

Republic of Vanuatu  
Republique de Vanuatu



Australian Government  
AusAID

# Governance for Growth Program

Program Review  
Sep 2007- Dec 2011



*Ladies of Malekula engaged in road building activities, Aop Junction to Lambumbu Wharf*

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# Acronyms

ADB	Asian Development Bank
ADR	Annual Development Report
AG	Auditor General
AUD	Australian Dollar
AVL	Airport Vanuatu Limited
CIO	Chief Information Officer
COM	Council of Ministers
FMIS	Financial Management Information System
FSB	Financial Service Bureaus
FY	Financial Year
GBE	Government Business Enterprise
GDP	Gross Domestic Product
GFG	Governance for Growth
GoV	Government of Vanuatu
HIES	Household Income and Expenditure Survey
HIV/AIDS	Human Immunodeficiency Virus / Acquired Immune Deficiency Syndrome
HR	Human Resources
HRD	Human Resource Development
ICT	Information and Communications Technology
IDPS	Ifira Ports and Development Services
IFC	International Finance Corporation
IMF	International Monetary Fund
JICA	Japanese International Cooperation Agency
KPI	Key Performance Indicator
M&E	Monitoring and Evaluation
MDG	Millennium Development Goals
MFEM	Ministry of Finance and Economic Management
MIPU	Ministry of Infrastructure and Public Utilities
MP	Member of Parliament
NBV	National Bank of Vanuatu
NGO	Non government organisation
NZAID	New Zealand Agency for International Development
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFTAC	Pacific Facility for Technical Assistance
PMO	Prime Minister's Office
PPSCBI	Pacific Public Sector Capacity Building Initiative
PSC	Public Service Commission
PWD	Public Works Departments
SOE	State Owned Enterprise
STD	Sexually Transmitted Disease
TA	Technical Assistance
UAP	Universal Access Policy
URA	Utilities Regulatory Authority
VAT	Value added tax
VBMS	Vanuatu Budget Management System
VCMB	Vanuatu Commodities Marketing Board
VERD	Vanuatu Energy for Rural Development
VTSSP	Vanuatu Transport Sector Support Program

# Executive Summary

## Introduction

Governance for Growth (GFG) is a partnership between the Vanuatu and Australian governments which aims to address obstacles to broad-based growth and service delivery that can be overcome through effective governance. After more than four years of operation, and with the design for the next phase of GFG currently underway, this report is an opportunity to take stock of the program's achievements and the challenges and risks facing the program. The report covers the period from program inception in September 2007 through to December 2011. Findings will be used to inform the design of the second phase of GFG.

## Summary of achievements

GFG has achieved many of the main outcomes envisaged in the original design and has been highly "effective at addressing impediments to growth and reducing the cost of doing business."<sup>1</sup> Reviews of the program have consistently concluded that GFG is an effective and highly regarded program, which is supporting critical reform issues in Vanuatu and contributing positively to the bilateral relationship. The recent mid-term review of GFG found that the program has been effective in building and nurturing a productive working partnership with the Vanuatu Government, noting that the government's ownership and support for the program has been critical to overall success. Achievements that GFG has played a major role in achieving include:

**Telecommunications reforms** have significantly increased access to an estimated 90% of population (up from 10% prior to competition), lowered prices, improved regulation and made a substantial contribution to economic growth (estimated at up to 1.5% of GDP per annum).

**Power sector reforms** have lowered prices and facilitated an end to the monopoly in the sector. Improved regulation of the sector has delivered an across the board price electricity price reduction of 4.7% (with a 6.8% reduction for Luganville customers and up to 48% for low income consumers). Solid foundations have been laid to accelerate expanded access to power in rural areas with the recent launch of the government's new Energy Road Map and the establishment of a new Department of Energy, which will guide future policy and investments in the sector. GFG has also supported the distribution of over 20,000 low cost solar lighting products across Vanuatu under the Lighting Vanuatu initiative, which has significantly increased the access to good quality and affordable lighting.

## Transport sector support

**Roads** – The Vanuatu Transport Sector Support Program has improved the reliability of over 107kms of rural roads (target of 156kms or around 10% of the rural road network) while also supporting improved road maintenance practices in the Department of Public Works. The capital works and changed management approach to road maintenance is improving access to essential social services, generating

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<sup>1</sup> Feedback received from 2009 survey of GoV officials.

significant local employment, and stimulating private sector development. A second phase of transport infrastructure support, which will be expanded to also include the maritime and aviation sectors, is in the final stages of design.

**Ports** – The design of a proposed new US\$80 million international cargo terminal for Port Vila together with a number of management improvements, including appointment of an experienced Ports General Manager, have delivered increased efficiency of stevedoring operations (eg. increases in labour productivity, doubling in the shipping container handling rate and faster delivery of imports). Australia has made an in principle commitment of a further A\$15 million in support for the new wharf linked to commitment to implement reforms critical to ensuring that any new infrastructure investments deliver the intended cost reductions.

**Aviation** – Two studies on Air Vanuatu's operations have been undertaken including a review of business operations and a financial audit. A review into the efficiency and safety of operations of Vanuatu's airfield operations has made several key recommendations which will further improve safety and operational efficiencies for Air Vanuatu and private users. Movement on these reforms will be the catalyst for future GFG investment in the sector.

**Public Financial Management** – Progress to implement PFM reforms has been more uneven, although positive overall. Macro-economic stability and budget discipline has been maintained along with improved financial reporting, and strengthened expenditure controls. There is now better integration of both donor and recurrent funding in the annual budget, although there is still work to be done to improve the accuracy of reporting from donors. The flow of financial information to the provinces has also been improved through the establishment of three Financial Service Bureaus.

GFG helped the Vanuatu government introduce **transparent banking arrangements for school grants**, which has been an important component in government and donors' willingness to support the school grants program. The roll out of subsidized schooling for primary school aged children has contributed to a substantial (8%) increase in enrolments – a major step towards achieving the Millennium Development Goal of Universal Primary Education.<sup>2</sup>

New areas of work to improve public budgeting and expenditure have opened up with GFG support, including **procurement, revenue and audit reform**. While it is too early to gauge impact, support to the Auditor General has already seen an increase in quality and quantity of government audits. GFG is also supporting the establishment of new **Major Projects Unit** to improve procurement and management of large infrastructure investments currently planned for support by Australia and other donors. Credible external assessments, such as PEFA, also point to overall steady improvements in financial management since 2006. Challenges remain however, with state owned enterprise reforms largely stalled and poor financial management in line ministries continues to undermine good quality public expenditure.

**Other initiatives supporting growth** – Creating a better investment climate is a key priority for the Vanuatu government. In 2010, GFG helped the government develop a

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<sup>2</sup> Increase in enrolment figures was from 38,762 in 2009 to 41,834 in 2010. Source: VERM

**new tourism campaign**, which was launched in Vanuatu's major markets of Australia, New Zealand. Tourism numbers have grown steadily with an increase of around 50% between 2006 and 2010, although recent figures show a decline in air passenger numbers due to deterioration in the global economic climate.

**Rural banking operations** have also been significantly improved with the National Bank of Vanuatu's installation of new high speed satellite communication network across eight islands and roll out of new products for low income earners (up to 6000 new bank accounts opened in 2011). This support has also helped consolidate the positive management reforms underway in NBV over the recent past.

Support for the new **Chief Information Office** is expected to strengthen government ICT policy, while the new **i-government initiative** will significantly improve the cost and time efficiency of government operations, with expected flow on benefits for service delivery.

GFG is currently working with the government to develop a major new **Urban Development program** (\$40 million over 4 years), which will help ensure Vanuatu is able to harness the benefits of urbanisation through an integrated planning and implementation approach.

## Major Challenges

**Absorptive capacity** – Donor funding represents a significant and growing proportion of the government's national budget accounting for around one third of total budget expenditure. AusAID has rapidly moved from being the biggest donor to being a major driver of economic growth (Australian aid is now equivalent to almost 10% of Vanuatu's total GDP). Moreover, much of the forward investment and projected growth in GDP is expected to come from donor funded infrastructure projects. This suggests that growth in aid volume and infrastructure investment in particular will need to be carefully managed to prevent potential adverse impacts on the local economy and/or government appetite to reform other key economic areas. With much of GFG's future investment funding linked to reforms, there is also a risk that the scale of major investments planned may be delayed (significantly in some cases) due to slow reform progress or GoV capacity constraints. While these risks will need to be managed, on the positive side, infrastructure investment is expected to help offset some of the negative impacts of the global economic downturn.

**GFG budget expenditure** – GFG's engagements are strongly driven by demand from the Vanuatu government. Where these demands also include a need for major internal reform, GFG funding is used as an incentive for reform. The program is continually working with GoV to identify where investments and/or reforms may generate high economic or development results. Political instability, as experienced for much of 2011, has negatively impacted on the appetite for reform, which has in turn had an impact on GFG's implementation progress and expenditure. For a program which has flexibility and quick response to reform opportunities at its core, this means in some years GFG's expenditure is higher than anticipated and in others it is lower. By working to promote and refine possible reforms during these more unstable periods, the program aims to be well placed to take advantage or catalyse new reforms as and when political will and stability returns.

**Transport sector** – Much has been learnt through the first phase of VTSSP as the first major foray into infrastructure support through the aid program in Vanuatu. Faster deterioration in rural road conditions and excessive tender prices reduced the length of road that could be targeted under Phase 1 of VTSSP, and necessitated a rethink of the delivery strategy. Staff shortages, changes of leadership and unfilled vacancies within MIPU, particularly at senior levels, have also constrained progress. Fortunately Phase 1 has been able to overcome many of the delivery issues and the revised approaches have been reflected in the new Phase 2 design.

**Regulatory reform** – The loss of external legal technical advice in the State Law Office has significantly weakened capacity in this critical area of government. Legal challenges, coupled with a growing list of demands on the office due to increased donor and political activity, will be a major future impediment for reform capacity of government unless resolved.

**Other** – Progress on some initiatives, including reform of state owned enterprises (eg. VCMB, Air Vanuatu) has effectively stalled pending further political decisions by the Vanuatu government.

# Main Report

## Overview

Governance for Growth (GFG) is a partnership between the Vanuatu and Australian governments which aims to address obstacles to broad-based growth and service delivery that can be overcome through effective governance. The program's purpose is to generate broad-based economic growth and to improve service delivery through good governance. The program was conceived on the back of a strong bilateral relationship, relative political stability and agreed reform priorities. Leadership of the program sits with the government of Vanuatu and is based on the principles of partnership, flexibility and responsiveness to the Vanuatu government's priorities.

GFG uses a modality unique within AusAID and, as such, has generated a high level of interest. With the Phase 2 design underway, this report is an opportunity to take stock of achievements, challenges and risks faced by the program. The report also makes observations about GFG's management approach and how this has influenced program outcomes. The report covers the period from inception in September 2007 through to December 2011.

GFG has achieved many of the main outcomes of the original design and has been highly "effective at addressing impediments to growth and reducing the cost of doing business."<sup>3</sup> The recent mid-term review of the program concluded that GFG has been effective partnership with the Vanuatu Government, noting that the GoV's ownership and support have been critical. A report in the *Pacific Economic Bulletin* found that the "Governance for Growth program gave a new impetus to [Government led] reforms. The introduction of competition in the air transport and telecommunication sectors was an important step that reduced costs and provided greater availability of services. It made a major contribution to the strong expansion of tourism." The report also notes that GFG's support for public financial management has played an important role in helping the government to maintain financial discipline and a balanced budget.<sup>4</sup>

Overall, GFG is assessed as being cost-effective and delivering good value for money. GFG staff effectively manage and deliver the program, sourcing in relevant expertise and entering into partnership arrangements as appropriate. GFG management costs are less than 10% of total program expenditure, which compares well with contracted out delivery models.

GFG has built on its early achievements and branched into new areas of support, including a large infrastructure portfolio. Investment in this area is consistent with the original design for GFG, which identified poor transport infrastructure as limiting access to services and economic opportunities, and signalled an intention to bring significant investment financing to the table to directly generate growth and back policy reforms.<sup>5</sup>

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<sup>3</sup> Feedback received from 2009 survey of GoV officials.

<sup>4</sup> Patrick de Fontenay, *Pacific Economic Bulletin* Volume 25 Number 2, 2010 The Australian National University, Economic surveys, An educated, healthy and wealthy Vanuatu, pg 25

<sup>5</sup> GFG Final Program Design Document, Sep 2007



While the overall picture for GFG is a positive one, progress in some areas (eg. reform of state owned enterprises, PFM reforms, increasing access to power, improving road maintenance) has been slower and, in some cases, more challenging than expected. Moreover, some past gains remain fragile and considerable effort has been invested over the past year to ensure gains were not eroded. In many respects, the hard work needed to consolidate gains and ensure the sustainability of earlier reforms has only just begun.

More broadly, as noted in the mid-term review, “many of the development challenges that faced Vanuatu when GFG began in 2007 remain today. Although progress to overcome these challenges has been steady, the global financial crisis has meant that economic growth has been solid rather than spectacular.” Moreover, emergent risks, such as political instability and financial mismanagement, could act to reduce future growth prospects.<sup>6</sup> Within this context, the support provided through GFG remains highly relevant.

## Summary of Progress

### Result Area 1: Improved infrastructure

#### Telecommunications

Prior to GFG support, the telecommunications sector operated as a monopoly which suffered from poor coverage and high prices. Only around 10% of the population had access to telecommunications (mobile or fixed line) in 2006.<sup>7</sup> The introduction of competition, together with improved regulation of the sector, has resulted in a dramatic transformation - over 90% of the population is now able to access mobile phone coverage at substantially reduced prices.<sup>8</sup> Future investments under the Universal Access Fund are expected to expand access even further. Reform of the sector has made a significant contribution to economic growth, estimated at up to 1% of GDP per annum.

Internet services have also grown, with six service providers now operating (13 licences issued) and increased competition beginning to bring down prices. Nationally, internet usage has doubled, although remains comparatively low at only around 7%.<sup>9</sup> GFG is working with GoV and the Telecom Regulator to support development of its policies on Universal Access and will consider options for support once these policy positions are finalised.

At an institutional level, the Telecoms Regulator office is now largely funded from licensing fees with the office playing an important role on a range of regulatory issues, including regulating the radio spectrum, resolving inter-connection disputes,

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<sup>6</sup> The Unfinished State: Drivers of Change in Vanuatu, April 2007

<sup>7</sup> ADB *Basic Statistics* 2006

<sup>8</sup> For example, prior to the introduction of competition a new SIM card cost around 5000 Vatu, which represents a significant barrier to entry. After competition was introduced, providers began to effectively give SIM cards away and are continuing to offer a range of attractive price specials.

<sup>9</sup> Internet access has doubled (from 3.5 percent of total inhabitants in 2004 to 7.1 percent 2009). Source:

<http://www.internetworldstats.com/sp/vu.htm>

issuing licenses, and monitoring service standards and compliance. Longer term capacity building challenges remain, however, with the office still reliant on external technical assistance which comes primarily from the World Bank (via a GFG funded trust fund).

GFG has funded longitudinal studies of the impact of telecommunications reform, the third of which was completed in 2011. The studies explore the changing impacts of increasing telephone access and have found that expanded access to telecommunications has delivered enormous social and economic benefits to the people of Vanuatu up to 95% population coverage, but the reliability of coverage remains an issue.

While the benefits of telecommunications reforms are impressive, both the Telecoms regulator and Utilities regulator face considerable pressure, from legal challenges from service providers to building internal capacity. The loss of technical advisory support to the State Law Office has further compounded these challenges, making it harder to advance regulatory reforms and increasing the legal costs borne by the two organisations. GFG has had to invest considerable effort into consolidating and sustaining previous reforms and will need to maintain this level of support and commitment to ensure past gains are not eroded.

### **Other ICT reforms**

GFG is helping the Vanuatu Government to establish its new Office of the **Chief Information Officer (OCIO)**, which is charged with developing and overseeing implementation of government ICT policy. Prior to the OCIO there was no dedicated ICT policy function within government, which meant the Telecoms Regulator was playing a de-facto policy role. This gap in policy direction provided little guidance to either service providers or the regulator, resulting in uncoordinated and at times contradictory actions by sector stakeholders. The OCIO will ensure that the policy functions are separated from the regulatory functions and provide a more coherent and transparent policy framework for the sector.

GFG has also supported the OCIO to roll out the new **i-Government initiative** which will bring all government IT onto a single government network. This initiative will see all IT managed centrally, generating cost and efficiency savings and ensuring unified security and data security arrangements for all government information. The initiative will also bring all provincial offices on-line and make all internal government phone calls free (using the internal network for phone calls). While there are considerable efficiencies to be made, the i-gov has also started work on developing new IT products for use by line agencies aimed at improving service delivery in key areas such as health and education. The World Bank (via a GFG funded trust fund) is also providing technical advice to this initiative.

GFG has also been engaged in policy discussions around a proposed **submarine cable project**, which is expected to provide a significant boost to local business and investment by bringing high speed internet to Vanuatu. GFG will consider a possible future contribution to the project depending on the option the government wishes to proceed with.

## Rural Banking

GFG support has helped improve banking services across Vanuatu through the installation of a new high speed satellite network connecting eight islands (GFG provided grant funding of \$500,000).<sup>10</sup> NBV now has ten branches with VSAT communications (with two more planned), and has recently conducted a program of Financial Literacy workshops, reaching around 5000 participants. Improved banking services have made a significant contribution to local business and economic development, with substantial growth in the number of rural savings accounts (6,000 new accounts opened), and increases in both deposits and lending activity in 2011.<sup>11</sup> There have also been major improvements in efficiency as the bank moves away from manual transactions to all branch data transmitted in real time via the high speed satellite network.

NBV has also been supported to roll out of a range of new products design to increase access to finance in rural areas. For example, the new Mobile Wallet (*IsiMani*) initiative, to be launched in early 2012, will allow customers to make deposits, withdrawals and transfers using their mobile phone. Up to 7,000 customers have registered for IsiMani accounts, with this figure expected to grow rapidly following full roll out. GFG is also supporting NBV to develop a strategy for financial inclusion to help better target banking services to the rural poor.



*Mobile banking- NBV Officer collecting customer information from a rural businessman.*

## Power

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<sup>10</sup> A total of ten satellite dishes have been installed across the country (including Aneitym, Tanna, Efate, Epi, Ambrym, Malekula x 2, Pentecost x 2, and Banks). These are supported by renewable power sources (solar panels and wind).

<sup>11</sup> For example, in 2011 more than 6000 new rural savings accounts were opened bringing the total to 40,000; rural deposits increased by around Vt 500 million; and more than 700 new microfinance and agriculture loans were established, with around Vt200 million in disbursements.

Vanuatu's electricity supply, while reliable, is one of the most expensive in the world.<sup>12</sup> In 2009, only 28% of the population used electricity for lighting and with only 17% access in rural areas (amongst the lowest in the world) Vanuatu experiences high levels of "energy poverty".<sup>13</sup> The GFG design aimed to increase access to electricity to 40% of the population while ensuring prices were reduced to more affordable levels.

GFG's support to the establishment and operation of the Utilities Regulatory Authority (URA) has been central to most gains to date, with better regulation helping bring down prices and improve service standards. The 2010 Tariff Review delivered an across the board price reduction of 4.7% for grid based customers, with a reduction of 6.8% for Luganville customers and 48% for low income consumers.<sup>14</sup> The Luganville tender also introduced a new concessioner into national electricity market for the first time (injecting some competition to the sector). Legal challenges to the outcome of the tender and other URA determinations will continue to place pressure on the URA's resources.

In late 2011, GFG, along with the World Bank, helped the Government launch the new Energy Roadmap and establish a new Department of Energy to drive the process and future policy implementation. The Roadmap (effectively the national energy policy) will create policy on energy security, renewable energy, and access to electricity. This framework will be used to agree to an sector investment program to ensure funds and programs are delivered in support of the Roadmap targets. The Roadmap process has received positive feedback from all stakeholders with several donors already committing funds to implementation. The Vanuatu Government's proposed new Vanuatu Energy for Rural Development (VERD) program (also developed with GFG support), aims to dramatically improve access to safe, reliable, affordable and sustainable off-grid electricity in rural areas and will be a major 'quick start' commitment under the Roadmap.

GFG has also supported the Lighting Vanuatu project, which has partnered with local NGOs to deliver more than 20,000 low cost solar lights across Vanuatu (review of impact to be undertaken in April 2012 with view to expansion if warranted). These products will not only provide families with low cost lighting, but can also be used to charge mobile phones, helping to further expand mobile access and affordability of ownership.<sup>15</sup>

## **Transport sector support**

### **Roads**

The Vanuatu Transport Sector Support Program (VTSSP) is improving the reliability of key roads on the islands of Malekula, Ambae and Tanna. Prior to VTSSP road conditions were poor, transport costs were high, and many communities were completely cut off during the wet season. This had serious negative impacts on school attendance, health outcomes, and economic and employment opportunities.

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<sup>12</sup> Castalia Strategic Advisers, *Infrastructure Regulatory Review for Government of Vanuatu*, 2005

<sup>13</sup> VERD Final Program Design Document, Dec 2011. The proportion of the population with access to electricity is largely unchanged from 2006.

<sup>14</sup> URA Tariff Review

<sup>15</sup> The initiative also received strong interest from the private sector with both TVL and Digicel distributing solar products with their mobile phones.

Roads targeted under VTSSP link up the most densely populated areas with essential services and commercial centres, and represent around 10% of Vanuatu's unsealed rural road network. As of January 2012, a total of 107kms of roads have been improved with 60km either completely reconstructed or rehabilitated and 47kms receiving spot improvements (against a target of 140kms). The improved road conditions have already delivered social and economic benefits, including:

- Quicker, more reliable and cheaper access to health centres, schools, and local markets (eg. the first ever passenger bus service was started in the Middlebush area of Tanna, with travel costs reduced by 50%). Ambae residents report that several lives have been saved by emergency health services on Ambae being able to access patients where previously not possible.
- Approximately 68,000 person works days generated to date (target of 105,000), of which over 9,600 work days (14%) were performed by women.
- Increased private sector involvement, with 28 small island based contractors trained, registered and conducting small scale routine road maintenance. Many of these small 'start-up' firms are now sub-contracting to established national contractors.

Strengthening the Public Works Department's management of the road network has also been gathering momentum, including development of standard designs, technical specifications, up to date registry of its assets, uniform tender documentation and improved quality control processes. The program is also supporting PWD to implement its transition to greater use of outsourcing, with supervision services tendered out for the first time in 2011. This shift in policy has seen private sector firms increase investment in business expansion and additional staff. Improvement in the timeliness of payments has also increased the credibility of PWD as an employer and customer.

The improvement in actual work outputs plus improvements in organisational operation has seen an increase in morale and enthusiasm in PWD despite continued political uncertainty and severe staff shortages (30% of positions are vacant).<sup>16</sup> As a result PWD management are actively seeking GFG assistance to help map out medium term sector reform priorities and options.

While VTSSP Phase 1 is largely on track to meet its objectives, the program faced many early challenges which reduced the length of target road from the original design of 190kms to 140kms. These include:

- roads in worse condition than expected due to severe weather between scoping and implementation, which necessitated complete reconstruction rather than spot improvement in many sections (thereby more money per Km so reducing the number of Km's)
- worsening PWD staff shortages<sup>17</sup> and repeated management changes

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<sup>16</sup> For example, assisting MIPU to complete a stock-take of all staff positions (over 300), skills audit, and review of salary levels across the PWD and four other Departments within the ministry. This has resulted in the development of a new HRD strategy, an interim restructure of the Department, revised job descriptions and staff KPI's, leading to salary increases (for first time since in 8 years). This has in turn significantly boosted staff morale.

<sup>17</sup> Staffing levels have reduced significantly over the last 10 years and currently 30% of positions are vacant. There is now approximately 2.5 PWD staff per 100 km. This ratio is far below that of developing countries in Central Asia/Vietnam with approximately 20 people per 100 km and in India 50 to 100 people per 100 km.

- unaffordable tender prices (300% above engineering estimates) due to small private sector and unrealistic bid building
- weak initial management performance of the Managing Contractor
- protracted political instability impact on decision making and procurement, and
- land owner claims over quarry access and gouging for royalty payments.

The current total program cost for VTSSP is A\$22.5m. With implementation now working faster and more efficiently, GFG will be seeking additional funds for VTSSP to rehabilitate a further 16kms of road under Phase 1, and will also implement specific adaptation measures to mitigate against the adverse impacts of climate change on project roads. This will take the total length of road to 156km under Phase 1. Phase 2 of VTSSP will incorporate the lessons and new approaches learnt under Phase 1, along with rolling in all of the maritime and aviation investments.

## **Ports**

GFG supported the design (engineering, environmental and financial) of a proposed new US\$80 million international wharf and container terminal for Port Vila. This support provided for management improvements which delivered increased efficiency of stevedoring operations (eg. substantial increases in labour productivity and a doubling in the shipping container handling rate, albeit from a low base).

Despite the genuine economic gains to be made through improving port operations, any investment and associated reforms of this size and nature will require considerable commitment from all key stakeholders (both government and the private sector stevedore), and will need to strike the right balance between various stakeholder interests and objectives. Australia has made an in principle commitment of A\$15 million in support for the project, linked to implementation of key management reforms. We expect negotiations on associated triggers to commence in mid 2012 in line with processes related to the GoV negotiations with the Government of Japan for project loan financing (A\$65m).

## **Aviation**

Through the IFC, GFG supported the Vanuatu government to run a tender for the part sale of Air Vanuatu in 2009 but a suitable buyer was not found. Following further request from the Vanuatu government, GFG supported a 2010 review of Air Vanuatu's business operations and a financial audit to help ensure the airline remained viable but recommendations from both studies remain to be implemented leading to continued uncertainty around governance of the carrier.

GFG has supported a study of maintenance and safety needs at all outer island aerodromes to determine what maintenance regimes and aviation regulation reforms need to be implemented to ensure safe domestic air travel. If these reforms are implemented, GFG has indicated it is willing to explore possible associated infrastructure investments in the second phase of the transport support program.

## **Integrated urban development**

Urban development is a major driver of economic growth in Vanuatu, with its two major urban centres contributing to almost 60% of GDP and about the same in government revenue generation. But rapid urbanisation is also creating new

challenges. The urban population of Vanuatu has increased by 42 percent or an average of 3.5 percent per year since 1999. One in every four people now resides in an urban area. This has placed increasing strain on existing but dilapidated infrastructure and is creating new social pressures.<sup>18</sup> There is an urgent need to institute integrated planning in these areas to help respond to these challenges.

GFG is currently supporting the design of a major new Urban Development program. The first phase of the program is expected to commence later in 2012 and will focus on renewal of key urban roads and drainage hot spots, together with sanitation improvements in Port Vila. Total funding for Phase 1 is \$40m over 4 years (of which \$31m is expected to come from Australia, \$5m from ADB and \$4m from GoV).

## **Result Area 2: Improved economic governance**

The Vanuatu-Australia partnership for development identifies the following key objectives which are being supported by GFG:

- Strengthen budget processes
- Improved public financial management systems
- Stronger transparency and accountability
- Improved management of Government Business Enterprises
- Enhanced collection and management of statistics

### **Broad context**

Vanuatu has performed relatively well having recorded positive growth over the past 5 years. Growth slowed in 2009 and fell further in 2010, due to the flow on effects of the Global Economic Crisis and this trend is expected to continue in 2011.<sup>19</sup> The global economic downturn will continue to affect the economy, via a decline in tourist arrivals, property prices and commodity prices. Major donor-funded construction projects will prop up growth over the medium term. Recent revenue receipts have been lower than expected, resulting in the budget deficit in 2011 and also projected for 2012. National elections in 2012 will place added pressure on the budget.

Vanuatu has steadily improved against most indicators of good governance over the last decade, although has slipped against regulatory quality, ease of doing business,<sup>20</sup> and perceptions of corruption.<sup>21</sup> This shows that continued effort and support is needed to ensure Vanuatu retains its reputation for good financial management.

### **Public Financial Management**

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<sup>18</sup> 2009 National Population and Housing Census, VNSO

<sup>19</sup> The IMF Article IV results suggest that growth in 2009 was 3.5% compared to 6.2% in 2008 and fell further to 2.2% in 2010.

<sup>20</sup> Source: 2010 World Bank Governance Indicators, 2010 World Bank Ease of Doing Business Survey. Refer to Annex C for further details.

<sup>21</sup> Source: 2011 Transparency International Perceptions of Corruption Index.

The original design aims of GFG's public financial management support were to: build financial management capacity in line agencies and the provinces; and to improve revenue administration and policy. Progress has been mixed.

Despite these broader aims, GFG's PFM support has mostly focussed on maintaining sound fiscal and budget discipline within the Department of Finance and Treasury. While this support has helped ensured macro level budget management performance, it has had little impact on improving financial management and quality of public expenditure in line agencies and the provinces. Areas of progress include:

- **improved budgeting** with the implementation of an integrated budget improving the link between financial reporting and budget allocations, analysis of recurrent funding and integrating donor funding into the budget (still work to be done to improve the accuracy of reporting from donors).
- **improved regulation** - critical amendments to Public Financial Management and Accountability Act have strengthened transparency and accountability.
- **improved financial reporting** – Annual Budget papers submitted on time, first ever Reg 2.2 Financial report was submitted to Parliament on ministry performance<sup>22</sup> and the Auditor General now undertaking audit of government accounts for the first time in over 5 years.
- **strengthened expenditure and financial controls** – Tightening controls of supplementary appropriations, which now go to Parliament for approval; and Deeds of Release, which now go through State Law Office and Council of Ministers, rather than at discretion of Minister.
- **improved revenue forecasting** through improvements to economic modelling
- **ongoing system maintenance and upgrades** of the Government's finance and budget systems (FMIS and VBMS).
- **supporting the restructure of MFEM** following the GoV's abolition of the Department of Economic and Sector Policy in 2008, and subsequent re-arrangement of responsibilities between Finance and the Prime Minister's Office. This included significant support to develop the new departmental structure and job descriptions.

At **line ministry level**, financial management continues to be weak despite some notable achievements. GFG helped to establish **transparent school banking arrangements** and conducted training for school administrators in grants administration in support of the GoV's Universal Primary Education initiative. As a result of the funding primary school enrolment increased by 8% between 2009 and 2010, with Net Enrolment Rate now 94.3%.<sup>23</sup> GFG has helped improve financial management practices within the Public Works Department, albeit with slow progress. GFG's more recent support to strengthen external audit, together with planned support to strengthen internal audit, is expected to make an important contribution to improving line ministry financial management practices in the coming year.<sup>24</sup>

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<sup>22</sup> Financial Regulation 2.2 Report is a report to Parliament on breaches of the Public Financial Management Act. Despite being a legislated requirement, this report had never been prepared. The first ever report was produced in 2011 (with GFG support).

<sup>23</sup> Government of Vanuatu Annual Development Report, 2010

<sup>24</sup> Current support is being provided to the Office of the Auditor General. Future support in audit is planned as part of the forward work plan for 2013-15, and will be expanded to help strengthen internal audit.



At **provincial level**, systems of accountability remain weak and financial decision-making is generally retained in Port Vila, reducing efficiency and impacting on service delivery. Following delays, a total of three Financial Service Bureaus have been established in the provinces (out of a target of five), with two more offices expected to open in 2012. The FSB's play an information sharing role currently but further delegation of financial responsibility to them will be needed to speed up management decision making, improve the targeting of expenditure, and facilitate improvements in rural service delivery. GFG is also supporting revisions to the financial regulations to facilitate payments in the provinces but this too will take time before the impact is noticeable.



*Prime Minister Kilman, Minister of Finance, Carcasus, Minister of Infrastructure, Iauko, High Commissioner Roach and AusAID DDG, Batley unveiling the plack marking the opening of the Malekula FSB.*

## **Other PFM Support**

**Revenue** – GFG's support in revenue collection (customs and VAT) builds on earlier work sponsored by PFTAC. While work has only recently begun, early progress is promising<sup>25</sup>. Work is primarily focussed on increased revenue collection through improved compliance.

**Audit** – Support to the Auditor General's office has already improved the quality and quantity of audits, and is expected to address the backlog of outstanding audits by early 2012.<sup>26</sup>

**Procurement** – Support to the Central Tenders Board has helped streamline contracting arrangements (e.g. through the introduction of standardised contracts), however significant procurement challenges remain. Most ministries continue to subvert proper procurement processes (eg. contract splitting) but GoV is now working on a series of new reforms to improve practices in this area, with GFG financial and technical support. The proposed establishment of a Major Projects Unit

<sup>25</sup> Support is expected to help return up to 1.5 billion Vatu in VAT arrears to the government (Vt17.6m already collected with aim to reduce arrears by 40% by the end of 2012).

<sup>26</sup> OAG is currently auditing the 2010 accounts, with a proposal to write off the remaining backlog.

within the Prime Minister's Office is expected to help fast track major infrastructure investments being funded by Australia and increase procurement transparency.

### **Future support for PFM**

Looking ahead, there is a need to develop a cohesive engagement strategy, which clarifies objectives, rationale and prioritisation of effort, including levels of resourcing. The main thrust will be to link support between the central and line agencies. Current and planned efforts to strengthen procurement and audit functions (including those by other AusAID sector programs) will be central to the approach.

### **Reform of State Owned Enterprises**

Support has largely focused on Air Vanuatu (discussed earlier) and the Vanuatu Commodities Marketing Board. The Government passed the VCMB Repeal Act but is yet to gazette it and bring it into force. Implementation of recommended reforms has effectively stalled pending further political action. GFG remains ready to support further reforms provided there is clear political will. Some assistance has also been given to the Vanuatu National Provident Fund to evaluate its member lending activities and human resource management systems. A new Government Business Enterprise Unit (recently staffed) will provide a clearer counterpart for these efforts in the future, including for future work planned by the ADB.

### **Other policy and governance reforms supported by GFG**

**Tourism** – While overall tourist numbers have continued to grow steadily, growth has been driven by cruise ship passengers, with higher spending air passenger arrivals declining in 2010 and 2011. The decline is attributed to more competition from other destinations (eg. Fiji), the global economic downturn, and Australian tourists taking advantage of the strong Aussie dollar and travelling to previously expensive destinations (eg. United States and Europe).

In 2010, GFG provided a grant of \$600,000 which helped the Vanuatu Tourism Office develop a new brand for Vanuatu, "*Discover what matters*". This included marketing materials, including a new in-flight video, bill boards, media advertising, a new Visitor's Bureau at the main wharf, and a new website for the Vanuatu Tourism Office.<sup>27</sup> The campaign was launched in major markets in Australia and New Zealand and GFG is supporting GoV to monitor the effectiveness and impact.

**National Statistics Office** – GFG (via twinning between the Australian Bureau of Statistics and Vanuatu Statistics Office), supported the rebasing of the Consumer Price Index and national accounts. Further support will come via an AusAID regional program in the future.

**Public Service Review** – GFG supported the Public Service Commission to undertake the first ever survey of public servants in 2009. In 2010, the PSC held a successful public forum in to share findings and proposed forward actions (funded by GFG). Unfortunately limited progress has been made, with performance management and political interference a growing problem. Weaknesses in the PSC continue to represent an impediment to wider public sector reform.

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<sup>27</sup> Matching support was provided by the industry via the Tourism Marketing Development Fund and the government.

## **Research fund**

The Research Program was originally intended to fund a competitive grants based program of research, with annual research priorities identified by the Vanuatu Government. However, the government's demand for research has not been high, and the telecommunications studies have effectively absorbed the research fund budget.

## **Cross-cutting issues**

GFG response to cross-cutting issues is addressed in Annex D.

## **Challenges and risks**

The original design identified several major risks, including political instability and change; the vulnerability of Vanuatu's economy to external factors; and limited human and technical capacity to implement reform, all of which have materialised and impacted on the program. While the program got off to a strong start with regulatory reforms in the telecommunications and power sectors, the 'second generation' of reforms have been slower to come and taken longer than anticipated to progress. While GFG's flexible approach has enabled the program to respond to changing circumstances and help mitigate some of these issues, several challenges and risks will continue to shape how the program is delivered over the coming period.

### **Political instability**

Political instability once again emerged as a feature of the Vanuatu landscape in late 2010 and impacted on program delivery throughout much of 2011. With national elections in 2012, politics are likely to feature heavily in decision making in the short term. Conscious of the changing environment GFG has used its strong relationships with key GoV partners to build a firmer program pipeline in addition to its flexible programs to ensure stability in decision making under the partnership for the next period.

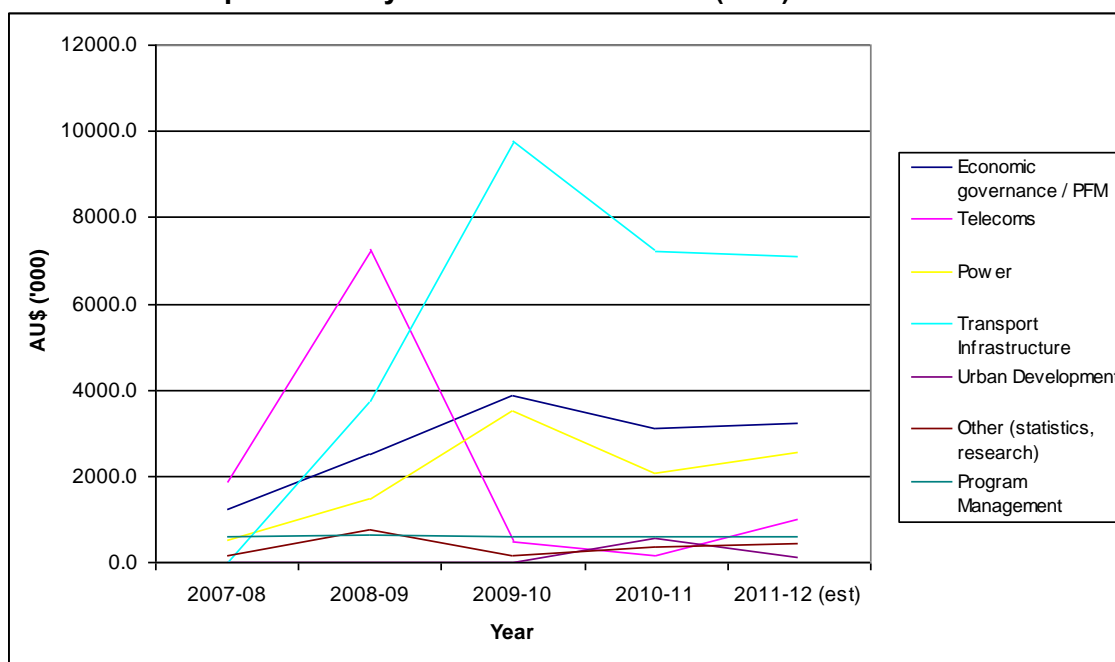
### **GoV absorptive capacity and the scale and focus of donor support**

The increasing reliance of GDP growth on donor funded infrastructure programs poses risks that will need to be managed through active and constructive policy dialogue between GoV and donors. With over \$65m of revenue (out of a total budget of \$210m) expected to come from donor programs in 2012, there are major implications for budget management if some (or most) of this funding fails to materialise. On the flip side, if all of these projects did come on stream at the planned time there are real concerns, expressed by Ministry of Finance as well as the Reserve Bank, that inflationary pressures will emerge that will be hard for it to control. Looking at longer term trends, increases in Australia aid have now taken Australia beyond just being the major donor partner but also to having an increasing impact on the shape and scale overall economic growth, with Australian aid now equivalent to almost 10% of national GDP.

A further concern is that economic growth is now projected to come on the back of big projects rather than fundamental reforms to the economy. For example, the 2012 GDP growth forecast of 4.3% is based on 2.1% growth in the agriculture sector, 3.7% for services and a massive 13.8% growth in the industrial sector (construction). This breakdown is repeated in the estimates through to 2014, by which time GoV is projecting 19.3% annual growth in construction. With growth so dependent on these projects, and the foundations for this growth contingent on robust legislative and policy settings (as well as public and private sector capacity, which is untested at this level of investment), there is a clear need for donors and government to carefully plan how these projects can become a driver for broad based and sustainable economic growth.

Total GFG program expenditure in 2010-11 was around AUD\$14.992 million (around VT1.500 billion). The chart below shows the changing focus of GFG expenditure over time. Expenditure on transport infrastructure (roads, ports, aviation) accounts for around half of total GFG expenditure in 2010-11. Further details of estimated program expenditure are provided at Annex A.

**Chart 1: GFG expenditure by sector over time AUD ('000)**

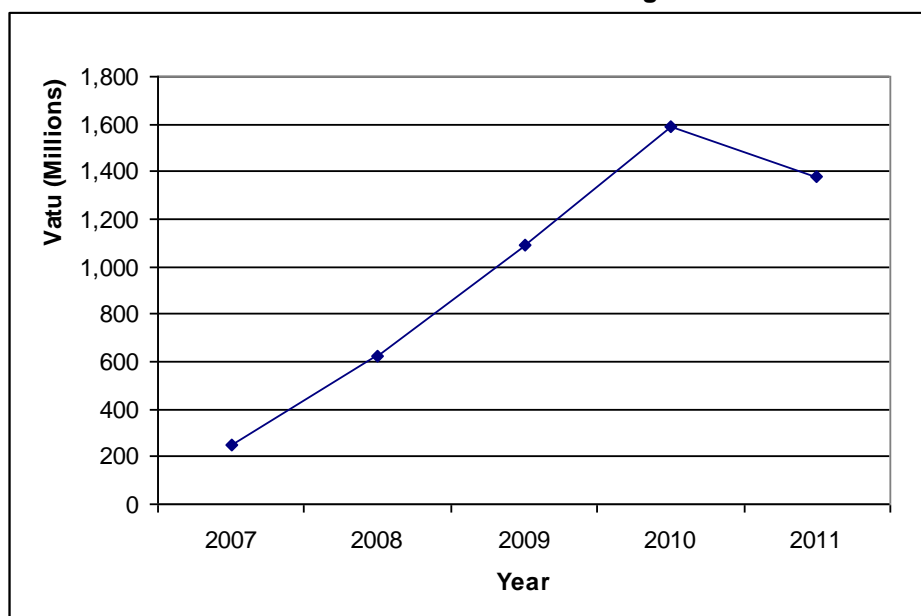


### Use of government systems

GFG's original design was based on the assessment that GoV's financial management and procurement systems were fundamentally sound and that GFG "will use direct investment in GoV systems in order to strengthen those systems and to provide incentives for reform, subject to appropriate controls." During the subsequent years of implementation it has become clear that government procurement systems were unable to cope with the rapid increase in external development funding. Given that historically recurrent expenditure (eg. staff, utilities, travel etc) was almost the only form of expenditure, it is not surprising that the systems that were only used to process limited development funding have struggled with the influx of funding expected to be processed through government systems.

Following protracted procurement delays and concerns over financial probity within some line ministries, GFG and the Vanuatu government mutually agreed to moderate the approach. GFG is now planning to move smaller amounts through government and couple this with more support to build capacity and increase the use of government systems over time (reflected in Chart 2). GFG is also working with the GoV to establish a new Vanuatu Major Projects Unit, to be located within the Prime Minister's Office. The new unit will be staffed by procurement professionals and supported by technical assistance, and will be charged with overseeing major infrastructure projects funded by Australia and other donors. This approach is expected to help fast track major investments and increase transparency.

**Chart 2: Australian contributions to the GoV Budget**



Source: Vanuatu Government FMIS

### **Expanding program focus**

GFG was originally designed to have a focus on rural areas, however, the increasing rate of urbanisation has seen rising rates of urban poverty and placed increasing strain on existing but dilapidated infrastructure. According to the 2009 Census, the urban population has increased by 42 percent since 1999<sup>28</sup>. In response, GFG is supporting a new Urban Development program with ADB and GOV. The first phase of the program (\$40m over 4 years, \$31m proposed to come from AusAID) is expected to commence in 2012 and will focus on roads, drainage and sanitation in Port Vila.

A future challenge for GFG will be to strike the right balance between its investments in rural and urban areas, and ensure that the management team is adequately resourced to meet additional programming demands.

### **Regulatory reform**

The loss of external legal technical advice in the State Law Office has significantly weakened capacity in this critical area of government. Legal challenges, coupled

<sup>28</sup> 2009 National Population and Housing Census, VNSO

with a growing list of demands on the office due to increased donor and political activity, will be a major future impediment for reform capacity of government. The latest available (2010) World Bank governance indicators also indicate Regulatory Quality has declined.<sup>29</sup>

## Lessons learned

**Reform leverage** – GFG’s involvement in major infrastructure has helped build credibility with government in both policy advice and delivery of high value programs. This has in turn helped strengthen the bilateral relationship and provided incentive for additional reforms. GFG’s engagement in delivery has sharpened its understanding of the policy and system issues facing government which in turn has lead to a better mutual assessment of the needs in both line and central agencies. Close links between program implementation and policy engagement have also helped strengthen the quality of the policy dialogue.

**Relationships** – GFG’s success has been built on the back of strong relationships with government, effective leadership and excellent staff. Getting the right people with the right skills has been critical. The program still faces risks, for example, quality technical advice or poor advisor performance, if not effectively managed, can undermine progress and potentially impact on program credibility. There is a need to manage sometimes robust debate and facilitate consensus, particularly when using different modalities to engage and manage TA (eg. through AusAID, GoV, Bank systems) and the fact that increasingly program delivery is contingent on government changing the way it is structured and operates as the program (and hence government’s budget and the broader economy) grows rapidly and with greater complexity.

**Co-location** – Closely related to the point above, co-location of GFG near the PMO has been important to the partnership, enabling frequent informal contact and the development of close relationships between GFG staff and key government counterparts. GFG has good access to politicians and senior officials, providing a strong platform for policy engagement.

**Flexibility** – The ability of the program to flexibly draw on different modalities has been a major contributing factor to success. The program has been able to quickly adapt to changing circumstances, adjusting the delivery approach where needed. The flexibility of the program to pursue new areas of support as well as to step back from non-performing areas has been a particular strength.

## Forward priorities

Forward priorities for GFG will be determined through the design process for Phase 2, which is expected to be completed by June 2012.

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<sup>29</sup> Source: <http://info.worldbank.org/governance/wgi/>

# ANNEX A – Program Expenditure

Table 1: Estimated Expenditure by Financial Year (AUD)

Item	Estimated Cost AUD ('000) - by FY		
	2010-11 (budget)	2010-11 (actual)	2011-12 (estimate)
<b>ECONOMIC GOVERNANCE</b>			
<b>Public Financial Management</b>			
Coordination and management	300.0	378.9	257.3
Capacity Building Activities	150.0	0.0	0.0
PFM Systems Development	500.0	0.0	0.0
PPSCBI funding for Economic Governance			
- Grant payment to MFEM	1,630.0	1,630.0	780.0
- Technical assistance	100.0	165.6	257.8
Financial Service Bureaus project: Grant to MFEM	550.0	470.0	550.0
Other technical assistance	675.0	224.4	0.0
<b>Sub-Program Total</b>	<b>3,905.0</b>	<b>2,868.9</b>	<b>1,845.1</b>
<b>Support for market reform</b>			
VCMB Reforms (Incentive program support)	2,900.0	0.0	0.0
Other VCMB	0.0	60.3	0.0
<b>Sub-Program Total</b>	<b>2,900.0</b>	<b>60.3</b>	<b>0.0</b>
<b>Other support for economic growth</b>			
Tourism Marketing: Grant to Vanuatu Tourism Office	0.0	32.6	18.5
Rural Banking: Grant to National Bank of Vanuatu	0.0	134.5	860.0
Grant to PMO (CIO, M&E)		0.0	500.0
<b>Sub-Program Total</b>	<b>0.0</b>	<b>167.1</b>	<b>1,378.5</b>
<b>TOTAL ECONOMIC GOVERNANCE</b>	<b>6,805.0</b>	<b>3,096.3</b>	<b>3,223.6</b>
<b>INFRASTRUCTURE</b>			
<b>Power</b>			
<b>URA</b>			
URA World Bank Trust Fund	1,000.0	2,000.0	450.0
Energy Unit TA	300.0	0.0	0.0
Training and Capacity Building	50.0	0.0	0.0
Unallocated TA	75.0	0.0	0.0
<b>Rural power access</b>			
Energy Road Map and Dept of Energy Grant	0.0	0.0	2,000.0
Design of investment program: Grant to Min of Lands	0.0	0.0	0.0
VERD Design		82.0	69.1
Analytical work	100.0	0.0	0.0
Access Power Coordinator: Grant to Min of Lands	50.0	0.0	0.0
Lighting Vanuatu initiative	200.0	0.0	30.6
Access investments	1,800.0	0.0	0.0
<b>Sub-Program Total</b>	<b>3,575.0</b>	<b>2,082.0</b>	<b>2,549.7</b>
<b>Telecommunications</b>			
<b>Telecommunications reforms</b>			
Interim Regulator	0.0	163.1	0.0
World Bank Telecoms Trust Fund	0.0	0.0	1,000.0
Other unallocated support	50.0	0.0	0.0
<b>Sub-Program Total</b>	<b>50.0</b>	<b>163.1</b>	<b>1,000.0</b>



<b>Transport</b>			
Coordination and Management	300.0	383.2	350.0
<b>VTSSP (RURAL ROADS)</b>			
Grant to MIPU for road works	3,471.4	3,000.0	4,800.0
Managing contractor	2,100.0	2,365.3	993.0
Other (design studies, tender, baseline, M&E)	250.0	472.4	250.0
<b>Sub-total</b>	<b>5,821.4</b>	<b>5,837.7</b>	<b>6,043.0</b>
<b>PORT REFORM</b>			
Port Reform: Grant to MFEM	200.0	0.0	0.0
Port Reform studies	0.0	296.3	100.0
Port Reform technical assistance	0.0	500.0	0.0
<b>Sub-total</b>	<b>200.0</b>	<b>796.3</b>	<b>100.0</b>
<b>Aviation reforms</b>	<b>250.0</b>	<b>182.0</b>	<b>595.1</b>
<b>Urban development</b>	<b>0.0</b>	<b>573.6</b>	<b>117.6</b>
<b>Sub-Program Total</b>	<b>6,571.4</b>	<b>7,772.8</b>	<b>7,205.7</b>
<b>TOTAL INFRASTRUCTURE</b>	<b>10,196.4</b>	<b>10,017.8</b>	<b>10,755.3</b>
<b>STATISTICS, RESEARCH AND OTHER</b>			
Research Fund	200.0	113.9	235.0
Support for National Statistics Office	0.0	236.7	0.0
Program design (second four year design)	0.0	0.0	200.0
Communication Strategy	25.0	0.0	0.0
<b>Sub-Program Total</b>	<b>225.0</b>	<b>350.6</b>	<b>435.0</b>
<b>PROGRAM MANAGEMENT</b>	<b>675.0</b>	<b>599.0</b>	<b>578.2</b>
Unallocated (flexible) funds	2,547.5	0.0	0.0
<b>TOTAL PROGRAM BUDGET</b>	<b>20,448.9</b>	<b>14,063.7</b>	<b>14,992.1</b>

**Table 2: GFG Expenditure by sector over time (% of total expenditure)**

Summary of Expenditure (%)	2007-08	2008-09	2009-10	2010-11	2011-12 (est)
Economic governance / PFM	28.1%	15.2%	21.1%	22.0%	21.5%
Telecoms	42.2%	44.3%	2.6%	1.2%	6.7%
Power	11.9%	8.9%	19.0%	14.8%	17.0%
Transport Infrastructure	0.0%	22.9%	53.1%	51.2%	47.3%
Urban Development	0.0%	0.0%	0.0%	4.1%	0.8%
Other (statistics, research)	4.0%	4.6%	0.9%	2.5%	2.9%
Program Management	13.9%	4.0%	3.3%	4.3%	3.9%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

**Table 3: GFG Expenditure by sector over time (AU\$ '000)**

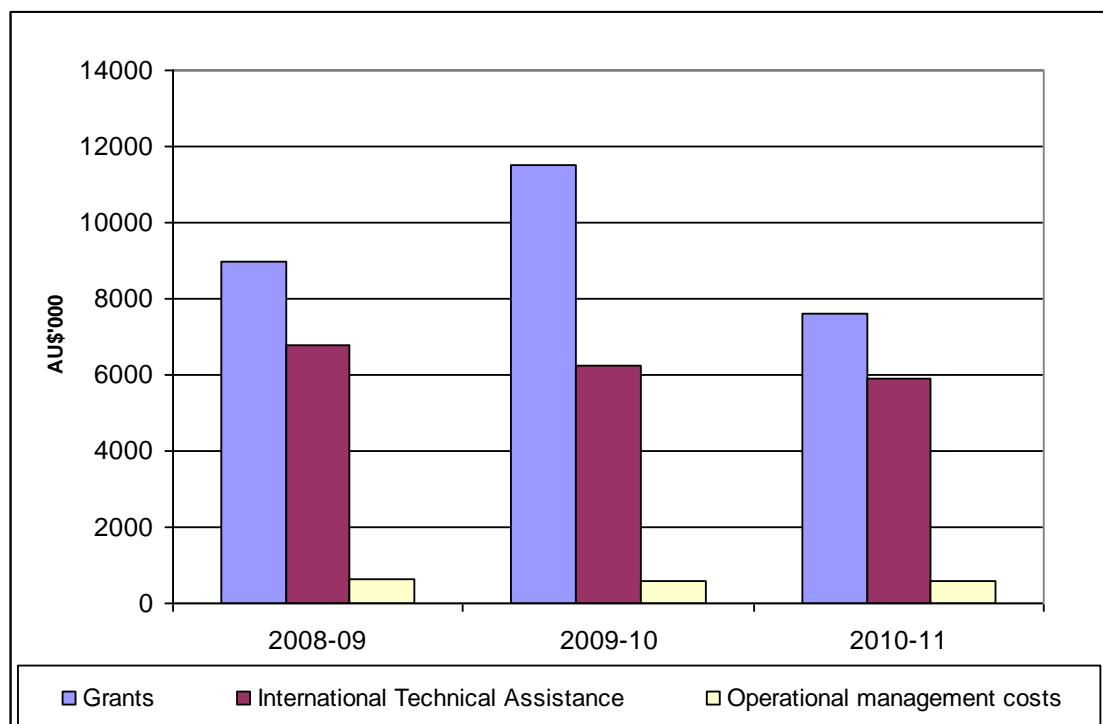
Summary of Expenditure by Sector (\$)	2007-08	2008-09	2009-10	2010-11	2011-12 (est)
Economic governance / PFM	1245.6	2494.3	3877.6	3096.3	3223.6
Telecoms	1,868.5	7,272.9	482.2	163.1	1,000.0
Power	525.6	1,466.8	3,503.7	2,082.0	2,549.7
Transport Infrastructure	0.0	3,754.4	9,760.9	7,199.2	7,088.1
Urban Development	0.0	0.0	0.0	573.6	117.6
Other (statistics, research)	175.3	760.8	173.5	350.6	435.0
Program Management	613.8	652.4	599.5	599.0	578.2
<b>TOTAL</b>	<b>4428.8</b>	<b>16401.6</b>	<b>18397.4</b>	<b>14063.7</b>	<b>14992.1</b>



Total budget expenditure was **\$14.064 million** in 2010-11. This is \$6.385m less than budget forecasts. Lower than expected expenditure was a function of political instability throughout much of 2010-11 and slower than expected progress in a number of activities (e.g. stalled VCMB reforms alone account for \$2.9m of under expenditure).

An assessment of program expenditure in 2010-11 shows that the GFG program provided around 54% of budget funding as grants to support key Vanuatu government reforms (this represents a decline on the 2009-10 figure of 63%). Around 42% of all expenditure was provided in the form of technical assistance (a slight increase). Management costs have been maintained at a low level, which compares very favourably with other forms of aid. Estimated expenditure by form of aid is shown in the following chart:

**Chart 3: GFG expenditure by form of aid over time**



**Table 4: GFG expenditure by form of aid 2010-11**

TYPE OF EXPENDITURE	2010-11 Expenditure (\$AUD '000)	% of total
Grants	\$11,535.9	62.7%
International Technical Assistance and other	\$6,262.04	34.0%
Portion utilised for Operational management costs	\$ 599.5	3.3%
<b>TOTAL (estimate)</b>	<b>\$18,397.4</b>	<b>100%</b>

## ANNEX B – Revised Reporting Structure

The Vanuatu-Australia Partnership for Development (signed by former Prime Minister Natapei and former Prime Minister Rudd in Canberra on 27 May 2009), establishes the shared vision of the Governments of Australia and Vanuatu to work together to meet common challenges and to improve development outcomes and sustainable improvements in the quality of life of all Vanuatu citizens. Overarching objectives of the partnership include:

- increase access and quality of schooling for all children
- accelerate progress towards health MDGs
- improve infrastructure
- improve economic governance

GFG is the main vehicle through which Australia is helping the Vanuatu government achieve the latter two objectives of improved infrastructure and economic governance.

### Reporting structure

GFG's reporting structure has been modified from the original design to better reflect the new Vanuatu-Australian partnership agreement.<sup>30</sup> Reporting is now structured around the two mutually agreed Partnership result areas, as follows:

**Result Area 1: Improved infrastructure<sup>31</sup>** - This objective recognises the growing priority and importance of infrastructure as an engine for growth. GFG is supporting investment and reforms across the three main modes of transport, including ports, aviation and roads. GFG is also supporting ongoing reforms in the telecommunications and energy sectors.

**Result Area 2: Improved economic governance<sup>32</sup>** - This result area largely encompasses both of GFG's design objectives, including:

*Objective 1 - Vanuatu's policy framework is more supportive of broad-based growth, and*

*Objective 2 - The quality of Vanuatu's public expenditure is improved*

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<sup>30</sup> GFG's outcomes, priorities and reporting structure is to be reviewed as part of the proposed joint mid-term review of the program (originally planned for late 2010, but now scheduled for 2011).

<sup>31</sup> This represents Partnership Priority Outcome 3 under the Vanuatu Australia Partnership for Development

<sup>32</sup> This represents Partnership Priority Outcome 4 under the Vanuatu Australia Partnership for Development

Annex C contains supplementary information which is tracked as part of GFG's performance assessment framework.

### **Donor coordination**

GFG continues to work effectively with a number of donors to support the government's reform efforts and to help leverage financing. Examples of assistance include:

- Partnering with the World Bank in telecommunications, energy and potential the maritime sector.
- IFC on aviation reform and public private partnerships
- Japan on ports reform (JICA)
- Cooperation with ADB on SOE reform and urban infrastructure

# ANNEX C – Supplementary Performance Information

The indicators below are being tracked under the GFG Performance Framework.

## 2009 PEFA Assessment

The following table compares overall scores for PEFA indicators between 2006 with 2009. There has been improvement in a total of 15 indicators, although Vanuatu has slipped back in a couple of areas. GFG support has helped the government achieve improvements in many areas. The next PEFA report is scheduled for 2012.

**Table 5: PEFA Scores 2006 and 2009**

PEFA Performance Indicators		Overall ratings		Change
		2006	2009	
<b>A. PFM-OUT-TURNS: Credibility of the budget</b>				
PI-1	Aggregate expenditure out-turn compared to original approved budget	A	B	Regression
PI-2	Composition of expenditure out-turn compared to original approved budget	A	A	Maintained
PI-3	Aggregate revenue out-turn compared to original approved budget	A	A	Maintained
PI-4	Stock and monitoring of expenditure payment arrears	A	A	Maintained
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>				
PI-5	Classification of the budget	B	B	Maintained
PI-6	Comprehensiveness of information included in budget documentation	A	B	Regression
PI-7	Extent of unreported government operations	D+	C+	Improvement
PI-8	Transparency of inter-governmental fiscal relations	B	B	Maintained
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D	D+	Improvement
PI-10	Public access to key fiscal information	C	C+	Improvement
<b>C. BUDGET CYCLE</b>				
<b>C(i) Policy-Based Budgeting</b>				
PI-11	Orderliness and participation in the annual budget process	B+	B+↑	Improvement
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	C+	Improvement
<b>C(ii) Predictability and Control in Budget Execution</b>				
PI-13	Transparency of taxpayer obligations and liabilities	C+	B	Improvement

PI-14	Effectiveness of measures for taxpayer registration and tax assessment	B	B↑	Improvement
PI-15	Effectiveness in collection of tax payments	D+	D+	Maintained
PI-16	Predictability in the availability of funds for commitment of expenditures	C+	B+	Improvement
PI-17	Recording and management of cash balances, debt and guarantees	C+	C+	Maintained
PI-18	Effectiveness of payroll controls	C+	C+	Maintained
PI-19	Competition, value for money and controls in procurement	D+	D+	Maintained
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	C+↑	Improvement
PI-21	Effectiveness of internal audit	D+	C	Improvement
<b>C (iii) Accounting, Recording and Reporting</b>				
PI-22	Timeliness and regularity of accounts reconciliation	B	B	Maintained
PI-23	Availability of information on resources received by service delivery units	C	C	Maintained
PI-24	Quality and timeliness of in-year budget reports	B+	B+	Maintained
PI-25	Quality and timeliness of annual financial statements	B+	A	Improvement
<b>C(iv) External Scrutiny and Audit</b>				
PI-26	Scope, nature and follow-up of external audit	D	D	Maintained
PI-27	Legislative scrutiny of the annual budget law	C+	C+↑	Improvement
PI-28	Legislative scrutiny of external audit reports	D	D	Maintained
<b>D. DONOR PRACTICES</b>				
D1	Predictability of Direct Budget Support	D	C	Improvement
D2	Financial information provided by donors for budgeting and reporting on project and program aid	D	D+	Improvement
D3	Proportion of aid that is managed by use of national procedures	D	D↑	Improvement

### **GFG Performance Indicator: Majority of vision level indicators as reported in the Annual Development Report are improving**

In Sept 2011, the GoV released its third Annual Development Report outlining performance in 2010. The report assesses progress against key government policy priorities, including the Priorities and Action Agenda and the Planning Long Acting Short policy framework. The report also records Vanuatu's progress against the MDGs (where data is available).

According to the 2009 ADR, Vanuatu is on track to meet most of the Millennium Development Goals (MDGs). The report indicates that the overall proportion of the population living on less than \$1 a day has decreased from 26% to only 4%; net enrolment rates have increased; rates of literacy have more than doubled; the under-

five mortality rate has continued to decline steadily; and the incidence rates for malaria have also decreased. Vanuatu's first Household Income and Expenditure Survey (2006) also provided important poverty data. It found a poverty gap ratio of 5.6 (3.8 in rural areas and a high of 10.4 in Port Vila - indicating relatively severe poverty in the capital and the important role of subsistence production in rural areas.

**Economic indicators** – Growth in 2010, at 2.2%, was lower than expected, due to the flow on effects of the global financial crisis. GDP per capita was estimated to be 242,000 Vt. Overall tourist numbers have continued to grow, although this has been mostly driven by cruise ship passengers, with higher value air passenger arrivals declining in 2010.

**Education** – Primary school enrolments increased to 41,834 in 2010, from a figure of 38,762 in 2009, in large part due to the government Universal Education policy initiative (supported by grant funding from Australia).

**Health** – Vanuatu remains on track to meet key MDG targets related to health (including child mortality, maternal health, combating HIV/AIDS and malaria). Malaria rates have more than halved since 2003, while measles vaccination rates have more than doubled. Infant and under 5 mortality rates have also declined over the past decade.

**Utilities** – The 2006 HIES confirms that access to, and uptake of, basic services, utilities and infrastructure in Vanuatu is generally poor. For example, only 54 per cent of households in Vanuatu use improved water supply (44 per cent in rural areas) and only 64 per cent use an improved sanitation facility (56 per cent in rural areas).<sup>33</sup> Only around 26% of all households are using electricity as their means of lighting their homes (with remaining household relying on other sources of light such as gas, kerosene and wood).<sup>34</sup>

### ***Other external data sources***

#### ***Transparency International – Perceptions of Corruption***

Vanuatu is now rated 77<sup>th</sup> out of 182 countries surveyed in the Transparency International Report in its most recent Corruption Perceptions Index 2011.<sup>35</sup> This represents a slight decline from the 2010 ranking (as shown in table below).

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<sup>33</sup> Government of Vanuatu Annual Development Report 2008

<sup>34</sup> Government of Vanuatu Annual Development Report 2009, Sept 2010, pg 52

<sup>35</sup> <http://www.transparency.org>

**Table 6: Perceptions of Corruption Index ranking over time**

Year	2007	2008	2009	2010	2011
Vanuatu Transparency International Perceptions of Corruption ranking	98 <sup>th</sup> out of 179 countries	109 <sup>th</sup> out of 180 countries	95 <sup>th</sup> out of 180 countries	73 <sup>rd</sup> out of 178 countries	77 <sup>th</sup> out of 182 countries

Source: Transparency International, Corruption Perceptions Index

### ***World Bank Ease of Doing Business***

The latest (2011) World Bank Ease of Doing Business Report ranks Vanuatu 76 out of 178 countries in terms of Ease of Doing Business (Vanuatu has slipped back from it's ranking of 60 in 2010). Vanuatu has also fallen back relative to other Pacific Islands, coming behind Samoa, Tonga and the Solomon Islands.<sup>36</sup>

### ***World Bank Governance Indicators***<sup>37</sup>

The governance indicators aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organisations. The latest available data shows that over the period 1998 to 2010 (see Table 1). Over the last decade Vanuatu has improved against most of the governance indicators, with the exception of Regulatory Quality, which has declined even further in 2010.

**Table 7: Australian financial contributions to Vanuatu government budget (Million Vatu)**































	2007	2008	2009	2010	2011
Australian contributions	247.253	620.105	1,088.326	1,586.367	1,381.991

Source: Vanuatu Government FMIS







<sup>36</sup> The Doing Business Report provides objective measures of business regulations and their enforcement across 178 countries and selected cities at the sub-national and regional level.  
<http://www.doingbusiness.org/>

<sup>37</sup> <http://info.worldbank.org/governance/wgi2007/pdf/c237.pdf>

**Table 8: 2010 World Bank Governance Indicators – Vanuatu<sup>38</sup>**

Governance	Sources	Year	Percentile	Governance	Standard
Voice and Accountability	4 	2010	64.0	+0.50	0.22
	4 	2009	66.8	+0.58	0.21
	4 	2008	64.9	+0.56	0.20
	3 	2006	67.8	+0.64	0.23
	3 	2004	59.6	+0.35	0.28
Political Stability	3 	2010	94.8	+1.40	0.33
	3 	2009	94.3	+1.31	0.32
	2 	2008	92.8	+1.19	0.36
	2 	2006	99.0	+1.40	0.38
	2 	2004	72.6	+0.73	0.38
Government Effectiveness	3 	2010	45.0	-0.27	0.31
	3 	2009	44.5	-0.34	0.31
	3 	2008	44.2	-0.33	0.30
	3 	2006	39.0	-0.47	0.27
	3 	2004	30.2	-0.63	0.23
Regulatory Quality	4 	2010	23.4	-0.78	0.24
	4 	2009	25.8	-0.70	0.24
	4 	2008	24.8	-0.71	0.24
	3 	2006	54.4	-0.02	0.27
	3 	2004	39.2	-0.41	0.27
Rule of Law	6 	2010	62.1	+0.25	0.21
	6 	2009	62.6	+0.42	0.22
	6 	2008	63.9	+0.46	0.22
	4 	2006	63.6	+0.48	0.28
	4 	2004	52.2	+0.00	0.24
Control of Corruption	5 	2010	67.5	+0.35	0.31
	4 	2009	67.5	+0.36	0.32
	4 	2008	67.0	+0.32	0.31
	3 	2006	61.5	+0.18	0.32
	3 	2004	30.7	-0.62	0.31

	90th-100th Percentile		50th-75th Percentile		10th-25th Percentile
	75th-90th Percentile		25th-50th Percentile		0th-10th Percentile

<sup>38</sup> <http://info.worldbank.org/governance/wgi>, World Bank Governance Indicators



## ANNEX D – Cross-cutting issues

**Gender** – An important underlying principle of GFG’s program is equality of access to the opportunities offered by growth and improved service delivery for all segments of the population, including women. GFG’s support is primarily targeted at national level policy reforms which are intended to benefit the population as a whole (eg. improving access to telecommunications, improving management of public funds). It is acknowledged, however, that the impacts of policy reform and investment are not always the same for women and men, just as they are not always the same for rural and urban populations. The different impacts on men and women are not always readily understood, in large part due to a lack of gender disaggregated data. This lack of data is also a major constraint for policy and decision makers when setting future policy directions.

In response, GFG has mainstreamed gender considerations and research into all of its programs. For example, gender has been an important aspect of research into the impact of telecommunications reforms and the Vanuatu Transport Sector Support Program. A review of gender mainstreaming was also undertaken in early 2010. The review found that “gender disparities in Vanuatu cut across the political, economic and social spheres. Girls are less likely than boys to finish their schooling, or continue into secondary school. This flows through to formal employment where women are also under represented - women make up approximately one third of employees in the formal sector and also tend to be engaged in lower paid jobs... Women are rarely involved in formal decision-making, either through traditional or modern democratic structures. Only one of the 50 MPs in the current national parliament is female, and women are also under-represented in the senior ranks of the public service. Violence against women is also a major concern.”<sup>39</sup>

GFG is working to address gender disparities in three ways:

1. Supporting the collection of gender disaggregated data – For example through support for the National Statistics Office (Population Survey), support for the Public Sector Survey.
2. Supporting better analysis of gender issues through targeted research – For example through Telecommunications Impact Studies and proposed VTSSP Gender and Economic Impact Study.
3. Supporting policies and initiatives which aim to address gender inequalities – For example initiatives to increase women’s employment participation under VTSSP which have been successful at engaging women in road maintenance works with a participation rate of around 14%.

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<sup>39</sup> AusAID Office of Development Effectiveness, 2008, Violence against Women in Melanesia and East Timor: Building on Global and Regional Promising Practices

**Climate change** – Vanuatu is vulnerable to the impacts of climate change, including more intense rainfall, more frequent cyclones and rising sea levels. When coupled with aggressive island topography, climate impacts are contributing to rapid deterioration of the road network. Under VTSSP additional funding has been sought from the regional Climate Change initiative to meet the increasing need to build structures that are more resilient to increased rainfall and sea level rise.

**HIV/AIDS** – Road maintenance works by their nature bring the men, money and mobility environment that is conducive to increased risk of STDs. Although the incidence of HIV/AIDS is relatively low in Vanuatu, the risk of STD transmission is being addressed by requiring contractors to implement awareness raising activities, including condom distribution. Local NGOs and the National AIDS Committee are being increasingly engaged to participate in the program. As this issue is relatively new, progress is mixed and requires continued management guidance and monitoring.

**Anti-corruption** – Under VTSSP, financial management controls and processes have been reviewed and strengthened to support anti-corruption activities and address financial mis-management. GFG is also working with the government to strengthen audit and procurement practices across the board in an effort to address corruption.

**Universal access** – Pedestrian and disabled access were not reflected in the original program design for VTSSP, but were identified as a constraint in the baseline study (eg. death of children trying to get across flooded crossings on their way to school, poor school attendance during the wet season in Ambae). VTSSP has worked on improving both pedestrian and disabled access (eg. footpaths in high traffic pedestrian areas, access ramps for disabled people) but is yet to adequately address the issue of dangerous river crossings in Ambae.