/sps33-1/South%20Pacific%20Studies%2033\(1\)%20pp25-51.pdf](http://cpi.kagoshima-u.ac.jp/publications/southpacificstudies/sps/sps33-1/South%20Pacific%20Studies%2033(1)%20pp25-51.pdf)

⁴ This is acknowledged to cause problem since there is no single customary system of land tenure in the country (Forsyth, 2009).

- Members of Parliament are often elected with very small shares of the vote in their electorate, indicating that their sense of obligations is often to a small clan or language group. Governments are formed when unstable coalitions are formed amongst groupings of politicians that have little resemblance to ideologically or issue based parties observed in western democracies.
- The resulting volatility works against pursuit of longer term policy agendas, and creates incentives for short lived coalitions held together by patronage. The most recent draft private sector assessment for Vanuatu (ADB 2016) observes that

Frequent motions of no confidence within government undermine effective policy formulation and implementation. This instability also affects the legislature's law-making role. It is a function of continued fragmentation within the political environment, with members of Parliament often elected on the expectation that they will provide access to resources and development funds, rather than on the basis of clearly articulated policy positions.

Corruption, according to western norms, is endemic

- But commentators argue that 'corruption in Vanuatu should be seen through the lens of the patrimonial system, rather than individual misconduct. The dispensing of largesse is seen as a legitimate means of obtaining status and influence. While some forms of corruption in Vanuatu carry heavy costs, and have even brought the state close to bankruptcy, most ni-Vanuatu do not recognise this as affecting their personal interests '(Cox et al, 2007).
- Like other small PICs, Vanuatu has been prone to interventions in the political system by internal and external business interests that have led to decisions that work against the longer term interest of the people.

There is a sense that the quality of governance improved significantly compared with a decade ago, but is tapering off

- Commentators suggest that the crisis-driven adoption of the ADB-led Comprehensive Reform Program (CRP) established some significant improvements in governance, but that these gains have recently been eroded (Appendix chart C.4).
- Improvements in information and communications technology (ICT) are probably improving people's knowledge about what is happening in the country, but civil society institutions do not seem to be particularly strong. (Although faith-based institutions play a strong role in Vanuatu society.)
- The public service is stretched, and administration is highly centralized – provincial and area bodies play a very limited role in service delivery or oversight.
- However, Vanuatu has not yet gone to the same extremes as PNG and Solomon Islands with the growth of politician-allocated expenditures.

Women play a very small role in formal institutions and power structures

- Legally, men and women are equal in Vanuatu, but there is an enormous division among ni-Vanuatu based on gender. Men are overwhelmingly the heads of households, are twice as likely as women to be in paid employment and hold the majority of positions of power (Forsyth, op cit).
- Custom law can operate to discriminate against women, and formal laws relating to matrimonial property, inheritance and citizenship discriminate against women (Bowman et al, 2009).

2. THE GFG PROGRAM

Australia's interaction with Vanuatu is broad, covering: economic exchange, investment and trade, some labour movement albeit at a low level, a deep and longstanding aid relationship and a security relationship. Australian aid (including regional programs) covers many sectors, enabling a wide ranging, if sometimes quiescent, relationship and associated dialogue. The evaluation team considers that implicit insurance arrangements underpin these sectoral interactions. Both parties are assuming that the aid relationship will continue into the longer term, with Australia as the largest bilateral donor and lead partner. This has important implications for the appropriate focus and time horizons for programs. The expectation is that they will be around for a long time, so should invest in and pursue longer term strategies and commit to stability in choice of activities.

Australia is an important economic partner for Vanuatu, providing the majority of tourists, foreign direct investment and aid. Australian aid promotes Australia's interest by supporting economic growth, stability and poverty reduction in Vanuatu. DFAT will provide an estimated \$62.5 million in total Official Development Assistance (ODA) to Vanuatu in 2016-17, making Australia Vanuatu's largest development partner. In addition, Australia committed \$50 million in cyclone recovery support in 2014-15.

In recent years, Australian aid has helped lift school enrolment rates to 87 per cent; reduce malaria incidence from 7 per cent to 1 per cent; and increase access to counselling and support services for thousands of women and children affected by

family and sexual violence. Australian aid has also helped maintain priority rural roads, increase government revenue, reduce electricity costs for low-income consumers and deregulate the telecommunications sector, lifting mobile subscriptions from 4.8 per cent of the population in 2004 to more than 71 per cent in 2011.

Australia's Aid Investment Plan 2015-16–2018-19 for Vanuatu proposes four strategic objectives:

- Objective 1 - Building resilient infrastructure and an environment for economic opportunity
- Objective 2: Improving early education and essential health services
- Objective 3: Improving community safety and resilience
- Objective 4: Supporting cyclone recovery and reconstruction

GfG has been a key part of Australia's program since 2007, established in the light of experience with the CRP and Australia's efforts to build Government capacity through programs such as the Ministry of Finance and Economic Management Institutional Strengthening Program (MFEM-ISP). While the CRP played an important role in helping recovery from crisis, it highlighted the limitations of formulaic approaches to reform that fail to take account of local context and capacity, and of the political economy of reform.

As the design for Phase 2 states, GfG was constructed primarily as a 'platform for effective policy dialogue, and represented an important shift, not only in what the aid program did, but 'crucially

in how it delivered effective, transformational, development assistance’.

GFG OBJECTIVES

The program objectives for the two phases are presented in table 2.2. There have been some subtle changes in the articulation of the objectives in the design for Phase 2, with a stronger emphasis on equitable growth. The design for Phase 2 also indicated that this phase would have a sharper focus on:

- improved integration and coordination of macroeconomic policy, development strategy, fiscal policy and managing donor resources; and
- extending the central system for budgeting and finance to become a Government-wide system of financial management, reporting and accountability.

(An additional result area was added to Phase 1 when GfG assumed responsibility for the Vanuatu Transport Sector Support Program: however, there was no such formal change when GfG became extensively involved in the cyclone Pam recovery effort.)

2.1 GfG Objectives Phase 1 and 2

Phase 1	
Purpose: To generate economic growth and improve service delivery through good governance	
Result area 1 Vanuatu's policy framework is more supportive of broad-based growth	Result area 2 The quality of Vanuatu's public expenditure is improved
<i>Outcome 1</i> Government develops and implements policy decisions to remove constraints to broad-based growth	<i>Outcome 4</i> The budget increasingly reflects national priorities for service delivery and investment
<i>Outcome 2</i> There is greater dissemination of information, and public debate, about economic growth and the role of government	<i>Outcome 5</i> Public financial management in line ministries and provinces is improved
<i>Outcome 3</i> Policy decisions are increasingly informed by sound research, evidence and analysis	<i>Outcome 6</i> Budget resources are increasingly used for their intended purpose
	<i>Outcome 7</i> There is stronger accountability to Parliament and the people for the results of public expenditure
Phase 2	
Purpose: To generate economic growth and improve service delivery through good governance	
Result area 1 Vanuatu's policy framework is more supportive of durable, equitable and broad-based growth	Result area 2 The quality of Vanuatu's public expenditure and its management is improved
<ul style="list-style-type: none"> ▪ <i>Better policy development</i> through better evidence, based on better analysis and better communication of policy options 	<ul style="list-style-type: none"> ▪ <i>Better policy implementation</i> through better public expenditure choices and better public expenditure management

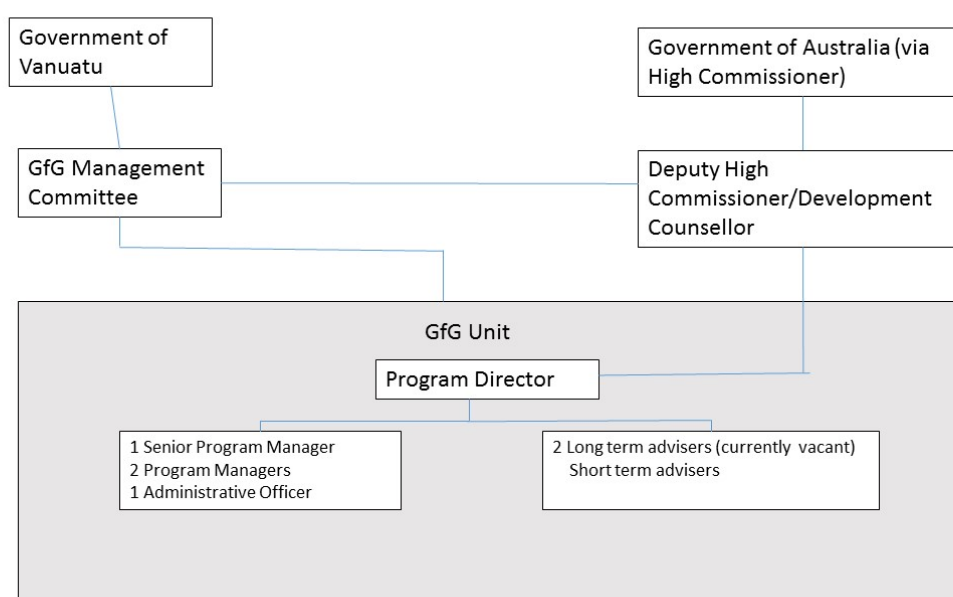
HOW GFG OPERATES – THE MODALITY AND APPROACH

At its core, GFG was intended to be a facility that acted as a broker of activities supporting locally driven reforms. It was expected to benefit from close interaction on policy development by working closely with key stakeholders in GoV, and interactions with other interested parties. This was to occur through: the management committee, regular meetings with government officials on and offsite, interactions with High Commission colleagues and other development partners, but most importantly from locating DFAT program management within the Office of the Prime Minister.

A core philosophy of the program is that the approach to relationships, particularly using High Commission officers, rather than a contractor or other intermediary to manage the program, creates a more responsive and knowledgeable program, that can better and more directly respond to GoV's needs.

The program's resources are: the implementation team (presently 4 people), grants to GoV agencies ("Direct Financing Agreements" - DFAs), and other contracting mechanisms (direct DFAT contracts), which currently include contracted administrative support to help agencies use their DFA. The GoV's resources are primarily the transactions costs of running their DFAs. The management structure for the program is summarised in chart 2.2.

2.2 The management structure of GfG



From an aid management perspective, the GfG approach is relatively intensive in the use of DFAT staff time compared with DFAT programs that are delivered through managing contractors or by a multilateral agency, such as the World Bank, the International Finance Corporation (IFC) or the ADB. This is because the team is implementing the program, making strategic calls between reform opportunities and also running the administrative

aspects of the program. Even when total resources are taken into account (including from GoV), the

modality involves lower operational costs than a comparable outsourced approach⁵.

Table 2.3 summarises the allocation of responsibility for the operation of key dimensions

of the modality – the GfG unit (staffed largely by DFAT officers) is responsible for most aspects of program management and setting the strategic direction and priorities, under the auspices of the management committee.

2.3 GfG – who does what?

<i>Program management activity</i>	<i>GfG approach</i>
Design	Joint GoV/GoA
Implementation and relationships with government	DFAT
Technical and policy dialogue	DFAT
Cost control	DFAT and GoV
Back office operations	DFAT and GoV
Monitoring	DFAT, GoV primarily
Activity selection	GoV. DFAT's agreement required
Strategic direction setting	DFAT and GoV
Accountability for outcomes	DFAT and GoV
DFAT staff time needed - intensity	High
Results and evaluation	DFAT
Coordination and complementarity with other programs	DFAT and GoV

Key features of the GfG approach are discussed below.

Co-location

A key - and unique amongst DFAT programs - feature of the program is its co-location within the PMO. The intention was to improve the opportunities for exchange of ideas on policy, and the responsiveness of DFAT to GoV proposals and ideas. It also appears that an implicit objective of co-location was to de-formalise interactions to give them some protection from exogenous political events on either side of the bilateral relationship. Judged against these objectives, the co-location approach has been successful and, almost unanimously, GoV officials felt it important to maintain this feature of the program.

Direct funding agreements (DFAs)

There is broad agreement across implementing agencies, key government stakeholders and within GfG and the Australian aid program that GfG is an effective aid modality. Providing flexible project funds and working through direct funding agreements (DFAs), GfG is able to use partner government systems, providing program ownership to the Vanuatu government while maintaining some oversight capacity for GfG (for example, no-objection clauses for recruitment and program activities). DFAs are considered a fast and responsive way of delivering aid that can be quickly tailored to the needs of government, particularly

⁵ A managing contractor would at the very least have the same staffing complement, and would charge a management fee on top of all staff costs, which is typically of the order of 15 per cent of these costs. In

addition, the cost of interaction between the program and DFAT are considerably lower when DFAT staff are in charge. Multilateral agencies also may charge significant management overheads.

when dealing with unforeseen issues. In addition, the responsiveness of DFAs is useful where political volatility in Vanuatu means policy actors need to act quickly when there is political will for reform. The approach allows GfG staff to work behind the scenes, balancing both technical and political discussions as needed. Furthermore, DFAs allow GfG's management to operate at arm's length from government-led activities, insulating Australia from criticism of direct involvement in sovereign affairs.

Using partner government systems

The use of GoV systems to engage TA and to commission and finance other activities, with assistance from the implementation team, is another important feature of the program⁶. GoV officials essentially run an agency specific budget support program, agreeing on the priorities with the GfG team and recruiting advisors and purchasing goods and services using GoV procurement systems. This arrangement started with MFEM, but has spread to other agencies. The agencies clearly like having a degree of control over implementation and choices, although DFAT has to agree. An alternative would have been for DFAT to have engaged TA directly, or use of a contractor as is widely used in other DFAT country programs (such as the Governance for Development program in Timor-Leste). It is not immediately clear what benefits this alternative would have, since the current mechanism has such buy-in from government and is operating satisfactorily in a fiduciary sense and does not appear to be imposing substantial transactions costs on DFAT or GoV.

GfG's use of government systems is seen by GoV as a clear point of difference with respect to other donor programs, and is an important contributor to the effectiveness of the program. It also allows GfG to work on issues – such as tax reform – that would not be feasible using a different modality. Also, as discussed above, the combination of co-located

management by DFAT officials and use of national systems is much more cost-effective than other modalities. Clearly there are inefficiencies in GoV's system: but having a large, politically valued program using the system increases the likelihood of reforms to address these inefficiencies. So use of national systems means that the operation as well as the substantive content of GfG contributes to PFM reform.

Where has the funding been directed?

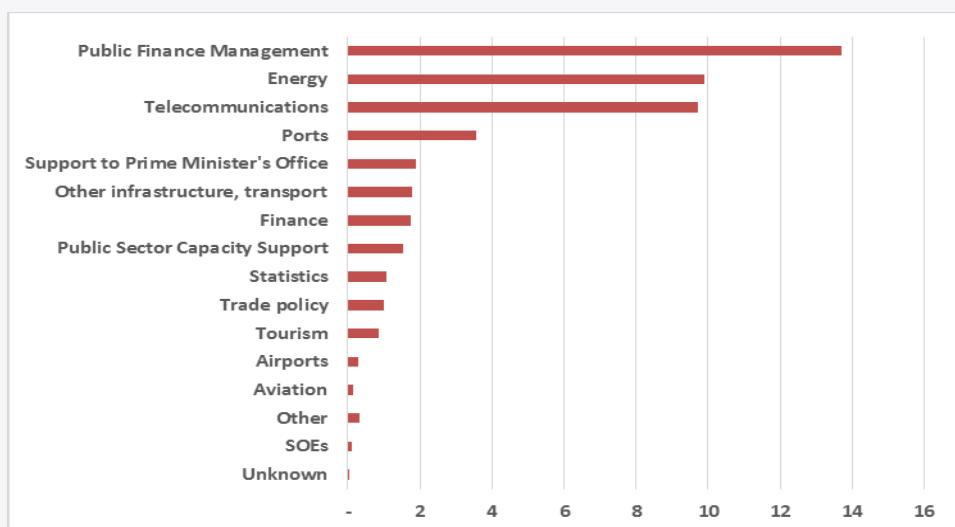
As Chart 2.4 shows, PFM (including revenue management) has absorbed the largest share of activity funding over the life of the program (28.8 per cent), followed by energy (20.8 per cent) telecommunications (20.4 per cent), ports (7.5 per cent), support to the Prime Minister's Office (4.0 per cent), other infrastructure (3.7 per cent) and finance (3.7 per cent). (Program management, not shown on the chart, accounted for 8.9 per cent of *total* program costs.)

About 23.3 per cent of activity funding went to support the two regulatory agencies, the TRR (12.6 per cent) and the URA (10.7 per cent). Just over third of funding was spent on TA, 24.3 per cent on salaries of specific officials/positions funded by the program, and 6.8 per cent on studies.

It is a little difficult to determine all of the agencies that have benefitted from GfG support. But at least a third of funding has been directed at two central agencies: MFEM and PMO. The Department of Energy in the Ministry of Climate Change and Energy, the Ministry of Trade, Tourism and Ni-Vanuatu Business and the National Statistics Office have all been targeted by GfG funding, along with the Office of the Auditor General and the Office of the Government Chief Information Officer.

2.4 Program expenditure by area/sector, 2007/08 to 2015/16, \$ million^a

⁶ Budget support arrangements using government systems are in use in Samoa, Tonga, Tuvalu and Timor-Leste (until mid-2016).



^a Excludes program management and administration
Data source: Data supplied by GfG program

Because, as discussed later in this report, there are some clear links – direct and indirect – between improving public financial management and enabling growth, it is a bit problematic trying to definitively ‘carve up’ GfG funding between the two objectives. Some funding beyond the 28.8 per cent mentioned above has been used to support PFM related activities (for example, employment of a PFM advisor funded out of program management costs). But the support that GfG has given to reforms in the telecommunications, energy, ports, infrastructure and finance – and the bodies working in these areas - has demonstrably had a *direct* effect on important constraints to business development and growth.

It is also apparent from the information on use of GfG funds that the program has not only helped with formulation of policy – with research, TA, and help with consultation, but most importantly it has continued support for implementation, including with longer term capacity supplementation.

Where has GfG management spent its time?

The report from the GfG Annual Monitoring Report for 2015 observed that:

Tracking the time spent on types of contacts over the last two years has confirmed the impression that too much senior level time has

been spent in supporting existing partnerships at the expense of wider relationship building.

And since early 2015, GfG has spent a lot of time assisting with the Cyclone Pam recovery effort, so that there was limited opportunity to devote more time to building new relationships. The use of Direct Funding Agreements, while demonstrating a very important commitment to the use of national systems does mean that the GfG team spends a lot of time on administrative matters and trying to expedite progress.

One thing that has emerged quite clearly is that GfG has somewhat limited relationships with private sector and business associations. GfG has provided support to the Vanuatu Tourism Office, which works directly with the private sector, has provided funding for training delivered by the Vanuatu Chamber of Commerce and Industry (VCCI), and also participated in Chamber board meetings as an observer. But it has not made much progress in creating platforms for improved public-private sector consultation. This could in part be a result of where GfG is located, the perceived constraints of its mandate, and the palpably problematic relationship between the government and the non-ni Vanuatu businesses which seem to dominate the formal private sector and its representative bodies. However, for a program aimed at supporting broad-based growth, this is a gap.

The limited interaction with the private sector is also a potential concern because of the extent to which some business interests try to influence policy through direct interactions with the political process. Rather than promoting pro-business reform, some parts of the business community appear to seek selective benefits: a situation which tends to reinforce negative attitudes towards the private sector with government. A strong open platform for government interaction with the business community could make an important contribution to counteracting these tendencies, as well as providing policy makers with an important source of information about priorities and implementation issues. (This is perhaps something that GfG could pursue working with partners such as the IFC or the ADB managed Pacific Private Sector Development Initiative (PPSDI).)

The management committee of GfG is generally seen as a positive and efficient mechanism for bringing matters to the attention of GfG, seeking further assistance and a means of engaging in policy dialogue. It is also regarded as an avenue through which GfG could play more of a brokering role, between MFEM and other ministries, where outreach work by MFEM seems to be poor. However, management committee meetings have been sporadic, and the opportunity that regular committee meetings could provide to strengthen the policy dialogue and strategic thinking role of GfG has not been fully realised. The management committee could enable GfG to play a greater convening role, engaging in direction setting and activity and sector coordination.

Capacity constraints on GfG


Some informants indicated that although GfG's design was intended to enable a high degree of responsiveness, capacity constraints in the GfG team, given the volume of work, meant it has not been as responsive as desired. Time dedicated to 'urgent' program management issues can come at the expense of strategic planning, analysis and coordination.

Stakeholder relationships and champions of reform

GfG has clearly developed strong relationships within key parts of the public sector: predominantly central agencies and regulatory bodies. It has also developed effective relationships with other partners and institutions as a result of its role in brokering inputs and engagement from agencies with specific technical and project expertise, such as the World Bank's Pacific Regional Infrastructure Facility, the IFC, the and the ADB-managed PSDI. However, apart perhaps for its engagement with the Trade Development Division in the Ministry of Tourism, Trade, Commerce and Ni-Vanuatu Business, GfG does not seem to have significantly expanded the range of agencies with which it engages since the beginning of Phase II. Some informants contend that GfG's relationship building has occasionally been too narrow, engaging with single individuals within government rather than a broader coalition. This can be problematic, particularly if these key individuals act as roadblocks, or, when they have been champions of reform, they move on leaving a hiatus.

The Design of Phase II of GfG suggested that the program needed to move from supporting champions for change to helping build coalitions for reform. This does not really seem to have occurred. It is clearly not easy to bring about, but entrepreneurs in the private sector ought to be candidates for growth-oriented reform coalitions. GfG also faces problems finding support for broader governance reforms, since civil society, the obvious source of such support, is relatively weak in Vanuatu.

This is not only a challenge for regulatory reform and efforts to promote competition, but also for reforms of public finance. The Ministry of Finance has been quite effective in creating a culture of compliance for the value added tax, with a mix of enforcement and education and support to the business sector, so there are examples that can be drawn on. Multiple avenues to engage and champions for change might avoid some of the problems of key individuals acting as roadblocks. GfG staff clearly have to move carefully with



respect to taking a stronger public profile to promote discussion of reforms and their benefits. However, the program could perhaps use its research resources to bring people – researchers and policy makers – from the Pacific and elsewhere to discuss lessons of policy reform in public or closed session forums. There are, for example, former ministers of finance from other Pacific countries who could talk with authority about the institutional and political dimensions of public

finance reform, and GfG might also be able to bring staff and leaders of regional organisations to Port Vila to engage in a dialogue concerning reform. And as mentioned above, GfG could encourage partners such as the World Bank, IFC and ADB to work on coalition building. There could also be some potential to work with the University of the South Pacific to organise forums/seminars to foster public discussion of policy issues.

3. GfG AND THE GROWTH AGENDA

The terms of reference for this study poses a set of questions that can be used to evaluate the actual and potential contribution of GfG to growth in Vanuatu. This section addresses each of these questions.

ALIGNMENT WITH EXTERNAL ANALYSES AND DESIGN INVESTMENT CRITERIA

The TOR ask how has GfG aligned with the recent economic analyses of the opportunities for growth in Vanuatu (and the investment criteria in its design) since its establishment

Across both of its Phases, GfG has maintained a strong focus on helping to ensure that Vanuatu's policy framework is supportive of broad-based growth, and the designs for both Phases gave clear guidance on the kinds of activities the program might engage in pursuit of this objective.

In Phase I, the design was much more prescriptive, identifying specific projects and sub-programs for GfG (including work in the power, telecommunications, aviation, and agricultural marketing sectors) and targeting support to improve the evidence base for and public debate about economic growth and the role of

government. This was possible in part because the government of the day had already articulated priorities for reform, and also because there were previously identified areas for change where a way forward was relatively clear and subject to substantive agreement.

The Design document for Phase II of GfG was less prescriptive, but laid out a set of criteria for deciding on significant interventions – see Box 3.1.

The findings of the recent economic analyses of opportunities for and constraints to growth are summarised in Appendix B.

These studies have looked at the issues through a number of different lenses.

- Some have looked at constraints only, from an economic perspective examining factors that might reduce private investment (opportunities and constraints analysis and growth diagnostics), or from a legalistic and procedural perspective that might be taken by formal, larger scale enterprises, especially foreign invested enterprises (private sector assessments, doing business analyses and enterprise surveys). Some of these have 'dipped their toes' into the question of why impediments to investment exist or might persist, alluding to aspects of the underlying institutional and political systems and processes in which policies are developed and implementation is motivated.

3.1 Investment criteria for Phase II

The design of Phase II of GFG specified that the criteria for deciding when to become significantly engaged on an issue should include that the intervention will assist in:

- Easing a major constraint on economic growth by way of skills, technology, finance, business services and support, financial and commercial literacy, bottlenecks in key infrastructure;
- Facilitating better decision making about the directions of public expenditure including aid sourced funds;
- Lifting the capability of a ministry with big development impacts to improve its policy formulation and service delivery;
- Creating and promote better service delivery in the rural areas and small towns;
- Creating a more enabling and supportive environment for the development of the private sector;
- Improving the effectiveness of regulations that impact on businesses, investors and consumers;
- Making Vanuatu more attractive to quality foreign investment.

- Others have taken a more historical and cultural perspective to explore the observed behaviour of political representatives and leaders (drivers of change), and how customary practices impact on the policy and institutional environment for private sector development and growth.

- Most analyses have alluded to the challenges created by political instability and the clientelist nature of Vanuatu's politics, in terms of its impacts on policy making and implementation⁷:

- policies are seen as too inconsistent and short-lived, policy making is insufficiently inclusive and politicians have little incentive to focus on national as opposed to local or sectional well-being or to perceive the costs of patronage and erosion of institutional integrity.

Some analyses have attempted to prioritise actions, and some have presented long lists of recommended actions. Some have acknowledged the truly binding constraint of public sector capacity and its implications for policy and

institutional reform, but few have considered what it means for sustainability and partner choices about capacity related support.

Where analyses have bothered to identify successes, they have nominated:

- Fiscal and monetary stability since the implementation of the Comprehensive Reform Program in the early 2000s.
- Telecommunications reform.
- Liberalisation of airline services.
- Policies towards foreign investment in tourism and real estate.

There is a broad consensus about what might be described as 'objective' constraints to growth, including:

- Geography – isolation and fragmentation.
- Size – small markets, limited opportunities to achieve economies of scale, high fixed costs of service provision.
- Vulnerability to weather related shocks.

⁷ Note that some commentators have challenged the use of the term 'clientilistic' to describe Melanesian politics, suggesting that it

conveys an inaccurate sense of the links that drive electioneering and the obligations that candidates accumulate, and preferring to see it as kin-based – see Hiriasia 2016.

And there is consensus about some issues that could be addressed by government or where solutions could be facilitated by policy reform:

- Poor quality and high cost infrastructure.
- Constrained connectivity- physical (inter-island shipping) and electronic (high cost internet).
- Inadequate regulation of natural monopolies (a common occurrence given the size and fragmentation of the market) leading to high cost business inputs.
- Low human capital from limited reach of the health and education systems.
- Difficulties with access to land, and problems with the land leasing system that constrain investment and access to finance.
- Limited delivery of financial services, and lack of innovation by the financial system.
- Limitations of the legal and judicial underpinnings of market transactions.
- Poor governance and management of State-Owned Enterprises, particularly those involved in aviation and commodity marketing and parts of the financial system.

More intermittently explored are issues such as:

- The interactions between traditional quasi-subsistence and the modern cash economy, the pressures that population growth are placing on traditional livelihood strategies, and the limited reach of services (publicly and privately provided) outside of Port Vila and Luganville.
- Growing geographic, ethnic and gender-based disparities in income and asset ownership, and the extent to which growth is not translating into an equitable increase in standards of living.
- The poor quality of the interaction/partnership between the formal and informal private sector and the government, characterized, among other things by limited communication and consultation about policy and institutional change, and private sector funding of clientelist behaviour by politicians.

- Limited support for engagement with international markets – trade facilitation, market entry
- The variable quality of donor engagement and its effect on government behaviour.
- The importance of improved PFM to service delivery and macroeconomic stability.

It is sometimes a bit hard to gauge from these reports how important some identified constraints really are. The ADB Private Sector Assessments seem to imply that there are significant problems with the business enabling environment. But Vanuatu ranks 94 out of 189 countries in the World Bank's Doing Business indicator assessment, higher than any other Pacific Island Country covered by the indicators. And the 2009 Enterprise Survey paints a quite positive picture, showing that Vanuatu performs better than the average for lower middle income countries for all but a limited set of indicators (losses due to theft, security costs and time to clear imports through customs). The survey also shows hardly any firms identifying access to land as the main obstacle – but it is worth noting that a survey of MSMEs including stakeholders in outer islands did find that land was a problem (AIMS 2011).

A final observation about these analyses is that while most suggest things that ought to be done to facilitate growth, only a few offer suggestions as to how these issues should be addressed within the social and political reality of Vanuatu, and taking account of the binding human capacity constraint. (The ADB has acknowledged the limitations of a conventional approach to improving the business environment, observing, with respect to the 10 Pacific Island Countries (PIC-10) where it has operations that

...implementing the full range of complex policy and regulatory reforms is likely to be beyond the reach or needs of most of the PIC-10 and certainly of the smallest. Private sector development initiatives are still worth pursuing, and sound macroeconomic management is relevant—over-regulated and outdated legal structures also impose costs on domestic businesses—but taken alone these reform measures will not be sufficient to offset the

severe cost disadvantages of isolation. (ADB 2015).

But this still does recognise the political and cultural issues that proponents of reform have to work with.)

These analyses identify specific policy issues concerning connectivity, business input costs, access to and the competitiveness of financial services, governance of SOEs, low worker skills, the legal underpinnings of market transactions and land leasing. But most have also pointed to ongoing instability and clientilism of the political system as an underlying driver of inadequate policy formulation and implementation and delivery of public services, which exacerbates the objective constraints of size and fragmentation.

Because of its design, location and strong focus on supporting the Government's own priorities, GfG has been primarily concerned with alignment with local reform priorities. These priorities have clearly been informed by the external analyses supported by partners and academic institutions, but GfG has been limited in the extent to which it can propose reforms and investments that are not on the agenda of the political leadership of the day. Further, GfG has been intended to act as a facilitator, adviser and broker of regulatory reform, rather than a funder and implementer of programs and projects. (There was a period in which GfG took responsibility for a major transactional investment (the Vanuatu Transport Sector Strengthening Program), but this was seen as creating a significant diversion of effort away from the GfG's primary business (Program Design Document for Phase II).)

For these reasons, there are elements of the external analyses that GfG was not designed or expected to tackle head on —including those

related to the way in which the political system operates. GfG's implicit strategy to deal with Vanuatu's political apparatus appears to be to couple opportunism with continued efforts to sustain the capability of independent institutions, central agencies and the Public Service so they can be a bulwark against the consequences of political instability and clientilism.

And there are other areas, such as land reform and corporate and finance law where other parts of the Australian aid program — or initiatives it funds -have been providing assistance with reform⁸, or interisland shipping, where other partners have been taking the lead.

That said, GfG has clearly been working — and achieving results - in areas identified by the analyses, as table 3.2 suggests. However, while GfG has had some kind of engagement in most issues, the quality and intensity of the engagement varies considerably. It has operated most effectively in telecommunications and energy reform, has an important stake in improving the efficiency of port operations and access to financial services and its work in PFM and revenue administration is playing a key role in improving the overall environment for business development. It has also taken a lead role in work on trade policy and trade facilitation. GfG plays an important role as donor coordinator for the Extended Integrated Framework, and this is an area where GfG senior management should be able to play an informal advisory role — for example with respect to adoption of a competition policy⁹.

GfG seems to have had less traction on SOE and aviation sector reform, and has not entered into land issues at the termination of previous Australian aid work in this field. Nor has it worked very much on legislative and regulatory issues affecting business establishment and operations.

⁸ The Vanuatu Short-Term Land Reform Initiatives Project (2007-2010) and the Mama Graon Vanuatu Land Program (2011-2016), Private Sector Development Initiative.

⁹ As long, of course, as this support is not seen to be unduly or overtly linked to Australia's commercial and strategic interests in the Pacific region.

3.2 GfG's work on growth opportunities and constraints

	<i>Activities</i>
Opportunity area	
Tourism	<ul style="list-style-type: none"> ▪ Support to the Vanuatu Tourism Office (VTO) for country branding and marketing ▪ Support for reforms and investment in sectors crucial to tourism – aviation, ports
Rural/agricultural development	<ul style="list-style-type: none"> ▪ Management of road construction program ▪ Support to mobile banking, rural finance ▪ Analysis to support reform of commodity marketing ▪ Support for rural electrification
Constraint area	
Poor quality and high cost of infrastructure	<ul style="list-style-type: none"> ▪ Support to port and aviation infrastructure reform ▪ Design and management of VTSSP and support to transport sector investment– road infrastructure ▪ Energy infrastructure?
Constrained connectivity	<ul style="list-style-type: none"> ▪ Support to telecoms liberalization, universal access, operation of regulator ▪ Support to improve efficiency of ports and border processing ▪ Support to development of trade policy framework and work on trade facilitation
Regulation of natural monopolies	<ul style="list-style-type: none"> ▪ Support to establish and operate Utilities Regulatory Authority, including energy sector regulation, concession tendering, increasing access to power, support for port sector reforms
Access to land	<ul style="list-style-type: none"> ▪ No engagement - Issues addressed by other elements of Australian Aid program
Access to finance	<ul style="list-style-type: none"> ▪ Support to mobile banking, use of ICT in rural finance
Legal and judicial underpinnings of market system	<ul style="list-style-type: none"> ▪ Limited engagement - some issues addressed by Australian-funded Private Sector Development Initiative
State owned enterprises	<ul style="list-style-type: none"> ▪ Support for reform of commodities board, Air Vanuatu and Aviation Vanuatu Limited, also being addressed through PPSDI
Low human capital	<ul style="list-style-type: none"> ▪ PFM support for school grants program to enable introduction of universal fee-free primary school access
Limited reach of services	<ul style="list-style-type: none"> ▪ Support for establishment of Financial Service Bureaus
Increasing inequality, gender disparities	<ul style="list-style-type: none"> ▪ Limited engagement - support to urban development program, support for gender impact studies, youth sector grants
Poor public/private sector interaction	<ul style="list-style-type: none"> ▪ Limited engagement - funded training by VCCI, some activities, for example in energy and transport infrastructure created opportunities for private sector
Donor engagement quality	<ul style="list-style-type: none"> ▪ Limited engagement in whole of government aid coordination, but assisted with the establishment of the National Trade Development Committee to coordinate trade related assistance, often cited by institutions like the WTO as a good practice example of government led coordination
Support for international trading	<ul style="list-style-type: none"> ▪ Support to development of trade policy, coordination of trade related assistance, customs management systems

BALANCE BETWEEN GROWTH AND PARTICIPATION

The TOR ask how has GfG managed the balance between promoting growth and promoting participation in the economy

There are a couple of key dimensions to the issue of participation/inclusion: gender, ethnicity, rural/urban. In practice these overlap:

- Gender: women's empowerment challenges are probably different across the rural/urban divide, where the predominant livelihoods shift from quasi-subsistence traditional utilisation of land and marine resources to formal and informal cash oriented employment and business. But in both locations, custom, and the strongly patriarchal structures that it supports, play an important role in shaping the economic participation of women and girls.
- The larger formal sector activities have significant differences with respect to ethnicity: tourism and financial services are frequently managed and generate income for expatriate or non-Ni Vanuatu residents, whereas government, the main wage employer, is the domain of indigenous nationals.
- It seems that a large proportion of the population is still involved in quasi-subsistence livelihoods, where the interaction with the cash economy is intermittent, driven by specific needs (for example school fees).
- The geographic issues of participation go considerably beyond a simple rural/urban dichotomy. Vanuatu has over 100 different language groups, and across the 65 or so inhabited islands, island loyalties and linkages are very important to ni-Vanuatu people's sense of identity. This manifests itself in the nature of

political representation, and has an impact on the spread of services and economic benefits more equitably across islands.

GfG has focused more on removing economy-wide impediments to growth than on improving economic participation and inclusion. This said, a number of its activities would have indirectly (and in some cases directly) addressed some of the impediments to participation:

- GfG's work on communications, connectivity and finance is helping reduce objective impediments to greater engagement with the cash economy, and its work on PFM - especially the introduction of FSBs - is increasing the reach (slowly) of public services to these people.
- GfG's work on the overall enabling environment and access to financial services could have a positive effect on women's economic empowerment. (A study commissioned by AusAID and the World Bank concluded that many of the constraints to doing business in Vanuatu bear particularly hard on women entrepreneurs (Bowman et al, 2009))
 - GfG's new mobile banking program with NBV, was designed with a gender focus building on earlier NBV programs, which have themselves had important gender results: in 2015, almost 3,500 women participated in NBV financial literacy training, over 3,000 women opened new bank accounts and 382 women received microloans to the value of A\$1.2m.

However, it is clear that GfG has *not* developed an overarching analytical basis to inform a more targeted approach to inclusion and participation¹⁰. This would be necessary, especially if GfG is to make a stronger contribution to women's economic empowerment, given the 'significant marginalization of women from pertinent discussions and decisions on areas of social and economic development, governance and human rights at community and national levels'¹¹ Analytical work would also be an important starting point for

¹⁰ GfG has, however, supported studies looking at the gender impact of programs, such as the VTSP, the Vanuatu Lighting Program and work on telecommunications

¹¹ Department of Women's Affairs, *Gender, Kastom and Domestic Violence*

addressing the limited interest that senior levels of government have in working on gender issues. And it would be useful for GfG to explore possible areas of cooperation with the Department of Women's Affairs in the Ministry of Justice and Community Service.

It also does not seem that GfG has devoted much time to questions associated with agriculture, which could assist with increasing participation in rural communities¹². GfG is not well placed to engage directly in agricultural issues, but might well be able to support work on policy issues that are identified by other programs working in the area – such as the Pacific Horticultural and Agricultural Market Access (PHAMA) program. It might also be in a position to help with analysis and monitoring of Vanuatu's participation in seasonal and temporary migration schemes.

LINKAGES BETWEEN GROWTH AND PFM OBJECTIVES

The TOR ask what are the links between the two halves of GfG's objectives (the policy framework for growth and public financial management)? To what extent has GfG exploited the links?

Improved PFM has some important impacts on the environment for investment and growth.

- A government that clearly has control over its finances and reduces the risk of fiscal crisis creates a climate supportive of investor confidence.
- In the longer term, improved PFM is critical to getting better delivery of government services: health, education, infrastructure, the institutional underpinnings of market

transactions and business such as law and order, trade facilitation, defence of property rights (customary and modern). This is important to enable the investment and human capital expansion that will generate the productivity gains that will underpin growth

- Improving the governance and operation of SOE's, and putting the funding of community service obligations (for example in inter-island shipping) onto a sustainable basis can help improve the quality and cost of business services, help improve connectivity.
- Changes in the way that government manages activities has created opportunities for business development (island businesses supported by the nature of procurement and the establishment of FSBs facilitating payment for services outside of the main urban centres). Similarly, improvements in procurement practices will increase opportunities for local businesses.
- Vanuatu's exposure to climate and weather related shocks creates whole of economy risks that the government is called on to mitigate and finance recovery from. Improved PFM is important to create fiscal space and management capacity to support recovery efforts and minimise impacts on growth.
- Well-designed tax policy and tax administration reform can help reduce the economic distortions associated with raising revenue, and facilitate a culture of compliance that does not provide disincentives to enterprise formalization and expansion, or entrench established players with connections who can 'play' the system.

Conversely, a stronger private sector and a growing economy can contribute to improving PFM:

- Obviously, a growing economy will, with an appropriately designed tax system, expand the base for revenue raising and assist with meeting the government's fiscal targets and its ability to expand funding of services.

¹² Apart from support given to the proposed reform of the Vanuatu Commodities Marketing Board.

- A stronger private sector can also assist government to pursue more efficient ways of delivering services: public private partnerships and contracting out can become plausible options for addressing poor performance of SOEs, improving delivery of public works, outsourcing administrative functions and providing support services to government (for example, ICT).

GfG has probably not exploited these links as much as might have been expected. There are a couple of reasons why this may have been the case:

- The central agencies – PMO and MFEM - with which GfG works on PFM and planning may not appreciate the potential contribution that a growing private sector can make to overarching development goals. This may in part be a consequence of the large role that development assistance plays in financing government expenditure – and absorbing the time of officials, as well as the serious cultural disconnects that seem to plague government-private sector interactions
- GfG and its government partners have not been very good at communicating to the private sector and the community at large the rationale and impacts of policies and programs. The current initiative to introduce an income tax has demonstrated the need for more consistent and timely engagement with the private sector on issues that will have a significant effect on business.
- GfG's engagement with growth has focused more on continuing ongoing initiatives and managing governments with less interest in reform and higher propensities to create risks to, rather than opportunities for, growth. This means that there has been less room to pursue opportunities in the interface between PFM and growth.

CONCLUSION

The bulk of GfG's work on the growth agenda has been predicated on the view that regulatory reform, better sectoral policies and improved governance are pre-requisites for growth. In this

regard, its work has been in line with much of the analysis undertaken by international agencies and researchers.

And this work has delivered some impressive consequences for growth. The reform of the telecommunications sector has led to GDP being one per cent higher than it would have otherwise been (GfG Phase II design, AusAID 2012). Very few single reforms can claim this kind of impact, and given the opportunities the reform has created, the benefits appear to have been very widespread. And its support to rural electrification, by increasing access, looks likely to complement the activities of the Utilities Regulatory Authority in regulating the activities of local monopolies supplying energy in urban areas. GfG has also played an important role in improving connectivity – internal and external – with its work on ports, aviation trade policy and border processing.

GfG has had less success working in some areas, such as the operation of SOEs involved in commodities marketing and aviation, where reform could be expected to be important for growth in agriculture and tourism, sectors that are important for livelihoods and income growth for a large proportion of the people of Vanuatu. It has also not touched the land issue – in part because of other elements of Australia's aid have been operating in this sector: but this remains a field where reform will have to be pursued at some stage to improve access to and social returns from such an economically and culturally important resource.

Perhaps the bigger questions about GfG's work in growth concern:

- Inclusivity, given that most of its attention has been devoted to economy wide barriers, rather than issues that may affect particular segments of the population
 - Especially gender, but also importantly the distribution of growth opportunities in outlying islands, and the need to meet the challenge of rural-urban migration.
- Sustainability, given the capacity limitations and political volatility experience by the country
 - In particular, sustaining reforms whose continued efficacy is based on the

- operation of ‘independent’ institutions dealing with complex regulatory issues
- The apparent absence of a strong constituency for market-based reforms,

especially the lack of a productive engagement between politicians, bureaucrats and the formal private sector.

4. GFG AND PUBLIC FINANCIAL MANAGEMENT, PUBLIC EXPENDITURE MANAGEMENT AND PUBLIC SECTOR MANAGEMENT

In both of its phases, GfG's work on public finance was explicitly expected to contribute to improved service delivery, as the articulation of program purpose makes very clear (see table 2.1). Objectives being pursued to help deliver this intent included: that budgets should properly reflect development priorities, that there should be better financial management in line ministries, that budget resources should be used as intended and that accountability should improve.

In Vanuatu as elsewhere, the key areas that underpin service delivery outcomes are the settings and performance of:

- public financial management (PFM);
- public expenditure management (PEM);
- public sector management (PSM); and
- macro-fiscal policy

This section considers GfG's work on PFM, PEM and PSM as a single set of initiatives. As the designs for both phases recognised, these government functions *jointly* need to be in a satisfactory shape for public services to have a chance of being delivered as intended. Not every element needs to be performing *perfectly* and some parts not working at all might not be a problem – it depends. However, each element needs to be *concurrently*

functional in some regard to have any hope of increasing the reach of public services. This is also the headline message from global experience¹³.

The experience in Vanuatu and elsewhere has shown that the impacts of better practice and sustained reform on the quality and reach of public services are diffuse and heterogeneous. In particular, reforms to central PFM, PEM and PSM systems can only go so far. They need the “software” of application at the line ministry level to make any meaningful impact on services.

In smaller countries like Vanuatu where Australian aid is substantial, having a broad and deep relationship across the public sector offers the chance to make programs that have joint objectives in key areas relating to PFM, PEM, PSM and service delivery. This potentially allows for a strong and consistent “joint and several” push on substantial public sector wide constraints, by explicitly involving activities across the country program. But it also requires coordination across complementary efforts supported by other partners, bilateral and multilateral (primarily ADB, Pacific Financial Technical Assistance Centre (PFTAC), Japan, World Bank, several UN agencies, the European Union (EU) and IFC).

¹³ See, for example, *Public Sector Reform: what works and why?* (World Bank 2008)

In practice, leveraging better *overall* outcomes from public spending is not an easy task for bilateral donors, particularly in small Pacific Island countries.

In part this is down to administrative structures. Donor programs are nearly always set up as stovepipes, with central and regulatory agency programs and line ministry sector programming separated. These then need to be coordinated with government policy objectives and political cycles. Australian aid in Vanuatu is no exception to this.

But the problems also lie in how reforms are identified and prioritised, and how they take account of country context. A recent analysis (Haque et al 2016) commissioned by DFAT, the World Bank and the New Zealand Ministry of Foreign Affairs and Trade observed that donor supported PFM reforms in the Pacific typically:

- were excessively complex;
- failed to reflect the political economy context within Pacific Island countries;
- did not have an adequate, formal prioritization process;
- responded to incentives to all parties to do more (when capacity to implement existing systems, let alone manage and deliver reforms was very limited);
- embodied development partner incentives to support best practice (rather than solving specific dysfunctions in existing systems); and
- had very superficial coordination across partners and initiatives.

The report's suggestions for producing more successful PFM reforms in the Pacific are summarised in Box 4.1.

4.1 Towards more successful PFM reforms in the Pacific

A recent report commissioned by DFAT, the World Bank and NZ MFAT observed that the more successful PFM reforms in the Pacific were those that:

- addressed a problem that has broad political support or is managed by relatively few actors, and where there is good local evidence that PFM weaknesses affect fiscal management or service delivery.
- strengthened pre-existing systems for basic control and resource management, rather than new, additional systems that mimic the logic of PFM systems elsewhere.
- clearly recognised the capacity constraints of the government and the political economy in which it operates.
- are the result of a clear prioritisation process, rather than attempts to support a 'comprehensive' roadmap.

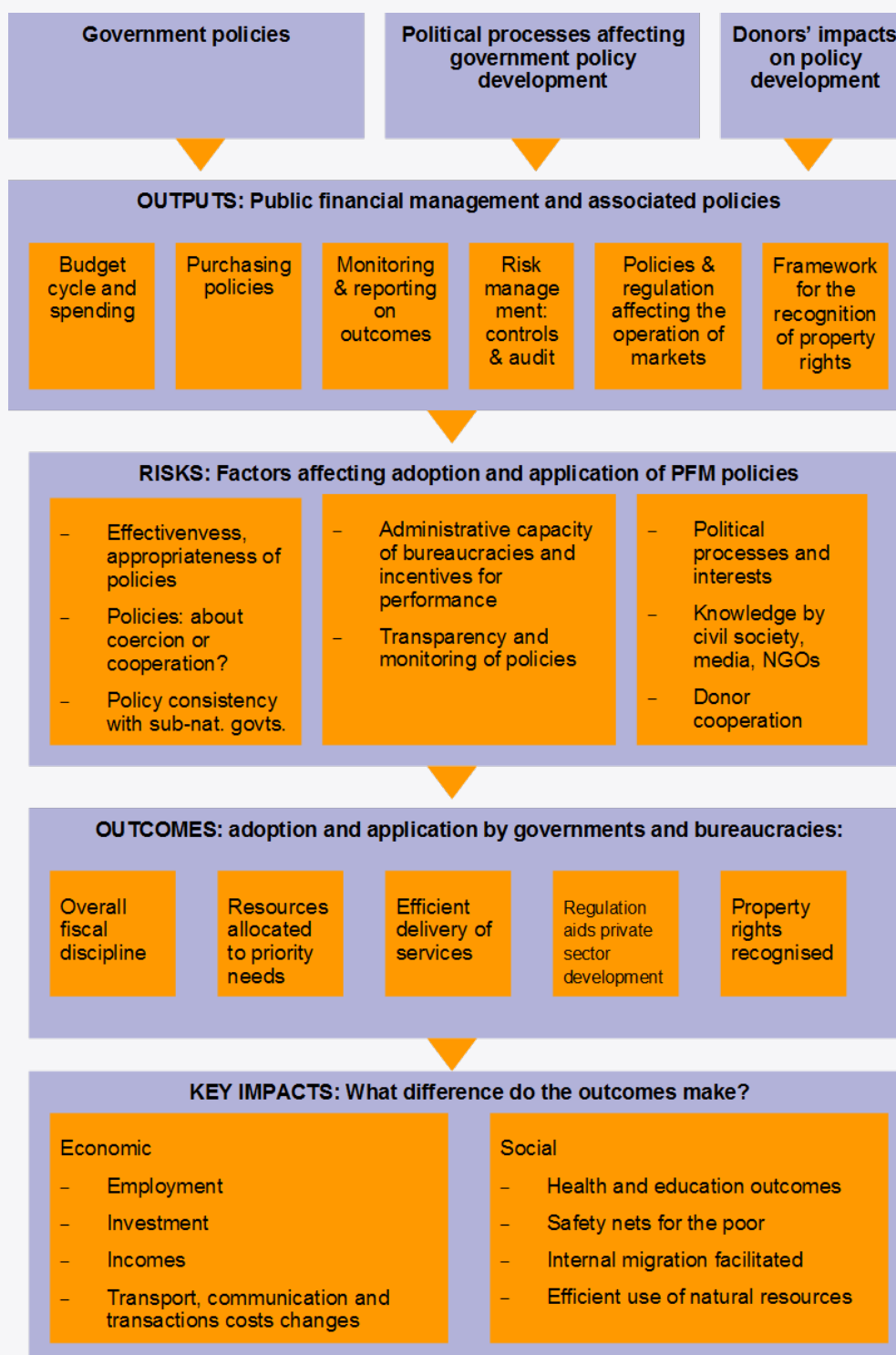
The report argued that to be useful, PFM reform needed be driven by country-specific problems, rather than notions of best practice built on experience in OECD countries. Specific elements of a problem driven approach would include:

- rigorous, problem driven prioritisation with a mix of inclusive consultation on problems (which would include, inter alia, line ministries) and more technical consultation on solutions;
- improved coordination, that might include a mechanism to allow all development partners the opportunity to peer review all terms of reference and project designs with a focus on ensuring that all initiatives: i) reflect country context; ii) are consistent with the activities of other development partners; and iii) are viable within capacity constraints and the country political context.
- a concerted effort to adopt problem-driven approaches, accompanied by less reliance on Public Expenditure and Financial Accountability (PEFA) scores as a basis for prioritization.

Source Haque et al 2016

Constructing and implementing reforms, and supporting them with TA, across the spectrum of government functions to deliver better macroeconomic management and service delivery is complex. Chart 4.2 illustrates the critical role that political and bureaucratic culture and capability play in shaping the impact that donor support can have on social and economic outcomes.

4.2 Logical framework for GfG's potential channels of impact on economic and social outcomes



As the framework in Chart 4.2 suggests, it is essential to recognise the way in which politics and the interventions of a broader range of stakeholders affect the implementation (and design) of PFM and other policies. Technical reforms need to be politically minded to have a chance of progressing, and the broader political economy and the risks and incentives it creates is a central consideration. GfG and similar programs in the economic governance and PFM, PEM and PSM space operate knowing that much of their work may be stymied as one or more of the risks eventuate, but some initiatives will be adopted. GfG's challenge has been to choose the activities that bear most strongly on the problems that stand in the way of better service delivery and fiscal management *and* have the highest chance of adoption.

PFM, PEM AND PSM: INITIAL PRIORITIES FOR GFG

There appears to be no formal roadmap or strategy document agreed with GoV that lays out the basis and rationale for the work that GfG has supported in the PFM/PEM/PSM space, or how that work should link in with the GoV's own plans for improving PFM and service delivery. However, GfG did commission an early study to examine opportunities for GfG to strengthen PFM, which according to the design for Phase 1

...looked systematically at PFM across the service delivery chain from budget formulation, execution and monitoring, based

on wide consultation with stakeholders. The aim was to identify key risk areas impacting on the ability to deliver services and practical opportunities for GFG to make improvements. (GFG design, 2007 p 83)

This assessment observed that:

- Vanuatu had a strong PFM system to build on, that was however dependent on a relatively small pool of skilled and committed individuals.
- Financial management capacity diminished away from the centre: strong aggregate financial controls were not ensuring that funds in Port Vila were translated into good quality services. Capacity in line ministries was limited, and was very weak in the provinces. There was strong support for introducing means, such as shared financial services bureaus, to improve financial control in line ministries, particularly outside of Port Vila.
- Donors, and the sector ministries they supported, were keen to make greater use of government systems in delivery of aid programs, which placed a premium on providing assurances and accountability around the use and impact of funds.

The assessment also prioritised the areas that GfG could focus on and also estimated for how long it should provide the GoV assistance to sufficiently improve policy or practice (see table 4.3). It seems the assessment was intended to form a structured basis for the development of the work plan for GfG. The priorities are mainly issues that can be worked on from the central agencies.

4.3 Priorities for improving budget management for GfG (2007 assessment)

PFM issue	Priority in 2007	Suggested period of GfG assistance
Financial management services in the provincial capitals	High	Ten years
Greater ownership of the budget development process	High	Five to ten years
Strengthening government policy and planning	High	Two years then reconsider further support
Revenue accounting capacity building	High	Three to five years
Internal audit	Medium	Two to three years
Procurement	Medium	Three to five years
Legal support for GoV in MFEM	Medium	No estimate made
IT systems	Medium	Ten years
Line agency finance officer support	Medium	Ten years
Rollout of corporate units in PMO and several other ministries	Medium	Six months
Training and the job support for finance officers	Medium	Ten years
Investing in the future leaders of GoV (addressing the capacity dimension of PFM reforms)	Medium	Ten years
PSC/HRD support re performance evaluation on financial management responsibilities	Medium	Ten years
Management of government business enterprises	Low	Two to three years
Debt management	Low	Three months

Source: Harradine & Soni, 2007

It would also seem that one key influence is the legacy of work initiated as part of the CRP and MFEM-ISP. This work was heavily motivated by a concern to re-establish control over government finances. For example, the 2013 PEFA report said that:

Historically, the initial impetus for PFM reforms in the late nineties stemmed from the need to restore macroeconomic prudence. The main objective of the Comprehensive Reform Programme (CRP) in terms of PFM was to develop a legal and regulatory framework that was accountable, free of political interference and incorporating independent oversight and regulatory bodies. In particular, the reforms

were aimed at reducing leakage from the finance system and improving the level of control and management of Government finances. (2013 PEFA p5).

But it is clear from GfG design documents that its work was meant to specifically target reforms that would help GoV more effectively deliver services, including significant work in line ministries, with a focus on their operations in provinces. At the same time, the program was expected to maintain support to MFEM to ensure that past gains were not lost, and that areas of known weakness were addressed.

PFM, PEM, PSM: DIAGNOSIS OF PROBLEMS AND CHALLENGES 2007-2016

In addition to the analysis undertaken at the beginning of the program, there have been a number of assessments of the PFM and related systems that have identified weaknesses, reflected on progress and suggested further areas of reform. These include reports of assessment undertaken using the Public Expenditure and Financial Accountability (PEFA) framework, reports on Article IV consultations with the IMF, and Assessment of National Systems (ANS) and Fiduciary Risk Assessments (FRAs) undertaken by DFAT. Some of these may have informed the reforms that GfG has supported¹⁴, and others have commented on implementation of these reforms. Reports commissioned by GfG have also considered the quality of systems.

Table C.1 in Appendix C outlines in detail the main issues and diagnoses identified by these assessments during the life of GfG. An overview of the issues across a number of areas follows: flows of funds, public service and its management, macrofiscal policy and PFM reform priorities, public investment, State-Owned Enterprises and accountability.

Flows of funds

A consistent observation across the assessments was that funds do not flow with enough consistency and speed to ensure that public employees can deliver the intended level of services. Many issues were raised with the efficiency and effectiveness of the practices and logistics for the flows of funds to frontline service delivery units. In part these were partly obviated when the Financial Services Bureaus were established and the school grants program created school bank accounts. However, the FSBs are considered to be underused by line ministries, particularly in policing, law and justice and the

health sectors. By 2016, flows within large ministries were still constrained by a lack of financial delegation to the local officials – informants reported an unwillingness for greater delegation by the headquarters of line ministries.

The appropriateness of budget execution in practice has been frequently raised. The movements of funds within agencies is an issue, as it tends to reduce core operational funds from the intended appropriation. This is caused by a mix of moving funds from higher to lower priority recurrent expenditures, overspending on the payroll and unaccounted costs (such as staff severances). These problems largely impact within agencies, and do not affect others.

Public service and payroll

Some key issues highlighted include the following.

- Agencies over spend on payroll budgets, do not properly account for severances, retirement and other non-salary costs of permanent employees. The impact is typically that recurrent operational (non-staffing) budgets have to be cut during the course of the budget year, adversely impacting on service delivery
- The allocation of staff within and between agencies is mainly a result of many years of incremental budgeting and so needs some revisiting to identify how unbalanced it is. The same applies to the geographic spread of staff in labour-intensive activities in the public sector – particularly for teachers and health workers. Questions have been raised about the spread and location of public sector workers, compared to heterogeneous beneficiary populations, though no analysis is available to shed light on this.
- Likewise, the link between payroll and the Financial Management Information System (FMIS) is not always operational, but reconciliations are done frequently enough to purge problem entries. There are negative

¹⁴ Although a number of informants expressed doubt that this was the case.

impacts on the application and effectiveness of controls. Persistent payroll overruns within agencies are more of an issue.

- It is unclear whether public sector remuneration levels, wage setting and bargaining arrangements make for a misalignment in conditions from underlying productivity of public sector workers. This of itself does not appear to a substantial structural issue, though the IMF has raised concerns about properly accounting for public workers' non-salary costs.

Overall fiscal policy and PFM reform priorities

The macrofiscal risks associated with elevated public external debt levels have been emphasized by some analysts. This includes the issue of the quality of due diligence for debt arrangements that are linked to infrastructure projects. This became more of an issue after 2013, when parliamentary oversight of new loans ceased, allowing the Minister of Finance to approve loans and report them back to Parliament at the next sitting. The limited overall coordination and prioritization of PFM reforms within MFEM and across GoV has been identified consistently as a weakness. Assessments up until 2012 highlighted tax administration gaps, although this has become less of an issue as GfG-supported reforms have taken effect.

Public investment

Key issues identified include:

- An inconsistent application of project choice methodologies – infrequently using cost benefit or other analyses, particularly for physical capital investment.
- Procurement rules for public investments are applied and followed with varying levels of consistency and compliance. Projects that are favoured and negotiated by the executive (particularly where debt is involved) are entered into at times against the bureaucracy's advice.

- Mismatches between projects and the resources to maintain them in the future. The separation in the approval and budgeting process between the creation of projects and decisions about maintenance budgets and activities makes many projects unlikely to be maintained in subsequent years. The lack of asset registers across GoV makes budgeting for maintenance and replacement more difficult.
- Public procurement scope, depth and predictability for private contractors is lacking, which impacts on the formation and makeup of construction firms domestically. It also elevates infrastructure costs, as firms require higher returns to make up for the uncertainty.

State Owned Enterprises

The assessments have consistently drawn attention to a range of issues related to the management of SOEs.

- Transparency and proper accounting for contingent risks and liabilities entered into on behalf of the state are weak. This, combined with the ability of the Executive to approve loans without parliamentary oversight since 2012 has added to these risks.
- There is an unclear rationale for public ownership and management for some SOEs
- The quality and consistency of regulation and regulatory arrangements, particularly pricing and access for the many monopolies are variable. In addition, cost recovery is not necessarily always pursued for services and clients that could pay their own way
- The framework for community service obligations in the less profitable parts of the country (for example, in electricity) are not clearly rationalized, costed or implemented to have positive impacts on the (typically) rural and remote customers.

Accountability

The quality and effectiveness of internal and external audit have been consistently raised. Internal audit arrangements have been described as patchy and of variable quality across agencies. The number, scope and response to external audits have been regularly raised, although this situation improved from 2012, when more audits were completed with GfG assistance. The closely related issue of the limited impact and capacity of the Public Accounts Committee (PAC) and other oversight bodies to take forward audit findings has been frequently highlighted. There has been a limited response to adverse external audit findings and so these have had little perceptible impact on the quality of spending, and incentives for good performance.

GFG WORK IN PFM, PEM AND PSM

These assessments could be used to support a very large agenda of reforms. However, governments cannot fix all of these things at once - the different strands of public finance and administration reform philosophies agree that governments infrequently succeed at trying to do too many things at once. (See the summary of emerging lessons about 'getting the basics right' and key outcomes for PFM systems in Appendix D, and the observations from the recent assessment of Pacific PFM reform in box 4.1). And in practice it does not appear that GoV has been very receptive to suggestions made in the reports, particularly during phase II of the program. So what did GfG support?

Table E.1 in Appendix E provides a detailed summary of GfG support to PFM, PEM and PSM over the life of the program. It shows that the program has supported work in:

- Overall fiscal policy and PFM reform management
 - Including significant work on revenue administration and tax policy, and

compliance with international agreements on financial transparency

- Amending the key PFM accountability act (the PFEM Act)
- Policy and planning in the PMO to support better coordination
- Donor funds management and coordination
 - Supporting the development budget to collate donor spends and integrating them as the budget is being formulated
- Controls, payments and financial management systems;
 - Including establishment of Financial Service Bureaus
 - Supporting the rollout of school grants
 - Upgrading the budget management system and related policy work to tighten up controls (financial regulations, FMIS controls)
- Human resource management;
- Planning, delivery and reach of public services;
 - Supporting fiduciary work to allow greater amounts of donor funds to be channelled through GoV systems
- Macroeconomic management, fiscal management, revenue and debt management;
 - Economic analysis and forecasting for the budget
 - VAT and customs administration and compliance
 - Statistics at the VNSO
- Management of state owned enterprises;
- Procurement and public investment;
 - Supporting procurement systems and policy reform
 - Access and affordability issues in electricity; and
- Accountability frameworks and auditing
 - Reducing backlogs of external audits.

There has been considerable work with central agencies. Work that can be clearly identified as supporting improved service delivery – as opposed

to work on financial controls, reporting and accountability includes:

- Assistance with establishment and operation of Financial Service Bureaus
- Rolling out the school grants
- Diagnostic work on PFM systems in line ministries, and analysis of sectoral public expenditures
- Effort to improve coordination of electricity sector activities and expenditures
- Fiduciary risk assessments for selected line ministries.

KEY ACHIEVEMENTS OF GfG SUPPORT

Some key areas and achievements stand out where GfG resources and consistent commitment over time gave rise to outputs being achieved and

4.4 Key outcomes from GfG support in PFM, PEM and PSM

adopted by GoV. Box 4.3 identifies those that were identified by the review team in its discussions with stakeholders. Outputs are important, but it is their adoption that determines whether they will have discernible real world impacts on income and social outcomes (refer to diagram 1). Of these things the team regards as achievements, the following had a positive real world impact:

- **School grants reaching schools and offering greater local discretion.** This would lead to a positive impact to the extent that educational attainment rose (greater enrolments are the best proxy at this stage) and that local expenditures rose. The critical element, however, is that more funds got to schools more quickly than before

Among the outcomes resulting from GfG support, the following seem to be particularly important.

- Introducing an **integrated national budget**, as well as major changes in financial management legislation.
- Supporting substantial **improvements in tax administration** led by Customs and Inland Revenue. The investment in VAT compliance by GfG has arguably provided one of the biggest returns on investment, with VAT revenue increasing from 4.2 to 6.2 billion Vatu between 2011 and 2014.
- Assisting the GoV progress its **consideration of income tax** and other related reforms, although it is clearly early in the policy process.
- Establishing and supporting the deeper use of the FSBs.
- Assisting MFEM strengthen its core **payments and controls** policy and practice over time – MFEM is TA free in DoFT.
- Strengthening of the **IFMIS** and associated controls in various forms within MFEM over time.
- Encouraging **better financial management culture** by using the DFAs in a range of agencies – although there is a cost on agencies of managing this money, the spillovers from having to be fully accountable for GoA funds more than offset this.
- Pushing out of **school grants** and the underlying local level financial management policy and practice.
- The mix of controls improvements probably improving **aggregate fiscal discipline** at the margin.
- Helping the government begin to work through the complex economic and policy issues in **expanding access to electricity**.

- Helping **improve the consistency and currency of external audit**, although the lack of debate or consideration by the GoV and civil society remains a weakness.

- The **FSBs**, to the extent that they have raised local expenditures, contributed to higher local incomes and economic activity and reduced transaction costs. The bureaus also lay the groundwork for greater and more effective deconcentration of public services and procurement, which is a political priority.
- **Increasing compliance with taxes**, to the extent this reduces distortions of poor tax administration across the economy (costs of tax avoidance, distortion costs of taxes being higher than necessary if compliance is patchy). The benefits of additional revenues, depend of course on the efficiency of additional expenditures they finance, or costs of borrowing they displace
- **Aggregate fiscal discipline improvements**, to the extent that the stronger controls over the 2009 to 2015 period reduced inefficient and low return recurrent spending at the margin, increasing the fiscal balance compared to the otherwise case.

WHERE HAS GFG SUPPORT HAD LESS SUCCESS?

Given the nature of the GfG program, its intended responsiveness to local priorities, its focus on local ownership and leadership, and its willingness to take risks, the fact that some of its work has not led to the desired outcomes is not necessarily an indicator of failure. And working on a particular policy issue may be valuable in the long run, even if in the shorter term it does not lead to changes. It may help inform decision making and contribute to the accumulation of evidence in that can support change in the future.

That said, some areas where success has been more limited include the following.

Accountability in the public sector

In principle, financial oversight, including external and other accountability mechanisms are an important instrument in encouraging compliance with public finance laws and procedures, and shedding light on how budgetary resources are used. GfG's support to the Auditor-General (OAG), has enabled the auditing of outstanding financial accounts - but this has not had an impact on the quality of spending. The appetite for performance audits is seemingly limited.

The PAC is ideally the key source of demand for the OAG's outputs, yet it has sat infrequently and tends to probe specific instances of financial impropriety or imprudence, rather than system-wide problems. This is a common situation in many Lower Middle Income Countries - if the political branch does not react to problems, the potential for improving incentives for better performance by the public sector is limited. The returns to external audit are therefore a function of the broader incentive structure.

It seems that the most important audience and demand for audits lies in the donor community, which is keen to make further progress on the uses of national systems. It is harder to find a clear local demand, given the apparent lack of interest of the members of parliament, and the limited engagement between government and the private sector and civil society on the issues raised by the audit process.

As things stand, the PAC seems unlikely to make a big difference to the incentives for good performance in public spending.

In addition, questions remain about the sustainability of improvements in the structure and operation of the Office of the Auditor General that have been supported by the program.

Nonetheless, stronger accountability is central to incentivising better performance in the public

sector and we consider it appropriate to remain a focus for the next stage of the program. GfG and GoV may need to consider whether more effort should be focused on strengthening internal audit functions, building on the work being done by MFEM's internal audit unit.

Some options for the focus of work to progress the service delivery accountability and performance objectives are:

- working with OAG and MFEM to identify options and areas to improve accountability across the public sector, including audit;
- identifying whether the internal audit function of MFEM might be structured to support improvements in line ministries' internal audit units;
- considering whether more effective spending could be supported by seconding MFEM officials to line ministries' finance units;
- determining whether internal audit could look at a few generic problem areas systematically, for example: payroll, operational budget virements, procurement, intra-year spending, expenditure over-runs, compliance generally, among others; and
- identifying whether any work to generate debate regarding public spending is feasible and would have any impact. For example, public expenditure tracking surveys, localised poverty and HDI assessments.

Management of State Owned Enterprises

A number of weaknesses in SOE governance and related regulatory settings exist and have been reasonably well highlighted in the ADB Finding Balance reports¹⁵. Overall, SOEs receive below average results on regional benchmarking

assessments and are much lower than outside the PICs.

Transparency and proper accounting for contingent risks and liabilities entered into on behalf of the state are patchy. Loan funded projects can be entered into by the Executive with limited oversight from Parliament. Cost recovery is not always pursued for services that could pay their own way and governance and oversight is complex and sometimes inefficient.

Vanuatu's debt levels remain a risk, particularly if they are elevated when Vanuatu is hit by a shock. This highlights the importance of keeping a handle on debt commitments - especially those entered into by SOEs – and the returns on debt financed public investment projects.

GfG has supported efforts to reform SOEs involved in aviation and the marketing of agricultural commodities, but limited progress has been made in the face of strong resistance from vested and political interests.

Improved financial management in line ministries

GfG has probably not worked as much with line agencies as envisaged in the designs of both phases. The MFEM Assessment of National Systems (2013) observed that:

The 1996 fiscal crisis precipitated major reforms in PFM that started under the Comprehensive Reform Program (CRP) in 1999 and have been continuing in one form or another ever since. However, whilst these have been focussed at the level of central agencies and largely successful, the major work of radiating improved PFM to the service delivery and line agencies has resulted in limited and patchy levels of improved financial management in these areas.

The major challenge is to utilise the improved regulatory framework and central PFM systems at the level of the line agencies and to improve

¹⁵ *Finding Balance*, ADB

their level of compliance with regulatory and internal controls. This challenge is not new as it was identified many years ago, but the task associated with doing this has been consistently underestimated.

It seems that early efforts to engage with line ministries, and also to achieve coherence in work on PFM across the different (Australian and other partner) sectoral programs were not sustained, in part due to personnel changes and the decision not to continue with a PFM coordinator (box 4.5).

4.5 PFM reform and coordination with GfG – phases of the program

For PFM, there have been perhaps four distinct periods of the program's genesis. In the first phase, the high point of a reform-rich policy environment was the substantive reform projects that the MFEM oversaw with GfG assistance, particularly the FSBs, that made local public sector payments out, the schools grants, a treasury (i.e., small transactions float), government contract orders and cheque printing possible¹⁶. There were improvements in the policy and practice regarding financial controls at the centre, procurement (more codification) and more effective use of the IFMIS. Some efficiencies were achieved regarding payroll, however the systems (payroll and staffing register) remain(ed) unlinked though helpfully with agencies bearing the cost of overruns¹⁷. Some of these achievements were done with and some without TA.

At the same time, the PFM coordinator in GfG was working across programs to try bring a common approach and narrative to the various PFM, PEM and PSM work going on at the sector programs. The impression the review team has is that this work was primarily working with the sector programs and their TA, to exchange views and information about common problems as they play out at the centre and at line ministries. These were not formal structured processes, but regular technical and informal interactions. The review team is unclear how much this coordinator function provided for additional things occurring in the PFM space that would have not happened (or happened later). However, it is clear that there was an informal clearing house where issues were discussed, particularly regarding the FSBs, school grants, external audit and FMIS.

A second phase occurred, when a second PFM coordinator was in place and the vitality and payoffs from additional PFM reform at the centre by MFEM were moderating. A number of informants suggested that during this period from the MFEM side, there was a sense that a lot had happened, the low hanging PFM reform fruit had been picked, and it was time to take pause and bed down the changes to policy and practice.

Arguably, a third phase followed the cessation of engaging a PFM coordinator under GfG. During this phase, there is good evidence that there were fewer meetings and exchanges of PFM and PSM advisers with GfG regarding common problems. The review team does not consider that these exchanges ceased taking place, but rather that they were more organic and also replicated the GoV's approach, that it was time to bed down the big reforms particularly in the core payments and controls areas of Department of Finance and Treasury, and use them from the line ministry perspective.

A fourth phase occurred after cyclone Pam, which led to attention being diverted away from the important but not (always) urgent business of improving PFM performance for a period. More immediate needs, disruptions to programs and diversion of key personnel on the government and donor side to the recovery effort have forestalled working on big agendas in this phase.

¹⁶ Cashing out available at five locations outside Port Vila, where a branch of NDB exists.

¹⁷ Agencies had (and have) to abide by the hard budget constraint of having their budgets reduced for payroll overruns.

Public sector employees' management, structure, remuneration and overall size

GfG does not seem to interact much with human resource management and issues concerning the government wage bill. As outlined earlier, the problems around agencies not properly accounting for severances and other non-salary costs does have a substantial impact on operational expenditures. This is reinforced by execution defining to some extent the size of the next year's appropriation. These factors combine to adversely impact the consistency of service delivery.

GfG did not devote much in the way of specific resources to this issue. It does not appear to have had many entry points at the centre for making progress on this – it has had minimal involvement with the PSC and in the absence of a push from MFEM and line ministries, progress in practice would likely have been difficult. The biggest immediate gains would arguably have been improving practices in these areas within line ministries, which DFAT sector programs' advisers have focused on to varying extents. However, GfG has not played an active role in coordinating across these programs to place more priority on this issue.

Going forward, the opportunities for broader engagement with PSC have increased. PMO has been focussing on feasible reforms. GfG has the opportunity to deepen work with both on an issues basis, particularly engaging on improvements to PSM. Some key areas are:

- delegation of panels, given that PSC sits on all panels
- deepening usage of performance management tools
- engage at the line ministry level on properly accounting for staff costs.

The allocation of public investment and implementation of public projects

GfG has had some interactions on public investment matters in the PFM space, primarily work on the procurement framework and for specific projects, such as the Luganville Wharf and investment in the electricity sector. This complimented work on SOEs and private sector development in energy, aviation and ports, among others. In terms of progressing on improving the mix, allocation and appropriateness of public investments, GfG has had a minimal footprint and impact. The environment for this work has been challenging throughout the GfG's life, particularly where debt funded projects have taken on a very political dimension – airports is one of example of this.

GfG seems to have determined that payoffs from this work would be far off and uncertain of adoption by GoV. Other informants in GoV highlighted the limits of their influence over some of these primarily political decisions and the lack of influence the bureaucracy faced. However, with Australia funding enormous quantities of infrastructure across the country program, increasing concerns over time about low returns from debt-funded investment projects and associated fiscal sustainability pressures, the issue has been critical for a long period. Information and analysis is important in debates about public investment priorities – it may be the absence of a PFM resource in the program in recent years has forestalled greater focus on public investment.

Office of the Government Chief Information Officer (OGCIO)

GfG's involvement with OGCIO had its origins in a GoV request to assist with integrating a network built using a loan from the Government of China into the existing public sector infrastructure. The network was designed to carry all of the government's telecommunications for voice access services, broadband internet and a stand-alone back up system to support management of all GoV ICT services - the 'iGov initiative'. At the same time,

GoV asked the program to source a full time Chief Information Officer to take on the new project and bring the network into effective operation. OGCIIO was established in the PMO to encourage the spread of ICT across Vanuatu and to be the policy and implementation arm of GoV's ICT investment. In addition, the OGCIIO plays an advocacy role on rights to information. The Chief Information Officer answers directly to the Prime Minister and works closely with the TRR.

The OGCIIO has developed a number of key ICT policies including around access to ICT in education, ICT infrastructure and devices, and the introduction of ICT into sectoral policies. The policies are designed to provide a clear roadmap for the sector – they are still relatively new and implementation has been limited. The Universal Access Policy (UAP), to which GfG provided seed funding, sets an ambitious target of making ICT available to 98% of the population by 2018. The UAP is currently rolling out a range of pilot projects including school internet labs, but achieving the target outlined in the UAP is likely to be difficult. Further, some informants indicated a desire for the OGCIIO to play a more active role in ICT roll-out, particularly in the provinces. More information is needed to understand the extent of OGCIIO's impact on service delivery.

CONCLUSION

The bulk of GfG's work on the PFM, PEM and PSM agenda has focused on central agencies. It has built on the foundation of earlier reforms to strengthen aggregate and specific controls over government finances, to improve the quality of expenditure planning and budgeting, and to improve revenue raising and the administration of internal and customs taxes. It has also supported a major initiative, the design and roll out of FSBs. MFEM's

reliance on international TA has reduced substantially over time and this is in part a reflection of the substantial investments by GfG and the earlier MFEM-ISP.

While this work has had some impact on service delivery – for example with respect to improving arrangements for school funding, it has arguably not delivered on the expectations articulated in the designs for both phases.

By and large, its work seems to have been strongly aligned with the priorities of bureaucratic leadership, and, from time to time, of political leadership. It has also generally avoided the problem of being driven by concerns to implement international best practice, and has focused on dealing with specific and well identified problems in the system. And GfG has been continually aware of the limited capacity of government, and the vagaries of the political economy in which it operates. Work on reforms seems to have been focused on areas where forward progress would be technically and politically feasible. This perhaps explains GfG's reticence about delving too deeply into staffing and payroll issues and public investment issues. As such, it has been broadly consistent with current thinking on good practice in PFM reform, even before some of that thinking was articulated.

Where it has been least successful is in reaching out to the agencies at the front line of service delivery, and providing sustained coordination of the efforts of Australian – and other donor's sectoral programs to improve systems in these agencies. Taking this agenda forward more substantively would have required more resources and focus than were available and also a more structured push from the whole Australian Aid program, to leverage positive improvements across GoV on the biggest PFM constraints to service delivery.

5. SUGGESTIONS FOR THE NEXT PHASE OF GfG

This section outlines some suggestions for the next phase of GfG, regarding its overall approach to providing support, and the issues it might work on.

It starts by discussing some general issues concerning a future agenda, and then considers current government priorities that will shape demands for GfG support in the next few years, and other emerging or continuing issues, and then offers suggestions for the next phase. Finally, it offer some suggestions for an agenda for the next phase.

GENERAL CONSIDERATIONS

Flexibility, momentum and strategic buy-in

GfG was designed to be flexible, responsive and empowered to take action when opportunities arose. This has enabled it to support some strategic and tactically important initiatives, and to take advantage of windows of opportunity.

But as it moves into its eleventh year of operation, it has accumulated a set of activities that will need continued engagement and support. This reflects the reality of working in a small capacity constrained country. The need to continue in existing areas automatically constrains the program's ability to take on new initiatives, unless an unlikely expansion of resources occurs or other

instruments can be established to provide ongoing support.

A second concern, which particularly applies to GfG's work in PFM and related areas, is that a long term engagement is underway to put in place the building blocks that will allow the ultimate goal – better service delivery – to be achieved. For some considerable time, the underlying strategy for doing this appears to have been shared by some of the key actors – advisors and GoV officials, but not formally expressed in strategy documents. This has been a source of strength – allowing a focus on getting things done rather than writing about it, but in year eleven, there is no clear instrument to inform new players of the logic of that strategy, or to document the consensus achieved around it.

It may be quite important to spend some time with key actors to revisit the strategy, and get endorsement of its key elements.

The still draft PFM roadmap developed with PFTAC may provide a useful reference point for Australia and other donors' efforts on PFM. However, there will need to be a concerted effort to address the absence of high level buy-in about PFM reform priorities are and how these relate to service delivery weaknesses, if this initiative is to make much difference.

Breadth of focus

Some concerns been raised that over the years, GfG has lost focus and has become too broad. Some of this is a product of the flexibility of the

modality – being responsive has meant GfG is often used as a resource finder, but there is a need to consider the overall focus and balance of the program between activities which bring shorter-term ‘quick wins’ and those with long term impacts. And, as indicated above, to recognise the limits to the new areas that a small, co-located program is able to take on.

In this regard, GfG has been quite effective in contracting other partners, such as the World Bank and the IFC, to take responsibility for some ongoing areas of support, so that the burden on the ‘creative’ capacity of the GfG team is minimised. Where bigger calls on team time have materialised is in the use of Direct Funding Agreements and of government systems: considerable team input is required to make these approaches work in a timely and effective fashion.

Communications and research

There is a consensus that GfG could do more to communicate what it is doing, the Ministries they were supporting and providing narratives of success. This can be challenging, given GfG is a complementary modality, working behind the scenes and at arm’s length. By design, it does not engage in self-promotion.

However, it is clear that there is limited awareness of the extent and impact of GfG-supported reforms across government, the private sector and academia. Information on lessons learned is not shared across agencies and there is potential for GfG to develop case studies on reforms with which it has been involved. Documenting and communicating these stories, including narratives of success should be nuanced in line with the GfG modality, but it is important for GfG to tell the story of what it has achieved – or more importantly for GfG to help GoV tell the story. Raising awareness of the reforms supported by the program can be a useful way to disseminate information and engage in networks, creating new linkages for policy

development and strengthening coordination across the program and with government.

Strengthening communication between the GfG program and the Australian High Commission is also prudent to ensure alignment of objectives across the Australian aid program. There is potential to use the GfG – as a program situated within government – as an avenue to socialise ideas with the Vanuatu government and filter sensitives back to the High Commission. This requires a closer working relationship between GfG and the Commission.

Another, perhaps related observation, is that GfG has not made much use of the resources at its disposal to commission research¹⁸. As Annex B shows, there has been no shortage of studies on constraints to growth in Vanuatu, but what may be lacking is research that could better inform work towards more inclusive growth, and perhaps getting a clearer perspective on what constrains better service delivery in line ministries (besides weak PFM). The research resources might also be used to bring regional expertise (such as former ministers of finance) to discuss elements of reform to help build local understanding and coalitions of support for change.

Co-location with the GoV

Co-location of GfG’s management in the Prime Minister’s Office has allowed the program to operate with exceptionally high levels of government ownership and to ‘fly beneath the radar’ as a trusted facilitator of politically sensitive reforms. This has been a source of great strength, has signalled Australia’s commitment as a responsive and approachable partner. It has also insulated GfG from occasional turbulence on the overall bilateral relationship.

From the perspective of the management of the overall Australian aid program, co-location ought also to enable the program to gain policy insights, and access information about developments in

¹⁸ This has also been a consequence of how cuts to GfG budget have fallen across the areas with most discretion and room for adjustment,

Government, and use this to strengthen other parts of the portfolio.

For these benefits to be realized, more effort may be required facilitate interaction with GfG and other parts of the aid program, to capitalize on GfG's deep relationship with central agencies. Some care, may however, need to be exercised to make sure that the access provided by GfG is not seen to be inappropriately used in the pursuit of Australian commercial or strategic interests.

CURRENT GOV PRIORITIES

While GoV is still pushing forward on elements of the growth agenda, two initiatives in the area of public finance are of prime concern for the current administration: decentralisation/decentralization and introduction of an income tax.

Deconcentration and decentralisation

The Government has embarked upon a program of deconcentration, in order to streamline administration and improve service delivery. This includes expanding financial delegations at the provincial level. GoV is also considering further decentralisation, providing larger resources and autonomy to Provincial and Area Councils.

Deconcentration

A critical part of the deconcentration process has been the establishment of Financial Services Bureaus, one of the most significant GfG-supported reforms. FSBs provide a range of services to line ministries including: cashier receipting; issuance of government invoices; processing of local purchase orders (LPOs) including payment to government officers and suppliers; attending to government payroll queries; and providing payment advices. Further work is underway to improve services in the areas of asset registrations and payment of government suppliers via cheques.

FSBs have grown considerably since the first 2 or 3 became operational in 2012. Functioning FSBs are present in 72 area councils across all 6 provinces. Deconcentrating funding down to the local area council level is a key aim of the FSBs. Though uptake has been slow, more and more departments are using FSBs, given the FSB's ability to collect revenue and execute LPOs. For example, FSBs have been able to expedite payment of invoices that would otherwise be delayed using central systems.

Some informants suggested that FSB officers could do more to support line agencies, for example by undertaking outreach work with schools and hospitals to help with acquittals. For example, school education grants could be disbursed through FSB systems, but are instead disbursed through the National Bank of Vanuatu. Part of the issue is that there is often only a single FSB officer in provincial offices, who is unable to engage in outreach work. This also poses additional challenges for financial controls where the same officer cannot conduct sequential parts of the budget process. In addition, reluctance on the part of line ministries to relinquish control of resources to local officials has limited the use of FSBs.

Some informants note that there is also some confusion around the deconcentration/decentralisation agenda. Information is not always disseminated and provinces do not feel adequately supported from the centre. Any further expansion of the deconcentration agenda will require FSBs to be far more active, with additional trained FSB officers to undertake outreach work with line ministries to improve uptake of FSB services.

Decentralisation

Decentralisation with larger budgets and mandates for Provincial politicians brings with it big risks for service delivery, as demonstrated in other countries that attempted rapid shifts in the allocation of service delivery responsibilities¹⁹. At present, provincial governments only control the (very small) budget for the running of their

¹⁹ In the region, PNG and Indonesia's 1990s big bang decentralisations are considered to be poorly conceived and implemented.

respective offices, but funding for each line area comes from the relevant central agencies. Going forward, there is a trade-off between managing the demands for greater local discretion and decision making with the objective for efficient service delivery, for which the small Provincial administrations will always struggle, each servicing only around 50,000 citizens, on average. More worryingly, if the Area Councils are each administering funds, they would each have around 4,000 citizens, far too small to reap any efficiencies from scale in delivering public services.

Implications for GfG

It is clear from experience to date that the funds and associated logistics for service delivery do not flow with enough consistency and speed to ensure that public employees can deliver the quantity of services intended. Further deconcentration and decentralisation are clear strategies of the current government to deal with the political imperative of increasing the reach of public services into the outlying areas of the country. While there are considerable risks associated with granting greater controls over spending to Provincial and Area councils, it seems that the Government is committed to going down this route²⁰. It seems appropriate that GfG should prepare to help with these initiatives, bringing international experience to bear on the issue of policy design, and helping with the challenging task of building local capacity to ensure effective management of devolved resources.

Tax reform

Vanuatu is undertaking a range of tax reform work including the introduction of personal and corporate income tax. GfG supports three advisers within the Department of Customs and Inland Revenue that have played a role in the reforms to-date.

Unsurprisingly, there has been vocal opposition to the introduction of income tax from the business community and there have been general concerns about the consultation undertaken by the Vanuatu Government.

The introduction of the tax will increase the complexity of the Vanuatu tax system, requiring significant work to grow the size and skills of the Department of Customs and Inland Revenue. Significant additional tax administration work created as a result will also require a number of highly skilled local staff. To this end, the design and implementation of the income tax will require TA in two key areas: the creation of an appropriate legislative framework and organisational capacity and readiness. As part of this process, awareness raising with the public will need to be conducted. Advisers have been important in achieving successful outcomes in previous areas of tax reform (e.g. VAT compliance) and will be an important part of any future tax modernisation process.

International tax reform

Vanuatu is balancing its domestic tax reform agenda with international tax obligations. Vanuatu has been categorised as an offshore finance centre by the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”) that designs and promotes international standards of tax transparency. Vanuatu failed to meet its international standards on the exchange of information in the October 2011 Global Forum Phase 1 peer review report. A failure to meet its international tax obligations has significant ramifications for Vanuatu, raising its status as an unreliable place in which to do business and creating uncertainty for investment and financing.

The Vanuatu Government has indicated that in order to meet its Anti-Money Laundering and Countering the Financing of Terrorism (AML/CTF) commitments, additional assistance will be required, potentially from GfG. Australia already provides funding to the Global Forum to assist

²⁰ And while risky, it may help head off pressures to expand the funds directly allocated by Parliamentarians, as has occurred in PNG and Solomon Islands.

developing countries in our region to meet their international tax obligations. There remain concerns that AML/CTF measures will have significant adverse implications for financial inclusion.

Implications for GfG

The combination of the Vanuatu government's desire to undertake significant domestic tax reform and pressure from multilateral organisations to meet international tax obligations will test the ability of the Ministry of Finance to undertake simultaneous large-scale tax reforms.

GfG is already involved in providing support to both in both domestic tax and international tax reforms, and is already bearing some reputational risk from its association with the introduction of an income tax. Given the complexity of the latter task, and the speed with which GoV intends to pursue it, GfG may have to make a decision to significantly increase the resources devoted to it, or be prepared to argue strongly for GoV to adopt a longer time frame (which it may not be prepared to do)²¹.

OPPORTUNITIES FOR WORK ON THE GROWTH AND PFM AGENDAS IN THE NEXT PHASE

Growth

Continuation

At the outset, it is important to stress that GfG will have to continue its support to implementation of reforms introduced in earlier phases. And it makes good sense to maintain an emphasis on connectivity and the costs and quality of business and infrastructure inputs.

- Agencies such as the URA and TRR will need continued access to expertise – technical and legal – and it may be some time before the transition to local leadership and management can be completed. Continued support from the Australian aid program may also provide these agencies with space to exercise their independence in the face of pressures from vested interests. Support may be required to develop amendments to the enabling legislation, for example so that URA can monitor fuel and gas prices.

- GfG should continue its work with the Ministry of Tourism, Trade and Ni-Vanuatu Business, supporting formulation and implementation of the new Trade Policy Framework and other areas of micro-economic policy. The proposed update of the Trade Policy Framework may well identify a menu of reforms from which GfG could select initiatives to support. And within the area of trade facilitation, GfG should continue supporting port and border processing reforms.

- Given the importance of tourism to the economy and its prospects for growth GfG should continue to work in areas that can help improve the enabling environment for sustainable development of the sector, and its beneficial consequences for the people of Vanuatu. This could involve continuing to support:

- reform of the SOEs involved in aviation
- improvements in maritime logistics,
- strengthening the collaboration between government and the industry in areas such as marketing, and accreditation
- pursuing stronger market-driven backward linkages from the sector.

Additional emphasis

GfG will have to exercise some caution in moving into new areas. It must avoid overtaxing its own staff, and needs to create space for them to be

²¹ And recognising that, unlike the VAT, there are very few people who have experience in introducing an income tax and in designing and managing the challenging change program that this entails.

involved in analysis and thinking. It also has to draw on its own hard-won understanding of the challenges in building new institutions and facilitating informed consideration of new policy initiatives in Vanuatu in choosing where –and if - to start new initiatives.

Participation and inclusion

GfG should bolster its efforts to facilitate a broader base and greater inclusivity in the growth process.

- A starting point would be to use GfG's research resources to commission a deeper analysis of issues facing, and opportunities for, women's economic empowerment, and to map out a strategy for seeking greater buy-in to the principles within the bureaucracy and amongst the political class.
- GfG could also explore opportunities for working with the initiatives of the Pacific Women program on women market vendors – perhaps as a vehicle for building a better understanding of the informal as well as formal constraints that affect small businesses. It could also reach out to the Department of Women's Affairs in the Ministry of Justice and Community to explore possible areas for collaboration.
- Another area for analysis would be to examine the constraints and opportunities facing ni-Vanuatu entrepreneurs, and businesses operating in the outer islands.

Coalition building and private sector consultation

GfG should work with its government partners to improve the quality, timeliness and consultation with the private sector. It should also explore ways or working with business associations - both to reach their constituents, but also to build their capacity as a useful contributor to policy discussion. This might involve:

- working with the Ministry of Tourism, Trade, Commerce and ni-Vanuatu Business and VCCI to build a framework for government-business dialogue – consideration might be given to an annual –government-private sector-donor dialogue on development plans; and
- working to build the analytical capacity of or available to VCCI or other business associations,

perhaps by involving them in commissioned studies.

- working with VCCI to help improve communication of government policy reforms and their impacts.

Business enabling environment and access to finance

It appears that the Private Sector Development Initiative will be changing the focus of its engagement, and de-emphasising sector-wide work on the legal and regulatory environment for business. If this should happen, then GfG might need to pick up some of the issues raised in the recent Private Sector Assessment.

- The work on the use of moveable assets as collateral is addressing an important problem in Vanuatu, but more work is required to broaden the use of this kind of security.
- With new entrants into the banking system, GfG could explore ways of expanding the work it has been doing with NBV on financial inclusion.

Agriculture and rural development

Given that some 70 per cent of the population is involved in agriculture in one form or another, it makes sense for the Government to be exploring ways of facilitating growth and improved standards of living for the people living in rural areas. This may need to be part of a multi-faceted approach to the ongoing challenge of rural-urban migration. Other development partners (especially the European Union) are working in agriculture, and regional Australian programs such as PHAMA are also operating in Vanuatu.

GfG's strength is supporting work on policy and institutional issues constraining growth, so it may not develop a large engagement with agriculture. But its support in the area of trade and improving connectivity has potential to have important impacts on the sector. GfG should consider building an understanding of government priorities and what other partners are doing, so that it can position itself to support work on issues, if it seems that it has the capacity to help.

Land

Land is a difficult area for development partners to work in, as Australia's experience with the Vanuatu Land Program has shown. But GfG may need to stand ready to provide support to locally driven reform efforts if the government considers that this might help with.

PFM reform, PSM and service delivery

For GfG going forward, the PFM reforms with the biggest immediate payoffs at present are more complex and involve more tradeoffs at the technical and political level than their predecessors (such as improving controls around payments and for treasury). However, they are important from a service delivery, macro-fiscal and PFM perspective:

- Getting funds to flow and more devolving management outside Port Vila using the FSBs more intensively – i.e., further deconcentration, recognizing that this will help moderate calls for big bang decentralization. Issues that will need consideration include the need to:
 - Work with agencies (Internal Affairs largely) to help them find ways of increasing local accountability and development that do not risk the centre handing over big budgets and mandates to nascent bureaucracies
 - Make a joint effort with line ministries to make greater use of the FSBs to deepen deconcentration where this is appropriate
- Revisiting the allocation and management of public servants within and between agencies, including properly accounting for their costs (e.g., severances)
- Improving the consistency and management of procurements underpinned by external debt arrangements
- Keep working, including with the ADB and other development partners, on improving the transparency and governance of SOEs, particularly to incentivise better performance, and reduce costs to business.

There is also an opportunity to deepen the coordination of DFAT work on PFM and PSM system wide constraints that affect service delivery. The key features of this bolstered approach would be:

- Devoting resources to work across all of the Australian program, not just within GfG
- Recognising that both line ministry and central agency focused Australian Aid programs have specific roles and responsibilities in pushing forward the PFM and service delivery agenda.
- Establishing a common view about key constraints and committing resources in all programs to dealing with them in a consistent way
- Where appropriate, establishing joint oversight and direct linkages with PFM and PSM advisers working in sector programs.

Downstream accountability frameworks and sanction remain challenging to implement in practice, as the Auditor-General work demonstrated – there remains a question about how best to support accountability, recognizing that the existing mechanisms appear to have a limited impact. Some possible alternatives include the following.

- Creating central resources to help agencies spend their money accountability – a government wide internal audit has been used in some countries, underpinned by finance ministry officials placed in line ministries to directly support capacity development (in financial management and accountability). This could build on the work of MFEM's internal audit unit.
- Working with OAG and MFEM to identify options and areas to improve accountability across the public sector, including audit.
- Determining whether internal audit could look at a few generic problem areas systematically, for example: payroll, operational budget virements, procurement, intra-year spending, expenditure over-runs, compliance generally, among others.

- Identifying whether any work to generate debate regarding public spending is feasible and would have an impact. For example, public expenditure tracking surveys, localised poverty and HDI assessments have been used in some contexts, but primarily to catalyse a policy debate and public attention about the implications of poor service delivery.

GfG's support for design and implementation of the income tax will have to continue, particularly to

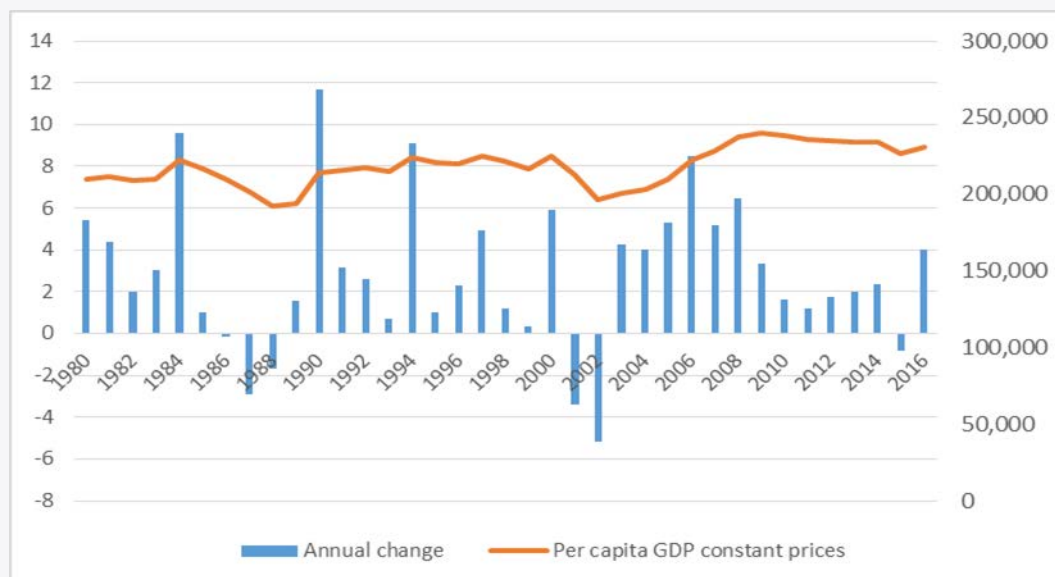
help ensure that adequate transition arrangements are made, that sufficient attention is paid to administrative capability and its implications for the compliance burden on businesses and wage earners.

GfG will also need to assist GoV in meeting its obligations with respect to Anti-Money Laundering and Automatic Exchange of Information to ensure that the country is not blacklisted, with potentially damaging consequences for financial system.

APPENDICES

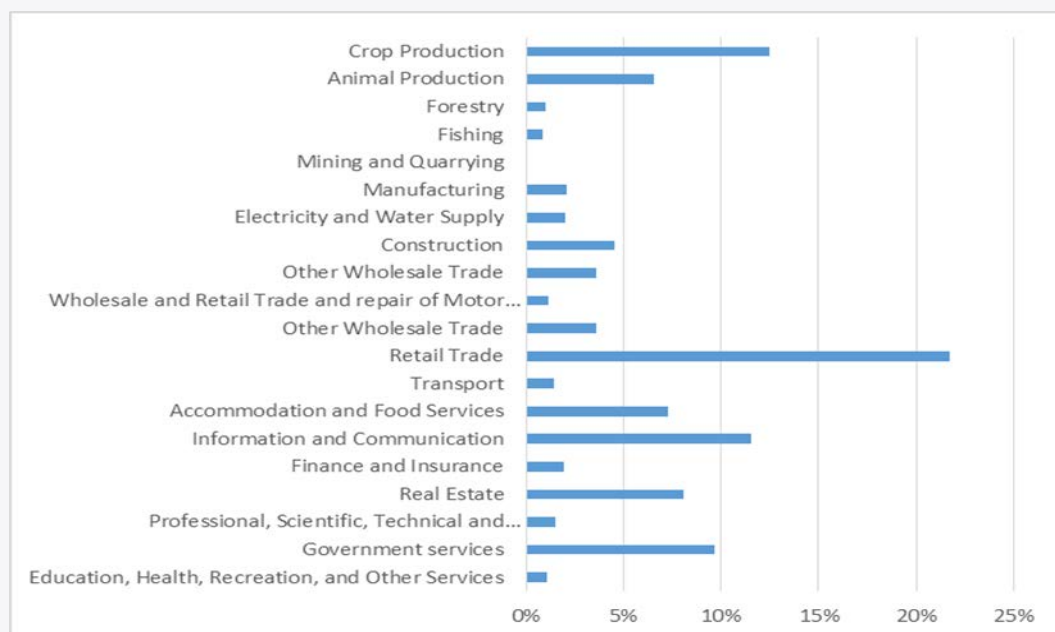
A. SELECTED INDICATORS, VANUATU

A.1 Movements in real per capita GDP, 1980 to 2016



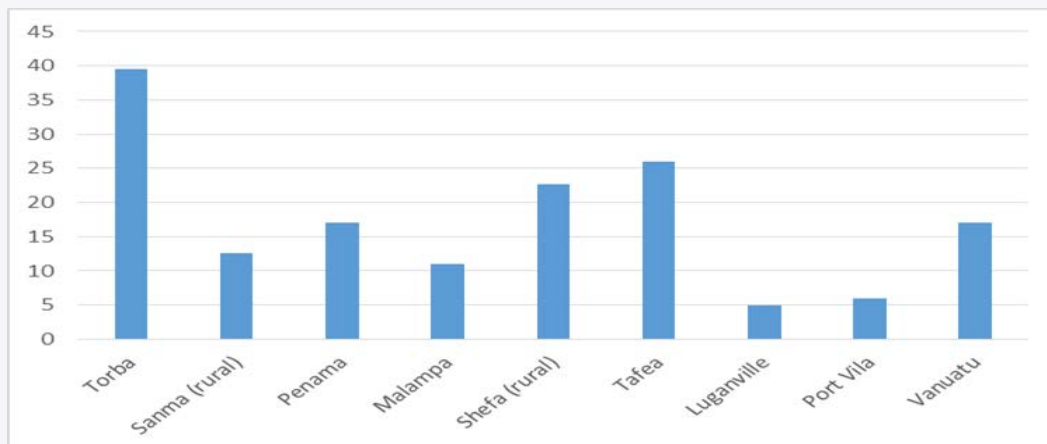
Note: values for 2015 and 2016 are estimates and projections, respectively
Data source: IMF WEO database

A.2 Contributions to GDP growth by sector, 2005–2014



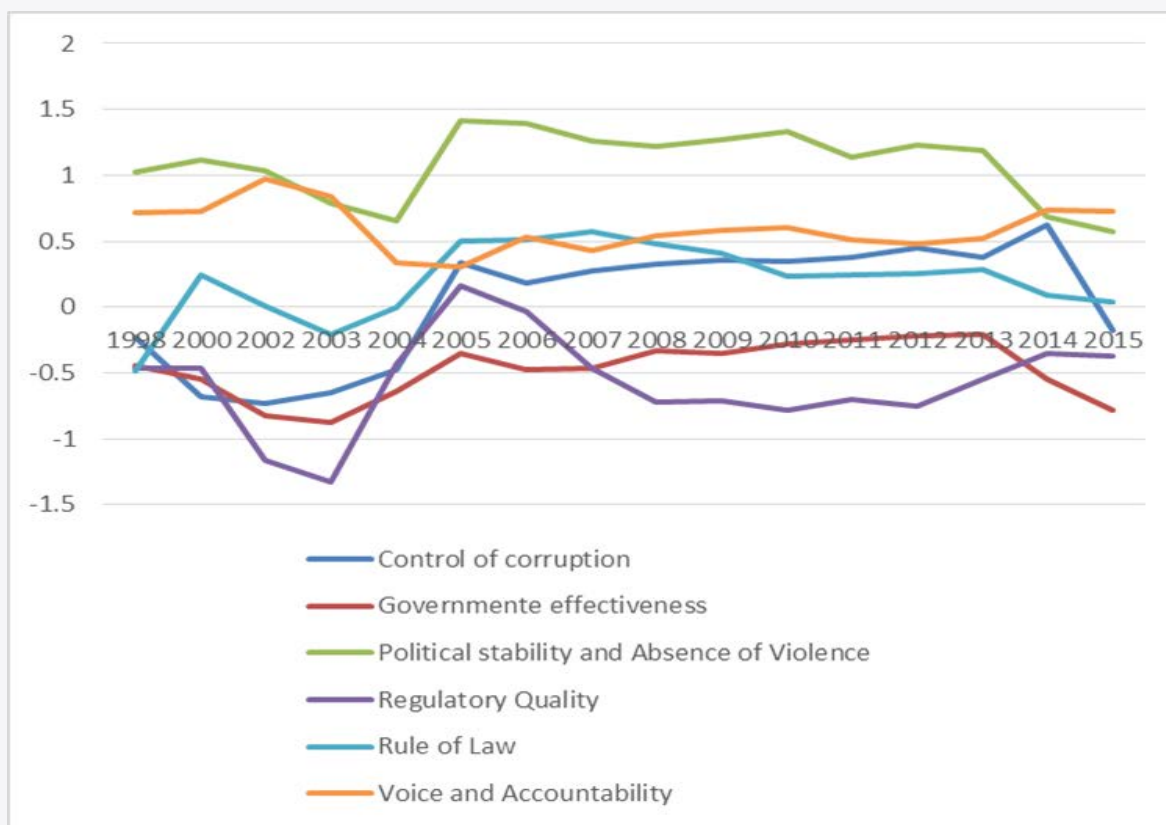
Data source: VNSO National Accounts

A.3 Child poverty rates by province, 2006



Data source: Social Policy Research Centre, 2012

A.4 World Bank governance indicators for Vanuatu, 1998 – 2015



Note: 2.5 strong, -2.5 weak

Data source: World Bank WGI data base

B. GROWTH OPPORTUNITIES AND CONSTRAINTS ANALYSES FOR VANUATU

This appendix examines the various analyses of opportunities for and constraints to growth in Vanuatu that have been published in the lead up to and during the operation of the Governance for Growth (GfG).

The analyses include:

- An analysis of opportunities and constraints carried out before GfG was designed (Bazeley and Mullen, 2006);
- A 'drivers of change' analysis also carried out before the design of GfG (Cox et al, 2007));
- A Diagnostic Trade Integration Study carried out under the Integrated Framework (Gay (ed) 2008);
- Two Private Sector Assessments conducted by the ADB (2009) and the ADB-managed Private Sector Development Initiative (2009 and 2015);
- An enterprise survey conducted by the IFC in 2009;
- A growth diagnostics exercise carried out for the World Bank (Duncan and Nagakawa, undated);
- A growth spurts analysis published in the Asia and the Pacific Studies Journal (Duncan, 2016);
- A study aimed at helping develop a micro, small and medium enterprise policy (AIMS, 2011)
- A set of reports commissioned by the World Bank on opportunities for Pacific Island Countries (2016);
- The 2016 Doing Business report on Vanuatu and the 2017 updates of indicators;
- IMF Article IV Consultation reports (IMF, 2013, 2015, 2016)

The analysis has also looked at economic reports and commentaries published in the Pacific Economic Bulletin (Gay 2004), by the ADB (Duncan 2011), East West Centre and the Pacific (Duncan and Codipilly, 2011) the Institute of Public Policy (Soni and Howes 2009).

A BRIEF ASSESSMENT OF THE ANALYSES

As is clear from the introduction, there was considerable variability in the approach/methodology used by the studies.

- Some have looked at constraints only, from an economic perspective looking at factors that might reduce private investment, or from a legalistic and procedural perspective that might be taken by formal, larger scale enterprises (especially foreign invested enterprises). And some of these have 'dipped their toes' into the question of why impediments to investment exist or might persist, alluding to aspects of the underlying institutional and political systems and processes in which policies are developed and implementation motivated²².
- Others have taken a more historical and cultural perspective to explore the observed behaviour of political representatives and leaders. They have gone some way beyond a simple characterisation of Vanuatu's politics as essentially clientilistic. But perhaps only one (Cox et al) has tried to lay out strategies for working within the political realities of reform and institutional development in Vanuatu

Some analyses have attempted to prioritise actions, and some have presented long lists of recommended actions. Some have acknowledged

²² It is worth noting that at least one author proposed adding an 'institutional branch' when applying the standard growth diagnostic framework to the Pacific. This would explicitly consider the impact of

weak institutional environment and elements such as human capacity constraints, elite capture of public resources and lack of social cohesion (Sugden, 2008)

the truly binding constraint of public sector capacity and its implications for policy and institutional reform, but few have considered what it means for sustainability and partner choices about capacity related support.

(Interestingly, a 2015 review of ADB's work in the Pacific (ADB 2015) seemed to raise questions about some of its own ongoing work:

...regulatory reforms may not necessarily be appropriate or sufficient for generating substantial private sector-led economic growth in the PIC-10 for two reasons: first, because of the countries' small size and distance from markets, measures to support a business-enabling environment are unlikely to be enough to ensure global competitiveness in manufacturing and services; and second, implementing the full range of complex policy and regulatory reforms is likely to be beyond the reach or needs of most of the PIC-10 and certainly of the smallest. Private sector development initiatives are still worth pursuing, and sound macroeconomic management is relevant—over-regulated and outdated legal structures also impose costs on domestic businesses—but taken alone these reform measures will not be sufficient to offset the severe cost disadvantages of isolation. As a result, the growth paths that the PIC-10 can follow are likely to be different from those taken in many other developing countries, particularly those in larger Asian countries.)

Where analyses have bothered to identify successes, they have nominated:

- Fiscal and monetary stability since the implementation of the Comprehensive Reform Program in the early 2000s
- Telecommunications reform
- Liberalisation of airline services
- Policies towards foreign investment in tourism and real estate.

There is a broad consensus about what might be described as 'objective' constraints to growth, including:

- Geography – isolation and fragmentation

- Size – small markets, limited opportunities to achieve economies of scale, high fixed costs of service provision
- Vulnerability to weather related shocks

And there is consensus about some issues that are notionally within the purview of public or private sector activity:

- Poor quality and high cost of infrastructure
- Constrained connectivity- physical (inter-island shipping) and electronic (high cost internet)
- Inadequate regulation of natural monopolies (a common occurrence given the size and fragmentation of the market)
- Low human capital from limited reach of the health and education systems
- Access to land, and problems with the land leasing system that constrain investment and access to finance.
- Limited delivery of financial services, and lack of innovation by the financial system.
- Limitations of the legal and judicial underpinnings of market transactions.
- Poor governance and management of State-Owned Enterprises, especially those involved in aviation and commodity marketing and parts of the financial system.

More intermittently explored are issues such as:

- The interactions between traditional quasi-subsistence and the modern cash economy, the pressures that population growth are placing on traditional livelihood strategies, and the limited reach of services (publicly and privately provided outside of Port Vila and Luganville.
- The poor quality of the interaction/partnership between the formal and informal private sector and the government, characterized, among other things by limited communication and consultation about policy and institutional change, and private sector funding of clientelist behaviour by politicians.
- Limited support for engagement with international markets – trade facilitation, market entry

- Growing geographic, ethnic and gender-based disparities in income and asset ownership, and the extent to which growth is not translating into an equitable increase in standards of living.
- The variable quality of donor engagement and its effect on government behaviour.
- The importance of improved PFM to service delivery and macroeconomic stability.

It is sometimes a bit hard to gauge from these reports how important some identified constraints really are. The ADB Private Sector Assessments seem to imply that there are significant problems with the business enabling environment, and Vanuatu ranks 94 out of 189 countries in the World Bank's Doing Business indicator assessment. But the 2009 Enterprise survey paints a much more positive picture, showing that Vanuatu performs better than the average for lower middle income countries for all but a limited set of indicators (losses due to theft, security costs and time to clear imports through customs). (The survey also shows hardly any firms identifying access to land as the main obstacle – but it is worth noting that a survey of MSMEs including stakeholders in outer islands did find that land was a problem (AIMS 2011).

A final observation about these analyses is that while most suggest things that ought to be done to facilitate growth, few offer suggestions as to how these issues should be addressed within the social and political reality of Vanuatu, and taking account of the binding human capacity constraint.

THE REPORTS

Bazeley and Mullen, 2006, Vanuatu Economic Opportunity Fact Finding Mission

This report, commissioned by AusAID and NZAID, examined potential areas of support to economic growth from productive sectors.

It argued that Vanuatu enjoys significant comparative advantage in several productive sectors, which it has successfully exploited for decades, but faces a set of strong inherent disadvantages which may well negate the comparative advantages (table B.1).

B.1 Comparative advantages and inherent disadvantages

<i>Comparative advantages</i>	<i>Inherent disadvantages</i>
<ul style="list-style-type: none"> ▪ A relatively (to the population) massive and - with proper husbandry - productive land resource; 	<ul style="list-style-type: none"> ▪ Very small size with none of the economies of scale in inputs (including fuel and utilities), processing or markets enjoyed by competitors;
<ul style="list-style-type: none"> ▪ A generally very favourable climate for agriculture (with some limitations), supporting year-round pasture and crop production (including forestry); 	<ul style="list-style-type: none"> ▪ Geographical fragmentation with high internal transport and communication costs;
<ul style="list-style-type: none"> ▪ Pre-existing commercial-sector agricultural investment and processing infrastructure; 	<ul style="list-style-type: none"> ▪ Geographical and economic isolation from large markets;
<ul style="list-style-type: none"> ▪ Relatively low incidence of agricultural pests and disease, naturally quarantined from the neighbouring countries; 	<ul style="list-style-type: none"> ▪ High fixed costs of providing governance and essential services per unit of population;
<ul style="list-style-type: none"> ▪ A unique natural and cultural environment attractive to tourism; 	<ul style="list-style-type: none"> ▪ Unique economic and social challenges in the interface between the 'traditional economy' and the 'modern economy';
<ul style="list-style-type: none"> ▪ A maritime environment with useful (if limited) fish stocks; 	<ul style="list-style-type: none"> ▪ Perennial cyclones, which produce occasional economic and societal shocks and restrict the range of viable crop and tree species.
<ul style="list-style-type: none"> ▪ Sea ports; 	<ul style="list-style-type: none"> ▪ Very small size with none of the economies of scale in inputs (including fuel and utilities), processing or markets enjoyed by competitors;
<ul style="list-style-type: none"> ▪ A stable, comparatively well-educated, society and abundant labour. 	

Source: Bazeley and Mullen 2006

The report concluded that the predominant constraint to growth is pervasive inefficiencies

throughout the value chain. It argued that there are no obvious binding constraints (as proposed by the

Hausmann, Rodrik and Velasco Growth Diagnostics framework). It also argued that a broader based growth was not an issue of finding a new commodity or identifying new niches per se, because productivity from existing crops and commodities could be significantly increased if society felt the incentive to do so, and Vanuatu has

little or no comparative advantage in pioneering new enterprise.

The report identified a set of inefficiencies in policy, the supply of public goods, operations of the private sector, infrastructure and the delivery of development assistance. These inefficiencies are summarised in Box B.2

B.2 Pervasive inefficiencies

Policy inefficiencies

- Policies are too inconsistent and short lived
- Policy making is insufficiently inclusive, consultative or evidence based
- A gap between executive and political arms of policy making

Inefficiencies in the supply of public goods

- Extension
- Enforcement of property rights
- Marginal capacity for sanitary and phytosanitary control
- Sub-optimal destination marketing of tourism

Private sector inefficiencies

- Monopolies, poor organisation of private sector, ambiguity re government investments in private sector activity

Infrastructural inefficiencies

- Market distorting protections in interisland shipping could be a binding constraint

Donor inefficiency

- Aid project-oriented and supply driven

Source: Bazelely and Muilen 2006

The report argued that in order to address the constraints

...more robust, locally-owned and transparent analysis of constraints to growth, and of policy and public investment options, needs to be generated and propagated. In part this can be achieved by freeing up existing analytical resources and strengthening units such as DESP – both in terms of resources and ways-of-

working – but it will probably also require some new mechanisms.

A deeper and more quantitative understanding is needed of the private sector and its strengths and weaknesses in contributing to broad-based economic growth. This implies a more responsive relationship between government and the private sector – again probably implying new institutional mechanisms – and the determination of how policy and public

investment can best be configured to support robust but equitable private-sector led growth. It also suggests a need for better sector performance data and information.

Cox et al, The Unfinished State

This report, commissioned by AusAID, adopted a 'drivers of change' framework to consider, from a political economy perspective, how structural (economic, social and cultural systems), institutional (formal and informal rules and incentives and actors (individuals and organization) interact to shape the environment for development. It places some of the factors affecting the nature of economic governance in an historical and cultural context, and discusses suggestions for development assistance that might that work in that context.

The report examines cultural drivers of the patronage system of politics in the country. It describes some of the drivers of political instability, and the role that patronage plays in driving the formation of unstable coalitions of politicians, with very short term agendas and limited commitment to creating a state that delivers public goods.

It argues that:

Corruption in Vanuatu should be viewed through the lens of the patrimonial system, as a systemic problem, rather than simply individual misconduct. The dispensing of largesse is seen as a legitimate means of obtaining status and influence. While some forms of corruption in Vanuatu carry heavy costs for the public, and have even brought the state close to bankruptcy, most ni-Vanuatu do not recognise it as affecting their personal interests. The formal accountability institutions – parliament, the Auditor General, the Ombudsman – have proved to be largely ineffective, and there is debate as to whether accountability processes of the adversarial type favoured in Western democracies are workable in Vanuatu.

Its main suggestions for Australian assistance are:

- Consolidate on the progress made in recent years in macroeconomic management, public

financial management and improved policy capacity. Make sure these core competencies are insulated against the effects of patronage and political instability

- Develop initiatives to enhance the capacity of the population to participate in the benefits of economic growth, to prevent inequality becoming a source of social and political instability.
- Increase opportunities to earn income in the rural areas, to relieve stresses on rural communities. Invest in rural transport and communications, and initiate credible agriculture and rural development programmes.
- Improve the capacity of the public administration to anticipate and respond to social changes and pressures, in areas such as land-use planning and social policy.
- Develop a coherent approach to state-building in Vanuatu, in particular by filling the gap between formal institutions and local communities, to enable the state to become an agent of development across its territory.

The report argues that there is a limited political constituency for radical reform, and argues for an opportunistic, issues based approach to building state capacity and improved governance. It also makes suggestions for improving aid effectiveness.

- Avoid overloading the policy agenda with too many initiatives and over-ambitious reforms. Given government's tendency to accept any assistance offered, donors need to prioritise their efforts, focusing on areas where there is a genuine political opening for change.
- Ensure consistency in donor interaction with the national policy process. Help build up policy capacity in key sectors, while supporting the Ministry of Finance to provide technical oversight through the budget process. Assist government to identify and focus on a limited number of development priorities, to provide a basis for medium-term budget planning.
- Improve harmonisation among donors, including through more joint programming, better strategic coordination and improved division of labour. Move towards simple forms

of programmatic assistance in key sectors, using government systems wherever possible.

- Give careful consideration to the prerequisites for effective capacity building. Recognise that long-term relationships with key institutions will be required. Ensure TA providers understand the importance of building relationships and consensus across stakeholders.
- Improve strategic coherence among donors through more intensive dialogue, including by selecting individual donors to lead the policy dialogue in particular sectors.
- Encourage government to develop a local service-delivery strategy that includes partnerships with non-state actors, including the churches.

Daniel Gay (ed) 2008, Diagnostic Trade Integration Study

The Diagnostic Trade Integration Study is an exercise carried out under the umbrella of the

Integrated Framework for Trade Related Technical Assistance to LDCs, an initiative established under the auspices of the WTO. It is designed to provide a basis for prioritized, coordinated trade related TA, and presents, among other things, a set of policy reform priorities and required capacity strengthening at the sectoral level to capitalize on major opportunities identified by the study.

The DTIS identified priorities in the areas of macroeconomic management, business environment and investment policy, the institutional framework for mainstreaming trade, trade policy, trade facilitation and trade, poverty and human development, as well as sectoral recommendations in tourism, agriculture, livestock and forestry, fisheries. The recommendations vary from very specific to core issues in trade to quite ambitious suggestions with regard to sectoral and regulatory change. Table B.3 presents a selection of macro and trade specific recommendations.

B.3 DTIS – selected recommendations

Macroeconomic management
Research localized reasons for decline in barter trade
Broaden government revenue base to reduce reliance on VAT and import duties
Provide audit training to customs and other revenue collection agencies, and TA for legislative drafting, training and strengthening of administration
Remove discretionary ability to grant exemptions, revise subsidies and tariffs
Review size and functionality of the public sector to reduce ratio of wages to expenditure
Train agencies to monitor and evaluate government expenditure. Review budget process.
.Review major government contracts, especially for stevedoring, and regulation of the gaming industry
Undertake study of interest rate spreads
Business environment and investment policy
Develop an e-business strategy to make it central to business development efforts
Address performance of Land Titles Office and capacity constraints
Ensure that court orders are enforced. Increase number of sheriffs
Reassess ni-Vanuatu micro-finance schemes under Ministry of Ni-Vanuatu Business, Support attempts of Department of Cooperatives to increase credit availability in rural areas
Develop a one-stop-shop for incoming foreign investment

<i>Institutional framework for mainstreaming trade</i>
Support an economic think tank and/or policy forum
Make the National Trade Facilitation Committee the national implementation unit of the enhanced Integrate Framework, and incorporate the DTIS into the government's Priorities and Action Agenda
<i>Trade policy</i>
Move External Trade Division to Ministry of Foreign Affairs
Adopt a national trade policy based in the DTIS
Update customs-related legislation
Re-start accession to WTO
Continue engagement with EPA process
Seek an FTA with New Caledonia
Monitor potential costs and benefits of Pacer Plus membership
Study impact of graduation from LDC status
<i>Trade Facilitation</i>
Review existing stevedoring contracts
Improve Vanuatu Quarantine and Livestock's ability to monitor import risks at the border, and assist efforts to ensure export quality
Initiate work on trade facilitation areas - standards and conformance, completion and consumer protection
<i>Trade, poverty and human development</i>
Improve access in outer island to financial services, study labour out-migration, research subsistence farming, promote indigenous entrepreneurship, undertake impact assessment before ratifying new trade agreements

Source: Gay (ed) 2008

Private sector assessments, 2009 and 2015

In recent years, the ADB has conducted, or managed a regional initiative that conducted, two private sector assessments.

These assessments follow a fairly standard approach of looking at factors in the formal business enabling environment that may hold back private sector investment and growth. Table 1 summarises the recommendations of the two assessments.

Both identified the poor state of infrastructure and its management as critical constraints, along with governance issues affecting governance of SOEs and the promotion of competition and access to land. But reflecting changes and progress made in the time separating the two assessments, the specific focus of suggestions under these heading differed.

The 2009 assessment focused primarily on passing commercial legislation that would underpin private

and financial sector operations, whereas the 2015 report focused more on implementation, institutional and regulatory issues.

As a significant departure, the 2015 assessment included recommendations on gender, and also ventured into the issue of political systems in Vanuatu.

Neither assessment seemed to consider the factors affecting the operations of informal and ni-Vanuatu owned business. Nor, beyond an observation about the nature of political parties, did either attempt explore the political economy issues shaping government-private sector relations. And neither seemed to take realistic cognisance of the severe capacity constraints limiting the potential operation of governance, regulatory and judicial institutions in the country when formulating recommendations.

B.4 Recommendations from two Private Sector Assessments

PSA 2009	PSA 2015
Upgrade Infrastructure <ul style="list-style-type: none"> Expand law for privately financed infrastructure Rehabilitate road network Review Port Vila wharves concession Review domestic shipping regulations and safety Contract out services at international airports Restructure Air Vanuatu Continue liberalising telecoms sector Review electricity tariff, introduce electricity sector regulation, tender Luganville concession Accelerate private piped water networks 	Upgrade infrastructure <ul style="list-style-type: none"> Urgently repair Port Vila airport runway Review and rationalize list of national infrastructure projects Strengthen national framework for infrastructure planning Build capacity to implement infrastructure policies and plans Improve maintenance of existing and planned infrastructure projects – build asset register and provide for maintenance expenditure in budget
Improve governance and reduce role of the state <ul style="list-style-type: none"> Reform SOE sector, especially governance and oversight Abolish VCMB Place VADB under regulatory authority of RBV, consider folding mandate into NBV Establish competition promoting legal framework, a regulator of natural monopolies and enact consumer protection legislation Repeal newly passed amendments to Employment Act 	Strengthen overarching governance <ul style="list-style-type: none"> Encourage formation of more representative and policy focused political parties Adopt more holistic and coordinated approach to addressing investment climate issues Improve engagement with private sector Strengthen institutions tasked with implementing reforms Reform SOEs <ul style="list-style-type: none"> Enact SOE legislation and supporting regulations Address immediate restructuring priorities, including Air Vanuatu, National Housing Corporation, NBV, VBTC, Asset Management Unit, VLDC, Metenesel Estates Make a decision regarding future of VADB Encourage Competition <ul style="list-style-type: none"> Develop a Competition policy and legal framework to encourage conditions that support competition
Reform the land leasing system <ul style="list-style-type: none"> Establish a registry of customary landowners who wish to lease their land Provide advisory services to all members of landowning family or clan Establish guidelines for lease agreements that specify low up-front payments and require annual payments to constitute a larger share of total payment Establish rules and laws to clarify customary landowners' rights of way on leased property Issue guidelines for restructuring lease payment to ensure landowners benefit from businesses established on their land Link leases to changes in CPI to eliminate need for frequent renegotiation of leases Speed up efforts to digitize land records and make them electronically searchable 	Implement land reforms Reduce investor costs and uncertainty in implementing new land laws – <ul style="list-style-type: none"> monitor piloting, amend Land Reform Act to remove certain preconditions for lease approval, Amend Land Lease Act to remove conflicts with Companies Act, make lease transfer fees consistent for all types of business, and develop a fairer and more transparent process for when a valid lease could be subject to forfeit Establish tools to assist landowners in negotiating beneficial lease agreement. Ensure improvement made in functioning of land registry are maintained, and that changes to leasing processes are integrated into its operations

B.4 Recommendations from two Private Sector Assessments (continued)

<i>PSA 2009</i>	<i>PSA 2015</i>
Modernise commercial legal framework <ul style="list-style-type: none"> ▪ Repeal newly passed amendments to Employment Act ▪ Enact new Companies and Bankruptcy Bills ▪ Amend Trustee Act ▪ Reform laws governing contracts, establish laws governing arbitration ▪ Streamline regulatory procedures to local and foreign investors seeking to start and operate businesses ▪ Ensure PACLii databases is up to date 	Improve foreign investment regime <ul style="list-style-type: none"> ▪ Improve transparency and speed of approvals ▪ Reduce number of activities from which foreign investment is excluded ▪ Separate regulation function from investment promotion function ▪ Strengthen investment promotion function, using people with private sector experience Improve labour regulations <ul style="list-style-type: none"> ▪ Strengthen labour legislation to better encourage employment generation ▪ Review policy and processes for issuing work/residence permits to foreign workers Improve business licensing <ul style="list-style-type: none"> ▪ Introduce framework licensing law to identify types of activities subject to licensing ▪ Convert business license application into a registration process Other <ul style="list-style-type: none"> ▪ Introduce a personal bankruptcy regime ▪ Amend Trustee Act Enhance system for resolving contract disputes
Expand access to finance <ul style="list-style-type: none"> ▪ Implement final phases of new Personal Property Securities Act ▪ Support NBV's microfinance initiative and smart banking program 	Improve functioning of the financial system <ul style="list-style-type: none"> ▪ Facilitate more effective use of collateral framework – broaden use of Personal Property Registry and sustain improvements Land Registry ▪ Improve usefulness of Data Bureau Vanuatu ▪ Encourage greater competition between second-tier financial institutions and commercial banks ▪ Strengthen role of VNPF ▪ Amend Financial Institutions Act to ensure that deposit taking entities above a threshold come under RBV supervision ▪ Build capacity of National Financial Inclusion Task Force ▪ Continue development of modern payment system infrastructure\ ▪ Strengthen regulatory foundation so financial sector – addressing deficiencies on AML/CFT system ▪ Monitor bank liquidity and ensure banks follow prudential norms for loan quality assessment ▪ Review economic costs and benefits of Offshore Finance Centre

B.4 Recommendations from two Private Sector Assessments (continued)

PSA 2009	PSA 2015
	<p>Advance gender equality</p> <ul style="list-style-type: none"> ▪ Strengthen Department of Women's Affairs ▪ Revise laws to address discrimination ▪ Introduce programs to help businesses achieve gender equality ▪ Increase number of women on overseas worker schemes ▪ Increase linkages between regulatory agencies and informal business sector ▪ Review licensing regime to reduce burden on small and micro businesses ▪ Ensure that screening of licenses and permits involves consultation with women entrepreneurs ▪ Increase awareness among women entrepreneurs of secure transaction framework for moveable property

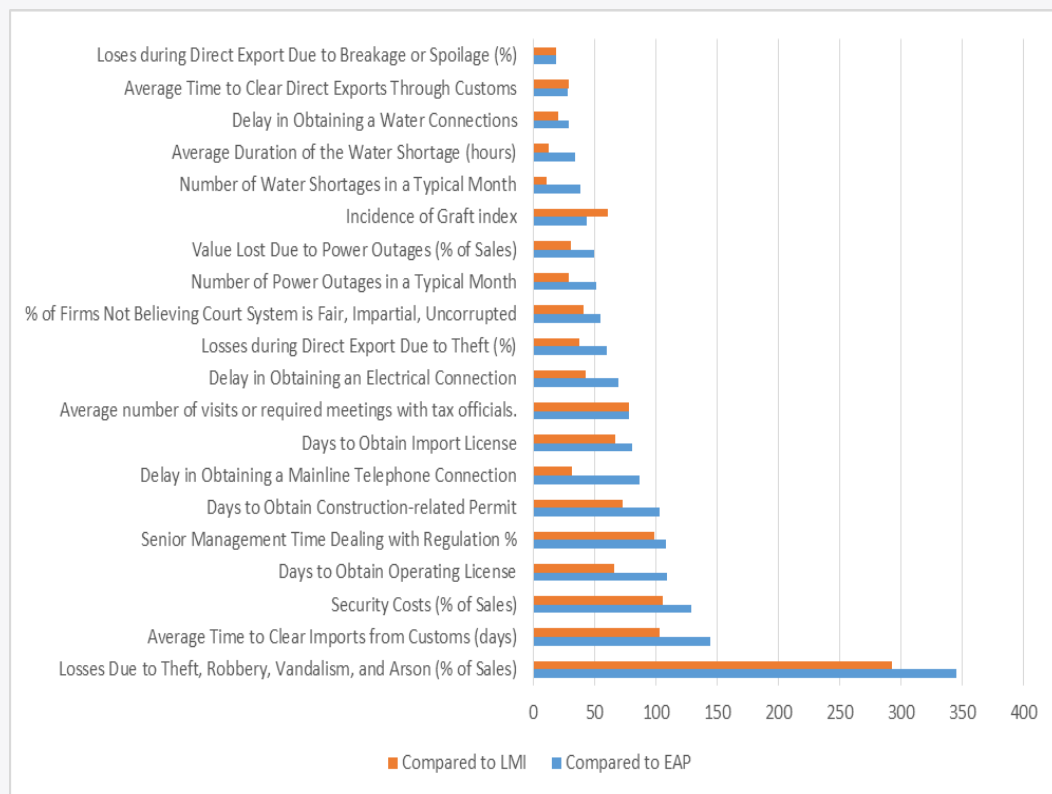
Source: ADB 2009, PPSDI 2016

IFC, Enterprise Survey 2009

This stratified survey covered a range of formally established firms operating in Efate Province. It found that the most frequently issues identified as major obstacles were: electricity (15.3 per cent of firms), access to finance (14.8 per cent), crime, theft and security (14.3 per cent), and inadequate education of the workforce (13.9 per cent). No firms identified access to land as the main obstacle, but the emphasis placed on access to finance may reflect issues with respect to use of land leases as collateral.

With the exception of costs of security and theft and time to clear imports through customs, Vanuatu compares favourably with comparator East Asia and the Pacific and Lower Middle Income Countries – see chart 3. (It does need to be stressed, however, that the survey is of established enterprises operating in the most developed province – it does not include perceptions of investors who have not established operations, or of firms on outlying provinces and islands.)

Error! No text of specified style in document...**1 Survey indicators – Vanuatu compared to East Asia and the Pacific and Lower Middle Income country averages**



Data source: IFC Enterprise Survey

AIMS, 2011, MSME Strategy for Vanuatu

This report, prepared with support from the Commonwealth Secretariat, included analysis of a survey of some 185 organisations, including 66 MSME operators, including enterprises in outlying islands.

The report observed there is little information about SMSEs in Vanuatu, since they are not captured in any official statistics, but pointed out

that most households operate some kind of cash generating livelihoods.

The survey identified 10 priority areas for action to address constraints perceived by respondents (see table 4). There were some slight differences in the set identified by respondents in outlying areas, who are more affected by costs of transport – within- and inter-island.

Error! No text of specified style in document..1 Priority action areas identified in MSME survey

<i>All respondents</i>	<i>Outlying island respondents</i>
Excessive government regulation	Difficulty meeting international standards
Shortage of quality suppliers	Shortage of quality suppliers
High interest rates	High cost of transportation
Difficulty meeting international standards	High interest rates
Access to capital	Land title difficulties
Policy distortions and inconsistency	Shortage of equipment/services
Land title difficulties	Excessive government regulation
High cost of inputs	Policy distortions and inconsistencies
Lack of strong business associations/cooperatives	Access to capital
Labour costs	Lack of support on product development

Source: AIMS, 2011

Among other things, the report argued in favour of producing specific MSME legislation, and working to improve the availability of business development services, assisting enterprises to meet quality and

other standards required in export markets, and bolstering the voice of the business sector (in addition to addressing infrastructure and business input cost issues).

Duncan and Nakagawa (undated) Obstacle to Economic Growth in Six Pacific Island Countries

In this undated paper, Duncan and Nakagawa apply the Hausman, Rodrik and Velasco Growth Diagnostic framework to assess binding obstacles to growth in Cook Islands, Fiji, Federated States of Micronesia (FSM), Kiribati, Samoa and Vanuatu. As proposed by HRV, the analysis examine factors that may comprise constraints in the main theoretical determinants of growth

- Inadequate returns to investment (geographical factors that raise the cost of

investment, poor human capital, poor infrastructure and high-cost of essential services, high costs of labour market interventions, and high business risks).

- Poor private appropriability due to:
- Government failure (micro-economic risks such as insecure property rights, poor contract enforcement, corruption, high taxes or inefficient tax structure, and high expected expropriation risk; macro-economic risks such as

unsustainable fiscal and current account deficits, unsustainable public debt, unsustainable monetary policy, and political instability or sovereign risk); or

- Market failure (large externalities, coordination failure, too little technology adoption or “self-discovery”, and weak public incentives for entrepreneurship)
- High cost of finance due to:
- High cost of access to domestic finance (low domestic savings, poor availability of collateral, controls over bank lending, risk of banking crisis); or
- High cost of access to international finance (high country risk, restrictions on foreign investment, regulations on the capital account).

The authors extend the framework to consider the possibility that some constraint may bind investment across the whole economy, while others may bind just one sector, giving the examples of government airline monopolies mainly affecting tourism, but telecommunications monopolies affecting the whole economy. The authors also point out that not all binding constraints may be fixable – they may be just too expensive or politically difficult to address. The authors go beyond the identification of market or policy based economic constraints to look at political economy factors that may underpin the prevalence and persistence of ‘technical’ constraints.

Table B.72 summarises the conclusions of the authors based on their logical, context specific examination of the factors in the HRV framework.

Error! No text of specified style in document..1 Constraints analysis

Growth determinant	Analysis
Returns to investment	Vanuatu is very high cost by reason of its geography - poor, high cost infrastructure and services - which lowers returns to investment Human capital is poor, but growth in private sector employment is demand, not supply, constrained
Private appropriability	Sovereign risk from potential devaluation not a major issue, but governance failures have threatened security of investments held in the financial system Poor contract enforcement by the judicial system is a constraint Insufficient protection of investment by the legal system, especially investment in land
Cost of finance	Difficulties in obtaining secure long term rights to land comprise a constraint to access to finance, exacerbated by difficulties of contract enforcement Scarcity of saving not a constraint, as evidenced by excess liquidity in the banking system

Source: Duncan and Nakagawa, undated

The authors examine aspects of the history of post-independence politics in Vanuatu, drawing on work by Keefer for the 2004 World Development Report²³, concluding that the underlying binding constraint in Vanuatu is the patron-client form of

politics that has developed in the country. They argue that this explains why it is difficult to mobilise political support to address constraints that generate rents that can be tapped into to support clientelism.

²³ Keefer argues that the probability of clientelism is high when the transaction costs of organizing voters are high, when ideological

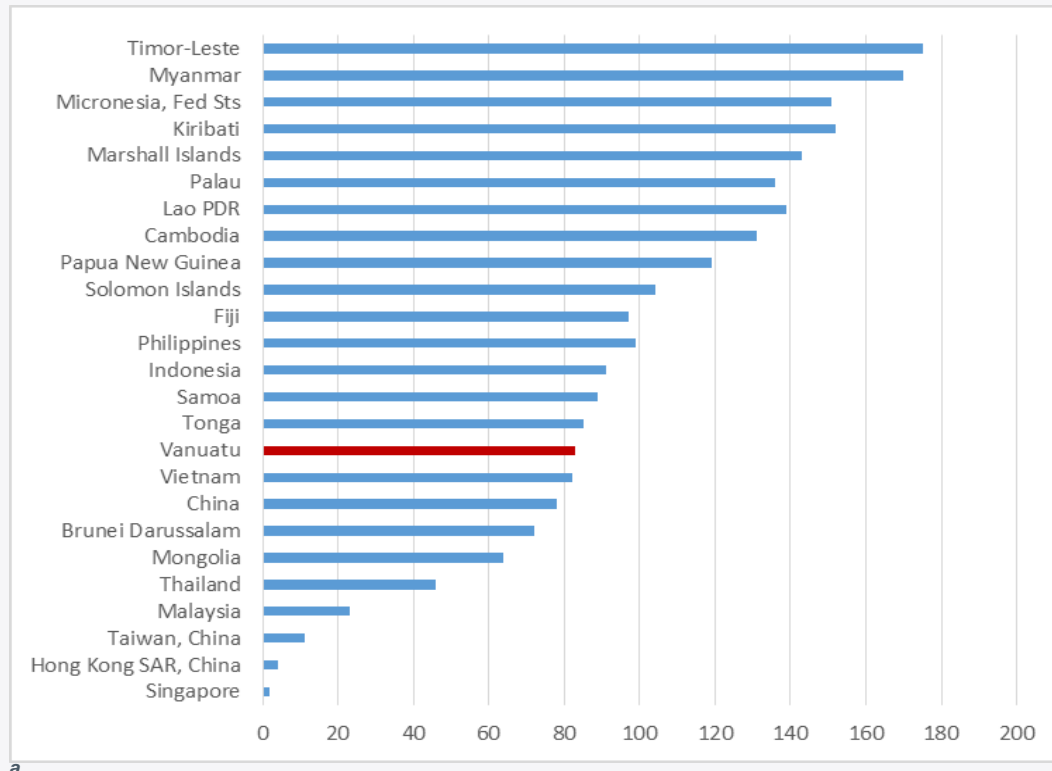
differences across politicians are slight, and it is difficult to provide credibility for promises made to potential voters

World Bank, Doing Business Indicators, 2016

The World Bank's Doing Business Indicators ranked Vanuatu 84th out of 190 countries according to its measure of the ease of doing business. As chart 4 shows, Vanuatu compares favourably with other Pacific Island Countries covered by the program. It

is important to note that the measures addressed by the analysis are based on expected experience of a wholly domestically owned limited liability company with 10-50 employees operating in the capital city.

Error! No text of specified style in document..1 Ease of doing business rankings in East Asia and the Pacific, 2017



Data source: World Bank, Doing Business 2017

Duncan 2016, Sources of Growth Spurts in Pacific Island Economies

In this paper, Duncan follows up on a suggestion by Lant Pritchett, who, bemoaning the lack of value in the large number of econometric studies trying to find correlates of growth, suggested looking in more detail at specific episodes of growth in developing countries. The paper examines growth spurts in eight Pacific Island economies, including the growth achieved by Vanuatu over the periods 1981-84, 2003-09, and a negative growth period 1985-89. It points to the critical role played by international commodity prices in shaping

Vanuatu's earlier growth record, and argues that the sources of the sustained growth spurt 2003-09 were initially improved agricultural export markets, followed by:

- aid-funded infrastructure investment;
- liberalisation of air-line services; and
- foreign investment in tourism facilities and real estate.

Unlike some other smaller Pacific Island economies, remittances did not play much of a role in

Vanuatu's recent growth spurt, which has mainly been driven by policy reforms supporting tourism.

The paper revisits the higher order principles espoused by Rodrik (2004) as necessary for growth to take place (macroeconomic stability, global integration, secure property rights and social cohesion and political stability). The paper argues that Vanuatu has enjoyed a reasonably stable macroeconomic environment since reforms were introduced in the early 2000s, observing that its strong fiscal and monetary institutions, and the sound fiscal and monetary policies supported by

these institutions (Ministry of Finance and Reserve Bank) have not been derailed by the country's political instability²⁴. The paper also argues that Vanuatu has (relative to many of its Pacific neighbours) has created a friendly business environment for tourism, with secure property rights for the sector, and open markets for international airline services and mobile phone and internet services.

The paper argues that contrary to conclusions in the broader literature, Vanuatu's experience suggests that reform can lead to growth spurts.

World Bank 2016 Pacific Possible papers

As part of a process of stimulating new thinking about development opportunities in the Pacific, the World Bank commissioned a set of studies under the label 'Pacific Possible'. Reports have been released for the following studies: Precautionary Management of Deep Sea Mining Potential in Pacific Island Countries, Pacific Possible, Climate and Disaster Resilience, Tourism, Labour Mobility, Tuna Fisheries, and Health. A further report on Knowledge Economy has been foreshadowed.

These reports are regionally focused, but they do serve to highlight some issues that the Government will have to address. These include:

- Improving the functioning of the education system to enable people to take advantage of

temporary migration opportunities, and to reduce the potential 'brain-drain' effects that expanded migration might cause.

- Addressing the impacts of non-communicable diseases: both in terms of the costs of morbidity and mortality on the workforce, but also the burdens imposed on the health system and budget.

These both have particular implications for improving financial management and resource use in the government education and health systems, and may be impacted by the pursuit of enhanced deconcentration/decentralisation.

²⁴ It is also worth noting that the strength of Vanuatu's Public Finance Management Act has been cited as one reason why the country has

not experienced the inflation of politically administered expenditures (or slush funds) that has been seen in other Melanesian countries (Fraenkel, in Duncan (ed) 2011).

IMF Article IV consultation reports

Recent Article IV consultation reports have raised concerns over debt and fiscal sustainability, particularly given the recent expansion of spending on major infrastructure projects. (The 2016 debt sustainability assessed the country's debt rating as 'moderate risk')²⁵. The reports have also recommended that action be taken on the financial sector, to secure financial stability by gradually normalizing regulatory requirements for the banking and non-bank financial sectors.

The 2016 report also highlighted the significant and ongoing fiscal cost of poor SOE financial performance, particularly Air Vanuatu (Operations) Limited and Airports Vanuatu Limited, and questioned the rationale for continued state involvement in the National Bank of Vanuatu and the Agricultural Development Bank. It argued for passage and implementation of the proposed Government Business Enterprises Bill.

The IMF's Article IV consultation reports often include brief discussions of structural issues.

The report for 2015 commented as follows:

- Infrastructure bottlenecks hindered economic activity, including tourism and agriculture.
- There is room to improve Vanuatu's ranking on the ease of starting a business and registering property. The cost of electricity is among the highest in the region. Land issues remain a challenge to business development, although to a lesser degree than in many other Pacific islands. The recent reforms to dispute resolution and leasing regime for customary land can be expected to improve transparency and fairness, but their impact on the ease of doing business remains to be seen.
- Vanuatu's export base is narrow, concentrated in tourism (primarily from Australia) and a few cash crops. Improvements in connectivity—thanks to the recently

completed submarine cable connection, planned investment in transport infrastructure, and lower fuel prices—should facilitate introduction of new activities (e.g., call centres), robust growth beyond the capital, and expansion into new markets. In particular, the growing middle class in emerging Asia could be a major source of tourists, but tourism promotion in new countries is needed. On the other hand, Vanuatu's offshore financial sector has been under pressure from various Anti-Money Laundering – Counter-Terrorism Financing (AML-CTF) initiatives, and has shrunk further after the Global Financial Crisis. The government may wish to consider whether the benefits of hosting the offshore financial sector outweigh the costs, including reputational risks.

The 2016 report observed that:

- Improving access to employment opportunities and to basic social services is a priority, especially in the outer islands. Enhancing the educational attainment and skills of the poor deserve particular emphasis. The ability to access external labour markets is a window of opportunity for poverty reduction and inclusion. Several PICs, including Vanuatu, have had labour mobility agreements with Australia, New Zealand, or the United States. Expanding these agreements will prove critical in addressing the country's unemployment challenges.
- Seasonal workers in Australia and New Zealand have increased, raising their living standards and those of their families at home. However, workers could be marketed more effectively and their skills enhanced with appropriate training policies.
- The authorities are making efforts to promote financial inclusion, but meeting lending needs by many small and medium-sized enterprises (SMEs) remains challenging,

²⁵ Note that Nik Soni in a recent commentary for the Pacific Institute of Public Policy has argued that contingent liabilities faced by the Government are very large, and not well accounted for (Soni, 2016).

especially given stringent collateral requirements

- Quality upgrading and diversification are expected to play a critical role in promoting inclusive growth. Improvements in connectivity—thanks to the recently completed submarine cable connection, planned investments in transport infrastructure, and lower fuel prices—are attracting more and higher quality tourism. Exploring niche markets and tapping on Vanuatu’s agricultural resources as in input for the tourism industry—agro-tourism—will be beneficial for poverty reduction and inclusion. Efforts to increase agricultural production, including beef production, provide diversification in domestic activities that can

serve the economy well and provide an additional buffer against external shocks.

- Improving the ease of doing business is an important complement in promoting quality upgrading and diversification. Enhanced competition would help address the high cost of doing business in Vanuatu that hinders entry into new lines of economic activity, which in turn limits opportunities for quality upgrading and productivity boosts. There is room to improve the country’s standing on the ease of starting a business, registering property, and land titling. The recent reforms to the leasing regime for customary land have caused unexpected delays in the process of registering land due to some inefficient procedures aimed at improving transparency.

C. PROBLEMS IDENTIFIED IN VANUATU'S PFM SYSTEM

Over the course of the GfG program, there have been a number of assessments of aspects of Vanuatu's public financial management (PFM), public expenditure management (PEM) and public sector management. These include reports of assessment undertaken using the Public Expenditure and Financial Accountability (PEFA) framework, reports on Article IV consultations with the IMF, and Assessment of National Systems (ANS) and Fiduciary Risk Assessments (FRAs) undertaken

by DFAT. Some of these almost certainly have informed the reforms that GfG has supported, others have commented on implementation of these reforms. Reports commissioned by GfG have also considered the quality of systems.

Table D.1 summarises the main issues identified in these assessments since the beginning of the program. Table D.2 presents the PEFA scores from the assessments made during the life of the program, in 2006, 2009 and 2013.

C.1 Weaknesses on PFM, PEM and PSM identified by external assessments

Year reported	Details of weaknesses and potential improvements
2008	<ul style="list-style-type: none"> ▪ Reporting on fixed assets and SOEs is poor ▪ External audit of financial statements is poor ▪ MFEM not producing its annual statement on its breaches of the PFEM Act ▪ Reactivating the Public Accounts Committee is a priority
2009	<ul style="list-style-type: none"> ▪ Intra-agency reallocations of budgets funding during the year harm service delivery and are not aligned with sector priorities ▪ Implementing school grants scheme for finance officers is and will be a capacity challenge – resources will be needed ▪ One-quarter of public servants are not aware of their responsibilities under the PFEM Act and only half know their department's budget. These results suggest greater financial management training is needed ▪ MFEM not producing its annual statement on its breaches of the PFEM Act ▪ Reporting on fixed assets and SOEs is poor ▪ Internal and external audit has gaps – MFEM outsourcing audits with the absence of an Auditor-General ▪ The Public Accounts Committee needs to be reactivated ▪ Need for better GfG analysis around some budget indicators, such as whether virements are decreasing
2010	<ul style="list-style-type: none"> ▪ The use of FSBs is limited as line ministries are not devolving greater responsibilities and spending power to their provincial managers. Awareness is an issue. That said, FSBs are sustainable provided that MFEM can continue to train and deploy personnel ▪ Ongoing need to strengthen integration between MFEM and line agencies in provinces ▪ Level of imprest held by agencies like the MoH is a concern for MFEM ▪ Problems in the budgetary costing of future year's expenditures from current and proposed physical capital and other GoV projects. ▪ PSC should consider ways to redesign and implement new structures for the public service – there are inconsistencies, gaps, weak controls and poor incentives for good management in the management of overall public sector staffing and costs. ▪ There is a backlog of external audits to be done by the Auditor-General ▪ A range of procurement system and practice gaps remain: legislation, regulations and templates for standard procurement procedures. ▪ MFEM's understanding of the operations of SOEs needs strengthening ▪ Customs revenues realized tracked well below expectations

C.1 Weaknesses on PFM, PEM and PSM identified by external assessments (continued)

Year reported	Details of weaknesses and potential improvements
2011	<ul style="list-style-type: none"> Agencies' capacity to apply procurement laws is variable SOEs should have better reporting
2012	<ul style="list-style-type: none"> There is a lack of control over staffing
2013	<ul style="list-style-type: none"> Lack of regular asset stocktakes generally a problem across government. Valuations are not in place for a range of property, plant and equipment and fixed assets. This limits the accuracy of GoV's financial statements. There is no meaningful scrutiny of the Budget estimates by Parliament. There is no sector based oversight or estimates committees. The estimates are the responsibility of the PAC, but it only met on four times in 2011 and 2012, with only one report tabled. The OAG has met several times earlier this year with the PAC to discuss options for support and assistance. Weak or no compliance with established systems. For example, MFEM are aware that Ministries hold on to invoices where funds are not available and do not submit them to MFEM, so they ask each Ministry to list these at the end of each year. Financial controls are by-passed in the recruitment of personnel – particularly the requirement for financial visas for staff recruitment, which is not always followed. The result is that funds have to be internally diverted from operational expenditures to payroll (virement), undermining the coherence of expenditure programs and service delivery. Virements within operational expenditure items frequently going to lower priority expenditures – e.g., scholarships, vehicles and fuels, international travel Payroll costs for severances and retirements not properly accounted for, and agencies have to make virements to cover this by reducing other expenditures At this time PMO, MoH and MoE had a tendency to overspend, forcing MFEM to require virements from other Ministries Unofficial purchase orders are honoured at times Sanctions for financial non-compliance are not consistently applied Internal audit recommendations are not always acted on by management at agencies SOEs are not reporting in a timely fashion on their financials There is limited overall co-ordination and prioritisation of PFM reforms within MFEM and across government Budgeting for equipment replacement and maintenance is poor Reduction of parliamentary oversight of new loans, removing the requirement for new GoV borrowing to be approved by Parliament. New arrangements allow the Minister of Finance to approve loans and report them to Parliament at the next sitting. Public availability of legislation and documents associated with PFM and PSM is lacking, with neither the legislation nor the regulations available to the public through the GoV website. PAC oversight of the public sector is limited. This year it met five times and had problems obtaining a quorum. No public hearings were held. Financial manuals supporting the Acts and Regulations exist, these are also not readily available to the public or staff in line agencies. This has reduced the awareness of the legal framework and increases the risk that the required processes and controls are not followed. No formal process for dealing with requests for information or complaints by the public within MFEM

C.1 Weaknesses on PFM, PEM and PSM identified by external assessments (continued)

Year reported	Details of weaknesses and potential improvements
2013 (continued)	<p>Key issues at line ministries:</p> <ul style="list-style-type: none"> ▪ A lack of knowledge of procedures and controls surrounding the PFM system result in poor awareness and compliance with PFM procedures. ▪ There are regular attempts to bypass purchase order requirements for entering into commitments ▪ There remains weak internal audit capacity ▪ MFEM has identified the main weakness at line Ministries is senior management failing to act on reported financial misconduct. This has prevented the PSC from initiating the misconduct procedures in the Public Service Manual ▪ Movement of funds within agencies is largely to reduce core operational expenditure. This is through a mix of overspending on the payroll, unaccounted costs (such as severances) and the movement of funds from high to lower priority operational expenditures. This mix of factors harms intended budget execution. ▪ There have been big improvements in the external audit function, with the appointment of a new Auditor-General and provision of TA. A substantially greater number of external audits have been carried out, opinions issued and reports prepared. Despite the outsourcing of some audits, capacity constraints (both in terms of staffing and expertise) are currently limiting the scope and nature of work. Impact is undermined by the fact that the PAC has not met on a regular basis. ▪ Use of and existence of plans and links between plans at the central and sector level has many gaps and do not link to the budget process closely
2014	<ul style="list-style-type: none"> ▪ Flows of funds to service delivery units, particularly in health is problematic. ▪ Reflecting the critical systemic role of MFEM, improvement initiatives have been largely centred in it and are widely regarded as successful. However, the major work of radiating improved PFM to the service delivery and line agencies has been limited and there are patchy levels of improved financial management in these areas. ▪ The backlog of auditing the Government Financial Statements has been addressed and these should in the future be available in a timely manner. This should enable a shift in the focus of work to undertake specific entity and performance audits. There is an overall concern in respect to the operation of the PAC as unless this body is prepared to take the material provided to them from the OAG and hold the respective public institutions accountable it signals that at the highest level, good PFM is not regarded as an important matter.

C.2 PEFA Scores for Vanuatu – 2006, 2009 and 2013

		2006	2009	2012
A. PFM-OUT-TURNS: Credibility of the budget				
PI-1	Aggregate expenditure out-turn compared to original approved budget	A	B	A
PI-2	Composition of expenditure out-turn compared to original approved budget	A	A	A
PI-3	Aggregate revenue out-turn compared to original approved budget	A	A	C
PI-4	Stock and monitoring of expenditure payment arrears	A	A	A
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency				
PI-5	Classification of the budget	B	B	B
PI-6	Comprehensiveness of information included in budget documentation	A	B	B
PI-7	Extent of unreported government operations	D+	C+	B+
PI-8	Transparency of inter-governmental fiscal relations	B	B	B
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D	D+	D↑
PI-10	Public access to key fiscal information	C	C+	C
C. BUDGET CYCLE				
C(i) Policy-Based Budgeting				
PI-11	Orderliness and participation in the annual budget process	B+	B+↑	A
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	C+	C+
C(ii) Predictability and Control in Budget Execution				
PI-13	Transparency of taxpayer obligations and liabilities	C+	B	B
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	B	B↑	B
PI-15	Effectiveness in collection of tax payments	D+	D+	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	C+	B+	B+
PI-17	Recording and management of cash balances, debt and guarantees	C+	C+	C+
PI-18	Effectiveness of payroll controls	C+	C+	C+
PI-19	Competition, value for money and controls in procurement	D+	D+	D
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	C+↑	C
PI-21	Effectiveness of internal audit	D+	C	D+

C.2 PEFA Scores for Vanuatu – 2006, 2009 and 2013 (continued)

		2006	2009	2012
C (iii) Accounting, Recording and Reporting				
PI-22	Timeliness and regularity of accounts reconciliation	B	B	B
PI-23	Availability of information on resources received by service delivery units	C	C	D
PI-24	Quality and timeliness of in-year budget reports	B+	B+	B+
PI-25	Quality and timeliness of annual financial statements	B+	A	B+
C(iv) External Scrutiny and Audit				
PI-26	Scope, nature and follow-up of external audit	D	D	D
PI-27	Legislative scrutiny of the annual budget law	C+	C+↑	C+
PI-28	Legislative scrutiny of external audit reports	D	D	D+
D. DONOR PRACTICES				
D1	Predictability of Direct Budget Support	D	C	D
D2	Financial information provided by donors for budgeting and reporting on project and program aid	D	D+	D+
D3	Proportion of aid that is managed by use of national procedures	D	D↑	D

Source: www.pefa.org

D. WHAT MATTERS FOR GOOD PFM, PEM AND FISCAL POLICY – SOME KEY HIGHER ORDER OBJECTIVES AND LESSONS FOR THINGS TO FOCUS ON

D.1 Objectives for fiscal policy - 3 dimensions

1. Aggregate Fiscal Discipline	Budget totals are the result of explicit, enforced decisions; they do not merely accommodate spending demands. Totals are set before individual spending decisions are made, and are sustainable over the medium-term and beyond
2. Allocative Efficiency	Expenditures are based on government priorities and the effectiveness of public programs. The budget system spurs reallocation from lesser to higher priorities and from less to more effective programs
3. Operational Performance	Public goods and services are delivered in a manner that is economic, efficient and effective

D.2 Schick's view - sequencing Public Financial Management Reforms

Under the heading Getting the Basics Right, Allen Schick advanced the following proposals for prioritisation and sequencing in PFM during a presentation to World Bank staff in 1998:

- Foster an environment that supports and demands performance before introducing performance or outcome budgeting
- Control inputs before seeking to control outputs
- Account for cash before accounting for accruals
- Establish external controls before introducing internal control
- Establish internal control before introducing managerial accountability
- Operate a reliable accounting system before installing an integrated financial management system
- Budget for work to be done before budgeting for results to be achieved
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector
- Have effective financial auditing before moving to performance auditing
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them

Sources: Allen Schick, 1998 and 2005

D.3 PFM reform lessons from OECD-DAC and DFID

Successful reforms:

- satisfy a demand for reform
- are country led and owned; donors step back and create space for government to lead
- fit the country's circumstance
- are appropriately sequenced
- do not have an excessively technocratic focus
- consider government capacity, and recognise that this is a government, not donor, job
- often, accompany broader public sector reforms
- consult widely to create customised solutions, not transplanted solutions
- strengthen the role of the Supreme Audit Institution
- embed reforms in regular budget processes and for key spending lines
- recognise that there is no quick fix
- have a champion to push agendas and shepherd reforms through the politics
- use joint diagnostics for better ownership
- take advantage of external incentives for reform
- builds ownership, awareness and some capacity in the line ministries and among lower governments
- reforms fundamental 'basics' first (Schick paradigm)
- do some diagnostic tracking of reform progress

Problematic reforms:

- are often overambitious or rushed
- tend to overestimate bureaucratic capacity to run more complex systems
- might have a failed integrated financial management information system
- have sometimes being pushed by donors wanting better government systems to funnel their resources through.
- might have suffered incoherent, or uncoordinated donor support.
- Sometimes have donors that impose reform programs or transplant international models

Sources: Compiled by the authors drawing on Pretorius & Pretorius, 2009.

E. PFM, PEM AND PSM INITIATIVES SUPPORTED BY GFG

Over the course of its two phases, GfG has supported activities across a broad range of elements of public financial management (PFM), public expenditure management (PEM) and public sector management (PSM). It has supported work in

- Overall fiscal policy and PFM reform management;
- Policy and planning;
- Donor funds management and coordination;
- Controls, payments and systems;
- Human resource management;
- Planning, delivery and reach of public services;
- Macroeconomic management, fiscal management, revenue and debt management;
- Management of state owned enterprises;
- Procurement and public investment; and
- Accountability frameworks and auditing.

Table E.1 presents detail of the work undertaken with this support and its sequencing.

E.1 GfG activities in PFM, PEM and PSM

	Key activities, grants to GoV agencies and timing	Achievements and outcomes that GfG supported
Overall fiscal policy and PFM reform management	<ul style="list-style-type: none"> MFEM grant 2008 to 2016, short term assistance to MFEM, including: <ul style="list-style-type: none"> VAT compliance adviser Revenue system upgrade CTB procurement adviser CTB tender database Fixed asset adviser and infrastructure valuation support Tax policy advisor Coordinator for PFM reforms. 2009/10 to 2011/12 Strategic PFM Adviser 2013/14 to 2014/15 OECD TIEA regulations drafting Statistics adviser SmartStream upgrade and budge software upgrade assessment PMO grant activities 2013 to 2016: <ul style="list-style-type: none"> Sectoral analysis and expenditure adviser Policy implementation adviser Economic analysis Support for the National Sustainable Development Plan Advisory support: machinery of government, administrative efficiency and local development, review of legislative instruments, organizational structure and corporate planning. VPMU legal support OGCIO PSC institutional strengthening GfG grants with the Ministry of Trade, Department of Energy, Utilities and Telecommunications Regulators, Office of the Auditor General and the National Bank of Vanuatu. Assessment of the PMO functions. 2013/14 	<p>2008:</p> <ul style="list-style-type: none"> helping government to design and implement a new budget process and supporting systems so the national budget better reflects government's policy priorities, including integration and alignment of donor funds. helping government to implement a major restructure of the PMO and MFEM, intended to improve the alignment between government policy and budgeting assisting the Prime Minister's Office to prepare the 'Thinking Long, Acting Short' policy matrix to focus effort and resources on the new government's core priorities Strengthening the level of information and analysis about the budget, including: assisting the government to install new Financial Management Information System modules, which substantially improved the quality and timeliness of information feeding into the budget process. For the first time, the Annual national budget process commenced with bilateral discussions between MFEM and the Prime Minister's Office, which resulted in the production of Budget Policy Statement to guide the formulation of sector level Budget submissions Supported Vanuatu government to implement a 'Development Budget' for 2010 and progress made to implementation. This important initiative will bring donor and government resources together under one budget, which will in turn help the government ensure aid programs are fully aligned with its policies. Amendment of the Public Finance and Economic Management (PFEM) Act. The bill will strengthen accountability and improved the structure of PFM responsibilities in government Strengthening the consideration and integration of public financial management within other AusAID funded sector programs (e.g. education and health). 2009-12: Upgrade of budget management system 2009: helping Vanuatu government to design and implement a new integrated national budget process so that the budget better reflects government's policy priorities, including integration and alignment of donor funds. 2009: facilitating a substantial increase in the amount of donor funding being channelled through government systems 2009: assisting the Prime Minister's Office to prepare the 'Thinking Long, Acting Short' policy matrix to focus effort and resources on the new government's core priorities 2009: Production of Budget Policy Statement to guide the formulation of sector level budget submissions 2010: supporting the Vanuatu government to implement the integrated national budget which is helping to ensure the budget better reflects government's policy priorities, including integration and alignment of donor funds.

	Key activities, grants to GoV agencies and timing	Achievements and outcomes that GFG supported
	<ul style="list-style-type: none"> GFG PFM coordinator. 2008/09, 2009/10 PFM Adviser (GFG). 2013/14 to 2014/15 	<ul style="list-style-type: none"> 2010: supporting the Prime Minister's Office to improve planning, coordination and better link line ministry outcomes with the Government's core policy priorities, including the 'Priorities and Action Agenda' and 'Planning Long, Acting Short' policies. 2013: Work on functions and guidance to improve efficiency and effectiveness of PMO
Controls, payments and systems	<ul style="list-style-type: none"> Establishment of Financial Services Bureaus. 2007/08 to 2011/12 and 2013/14 Amending PFM Act – assistance to the SLO. 2008/09 MFEM Systems adviser. 2009 to 2012 Vanuatu fiduciary risk assessments for DFAT (Assessment of National Systems), 2011, 2012 Upgrade of Vanuatu Budget Management System. 2008, 2009 OGCIO grant 2013-2016 Provision of PFM and procurement advisory support for the GFG program grant recipients. 2015/16 to 2016/17 	<ul style="list-style-type: none"> 2009: The first FSB was established in Santo. Planning for in Tanna and Malekula underway. 2009-2013: FSBs established in all provinces. Payments through the FSB's increased and FSB's have reduced payment times and increased confidence in government with the local private sector. 2012: OGCIO and MPU established in the PMO, improving capabilities for ICT and major infrastructure projects Various: Strengthening FMIS Various: Revisions to Finance Regulations 2009 onwards: Strengthening FMIS controls
Human resource management	<ul style="list-style-type: none"> Survey of public servants. 2009 Executive Development Workshop for PSC. 2010/11 PSC performance framework project - PSC role and issues, with a full functional review, 2016 	<ul style="list-style-type: none"> 2010: Public forum on Survey of Public Servants
Planning and delivery and reach of public services	<ul style="list-style-type: none"> Financial management support – Vanuatu Malaria Program. 2008/09 Public Policy and Planning (Asquith). 2008/09 PFM Assessment of the Ministry of Agriculture. 2015/16 Assessment of financial management capability and capacity in the Ministry of Tourism, Trades, Commerce and Industry. 2013/14 GFG flags that Phase II of the program will provide increased program capacity to address the outstanding whole of government issues surrounding the relationship between policy development and budget and improving PFM in the line ministries. Some of the work at the line ministry level will be within the agencies of MPM, particularly DSPPAC. From 2013 	<ul style="list-style-type: none"> 2008: Health and education sector strengthening of financial management, to facilitate provision of grants through government systems (e.g. Malaria Fund). 2009: Health and education sector strengthening of financial management, to facilitate provision of grants through government systems (e.g. Malaria Fund, school grants). 2009: Supported GoV to develop the concept to do the school grants program and implementing financial management arrangements, to support the policy goal of fee-free primary school education by 2012. 2010: School grant work reached 351 out of a target 355 schools setup with new bank accounts. 2010: facilitating an increase in the amount of donor funding being channelled through government systems

	Key activities, grants to GoV agencies and timing	Achievements and outcomes that GFG supported
	<ul style="list-style-type: none"> GoV public expenditure reviews for health, education and infrastructure 	
Macroeconomic and fiscal management, revenue and debt	<ul style="list-style-type: none"> ABS support to VNSO 2008, 2009. GFG support to VNSO (census, statistical coordination and dissemination), 2009, 2011. MFEM advisors in the Customs and Compliance and VAT sectors, 2011 	<ul style="list-style-type: none"> 2008, 2009: Strengthened corporate governance within NSO including development of a strategic plan and work plan, improving quality of national accounts and CPI data (rebasings). 2008: GFG advisers in MFEM worked on: economic analysis and forecasting, including production of the Mid-year, End of Year and Budget Economic and Fiscal Updates, and analysis of expenditure submissions for 2009 budget. Improvements to the approach to forecasting revenue, to get a more accurate resource envelope. 2009: Further improvements to revenue forecasts. Supporting GoV enforce aggregate fiscal discipline and record a second straight surplus. 2011: DoFT set up a working group with Customs and Inland Revenue to improve transparency in tax compliance measures and policy. 2011: VNSO for the Statistical coordination and dissemination unit releases census data 2012, 2013, 2014, 2015: Support to revenue collection saw targets largely met and VAT compliance rise 2012 onwards: Capacity building in Customs and Inland Revenue to improve skills in risk management and audit, and to improve compliance levels 2015: GFG's tax policy advisor commenced a wide ranging tax review, led by the new government, supported by three GFG funded advisers (including in policy and administration). 2016: GoV proposes to introduce an income tax, with support from GFG funded advisers 2008 onwards: enforcing hard budget constraints and general fiscal discipline at the agency level
State Owned Enterprises	<ul style="list-style-type: none"> National Bank of Vanuatu Grant for ITC satellite systems with renewable power systems. 2009/10 GfG and IFC work with the government to improve efficiency and corporate governance of Air Vanuatu, including assessments of Air Vanuatu's viability and financial accounts preparation, 2009 and 2010 	<ul style="list-style-type: none"> 2008: GfG helped the government to engage IFC to run a transparent tender process for the part-sale of Air Vanuatu. 2010: NBV - establishment of a Satellite Communication Network connecting 12 branches throughout the country 2011: A 5 year strategic plan is in progress for the Vanuatu National Provident Fund
Procurement and public investment	<ul style="list-style-type: none"> Port terminal and reforms and General Manager. 2009- Procurement diagnostic Study, 2009. Scoping for procurement reform, 2010. Procurement policy and procedures. 2011/12 	<ul style="list-style-type: none"> 2009: Power sector coordinator is working to support the government in addressing access and affordability issues, and in developing a forward investment program. 2010 to 2015: Supporting procurement reform (streamlined procedures, standardized bidding documents) gave rise to greater use of GoV systems among donors, an increase in use and compliance by GoV agencies and, perhaps, improved procurement capacity and awareness across GoV.

	Key activities, grants to GoV agencies and timing	Achievements and outcomes that GFG supported
	<ul style="list-style-type: none"> ▪ Analysis of options to improve operations at the Luganville wharf, 2011 ▪ Energy department grant 2013 	<ul style="list-style-type: none"> ▪ 2010 onwards: increasing economic activity at the local level (through FSB's, due to greater reliability and efficiency of government payment systems, encouraging private sector to do business with government)
Accountability frameworks	<ul style="list-style-type: none"> ▪ OAG grant agreement 2010 onwards ▪ Senior auditor in the Office of the Auditor-General. 2010/11 to 2016/17 	<ul style="list-style-type: none"> ▪ 2008: Assisting in the preparation of revisions to the PFEM Act which will enhance accountability in the use of public funds. ▪ 2008: assistance to the Internal Audit Unit of DoF to review the financial management arrangements in the Ministry of Health (MoH) which resulted in several key recommendations for improving financial management in the Ministry. ▪ 2008 and 2009: The GoV met its fiscal and reporting obligations ▪ 2009: Assistance to the Internal Audit Unit of DoF to review the financial management arrangements in the Ministry of Health (MoH) which resulted in several key recommendations for improving financial management in the Ministry. ▪ 2009: Passage of the amended Public Finance and Economic Management (PFEM) Act, which has strengthened the management of public funds and improved accountability to Parliament and oversight. ▪ 2011 onwards: The Office of the Auditor-General clears the backlog of government audits. Between 2011 and 2013, 34 audits were completed, compared to 1 between 2007 and 2010. OAG continues to make good progress clearing backlog of audits, but the nascent Public Accounts Committee needs attention in order to justify current model of support. In 2012, it met five times and had problems obtaining a quorum. No public hearings were held. ▪ From 2013: Supported improvements to internal audits and controls ▪ 2015: Assisting GoV to monitor expenditure and revenue at the provincial level

F. VANUATU TAX REFORM

DOMESTIC TAX REFORM

Vanuatu is undertaking a range of tax reform work including the introduction of personal and corporate income tax, a review of existing taxes, non-tax revenue and modernisation of the Department of Customs and Inland Revenue.

The introduction of the income tax is by far the most controversial and extensive of the proposed tax reforms. Vanuatu currently operates as a tax haven, with no tax paid on income. The proposal is to introduce a three tier progressive personal income tax system: a tax-free threshold of 750,000 vatu (approximately \$9,000), a base marginal tax rate of 10% for income above 750,000 vatu and below 3.5 million vatu (\$44,000), and a top marginal rate of 17% for income above \$3.5 million vatu. Corporate income tax will be a flat tax set at 17% on profits. Current calculations indicate the tax will target 15% of formal sector employees. Some informants indicated consider this is too few, and that a broader tax base is needed. The majority of public service employees will fall within the first tier of tax at 10%.

There has been some controversy on the role Australia is playing in the introduction of the income tax. GfG supports two advisers within the Department of Customs and Inland Revenue that already play an important role in the reforms. Earlier this year, newspapers suggested Australia was 'bullying' Vanuatu into introducing an income tax. The paper later issued a retraction, but the example shows that involvement in tax policy work can be fraught. Further, this is another example of the benefits of the GfG arm's length modality providing ownership to the Vanuatu government to manage recruitment and insulating Australia around such sensitive issues as tax reform.

Unsurprisingly, there has been vocal opposition to the introduction of income tax from the business community. Common grievances include the additional layer of regulation created by the income tax and that the introduction of the tax is ill-timed.

Further, uncertainty as to whether or not the tax will be introduced at all is potentially impacting investment as investors delay decisions until the matter of introduction is resolved.

There have been general concerns with the consultation undertaken by the Vanuatu Government around the introduction of the income tax. Though more is being done, there are some concerns that the consultation process is perfunctory rather than meaningful.

There is also general consensus that the timeline for introduction of the tax by July 2017 is very short, creating another set of risks for successful policy implementation. Ideally, a longer timeframe would allow greater opportunities for consultation, preparedness and implementation. However, there is also an acceptance that the political economy in Vanuatu means that despite the short timeframes, the current political climate is conducive to the introduction of the tax.

This accords with the general attitude that political volatility in Vanuatu is the impetus for acting quickly to implement policy reforms when windows of opportunity present themselves.

The introduction of the tax will increase the complexity of the Vanuatu tax system, requiring significant work to grow the size and skills of the Department of Customs and Inland Revenue. Significant additional tax administration work created as a result will also require a number of highly skilled local staff. To this end, the design and implementation of the income tax will require TA in two key areas: the creation of an appropriate legislative framework and organisational capacity and readiness. As part of this process, awareness raising with the public will need to be conducted. Advisers have been important in achieving successful outcomes in previous areas of tax reform (e.g. VAT compliance) and will be an important part of any future tax modernisation process.

INTERNATIONAL TAX REFORM

Vanuatu is balancing its domestic tax reform agenda with international tax obligations. Vanuatu has been categorised as an offshore finance centre by the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”) that designs and promotes international standards of tax transparency. As such, Vanuatu is subject to particular scrutiny and must implement the Common Reporting Standard (CRS) automatic exchange of financial account information (AEOI) with the first exchange of information due in 2018.

Informal advice from the Global Forum is that Vanuatu could meet the 2018 commitment, though this will require significant work in three key areas over the next 12 months: secondary legislation/regulation detailing the mechanics of AEOI (currently underway); confidentiality and data safeguard requirements; and CRS-compliant IT systems.

Vanuatu failed to meet its international standards on the exchange of information in the October 2011 Global Forum Phase 1 peer review report. A more recent draft peer review indicates that they can proceed with a Phase 2 review. This is one of several criteria that they must meet in order to

avoid being considered non-compliant and therefore subject to possible ‘defensive measures’ by the G20.

A failure to meet its international tax obligations has significant ramifications for Vanuatu, raising its status as an unreliable place in which to do business and creating uncertainty for investment and financing.

Some concerns have been raised at the difficulty of emulating bigger tax administrations and that compliance with anti-money laundering/countering the financing of terrorism (AML/CTF) will require a significant injection of resources. This concern is echoed by the Vanuatu Government who have indicated that in order to meet its AML/CTF commitments, additional assistance will be required, potentially from GfG. Australia already provides funding to the Global Forum to assist developing countries in our region to meet their international tax obligations. There are also concerns that AML/CTF measures will have significant implications for financial inclusion.

The combination of the Vanuatu government’s desire to undertake significant domestic tax reform and pressure from multilateral organisations to meet international tax obligations will test the ability of the Ministry of Finance to undertake simultaneous large-scale tax reforms.

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