

DRAFT REPORT

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*Volume 1*

***VANUATU***

*Diagnostic Trade Integration Study*

November 2007

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## FOREWORD

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

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

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

- A review and analysis of the country's economic and export performance.
- A description and assessment of the country's macroeconomic environment and investment climate.
- A focus on the international policy environment and specific constraints that exports from the country faces in international markets.
- A focus on a small number of key labour intensive sectors where the private sector can contribute to a significant expansion of output and exports and a good *a priori* case can be made that the poor stand to benefit either in terms of employment and/or lower prices.
- A set of policy reform priorities and required capacity strengthening at the sectoral level to capitalize on the major opportunities identified in the strategy.

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

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

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

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

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

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

## EXECUTIVE SUMMARY

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

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

For Vanuatu fully to benefit from the IF the various institutions involved in trade policy need to be improved and better co-ordinated. Vanuatu already has a strong focus on gender issues in trade, but the relevant institutions dealing with women's affairs must be systematically represented in trade policy decisions. The principal institutional changes recommended in the DTIS are to move the Department of Trade and Industry (DTI) to the Ministry of Foreign Affairs; to improve facilities at the

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