



Establishing Coherent and Effective Policies for Trade:

The Republic of Vanuatu

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1. Introduction

Vanuatu is at a crossroads of undertaking important domestic reforms with significant implications for both trade and poverty alleviation. After years of political and more recently economic instability, the country has shifted into a period of relative prosperity in the past five years, with a palpable sense domestically that even better things are on the horizon. In part this is driven by positive economic trends – it is one of the fastest growing economies in the South Pacific, driven largely by booming tourism exports. On the other hand, this is driven by the advancement of some key domestic reforms aimed at modernising both the government, the economy and, importantly for our purposes, ascribing a greater priority to trade and trade policy-making to support and deepen these reforms and catalyze associated benefits in return.

As we shall uncover below, the single most important constraint to Vanuatu developing an effective and coherent trade negotiating strategy has little to do with negotiations at all. Rather, this constraint lies in a coordination failure – or horizontal operational incoherence – and the absence of a coherent and inclusively-designed trade policy or decision-making framework to set the appropriate foundation from where such a negotiating strategy can flow. Addressing this institutional deficiency is paramount.

With a predominant focus on trade negotiations (irrespective of their potential benefits), the government arm responsible for trade policy, the Department of Trade, Industry and Investment, has been understandably preoccupied with attempting to make sense of this web of complex agreements. As a result, there has been inadequate attention to supply-side concerns, which arguably pose a far greater challenge to increasing trade and production for Vanuatu than the need for greater market access.

In light of the above, the analysis that proceeds is predominantly focussed on horizontal incoherence, though not to the exclusion of important vertical incoherence considerations. What follows is an overview of the general socio-economic characteristics of Vanuatu in Section 2 and a review of the national development strategy in Section 3. By first providing an overview of the main trade-related development priorities (TRDPs), we shift to investigate the nature of incoherence in terms of support provided to these by the policy objectives in a number of trade and trade-related domains. Section 4 delves deeper into policy incoherence, in particular to identify some illustrative examples of where incoherence between the implementation and impact of trade and trade-related policies and TRDPs are prevalent. With a view to prioritising high-impact areas where the government has a relatively larger ability to elicit change, Section 5 considers potential interventions aimed at minimising this coherence. We conclude with Section 6, which looks at developing a coherent trade negotiating strategy.

2. General overview¹

With numerous waves of regional colonizers throughout its history, Vanuatu was 'settled' by the West in the 19th century, officially becoming the Anglo-French Condominium of New Hebrides in 1906. It was under dual colonial administration until its independence on 30 July 1980, when it adopted the name the Republic of Vanuatu (hereafter Vanuatu). As a group of remote and highly-dispersed islands in the Pacific Ocean, in the sub-region known as Melanesia², the following section provides an overview of some key geographical and socio-economic characteristics of Vanuatu.

An important data caveat is noted at the outset, in that both the availability and quality of social and economic statistics is relatively low. Statistical collection methods were only brought up to international standards in the late 1990s (thus only 10 reasonably reliable annual data samples) and have been subject to frequent and sometimes significant revisions. Recent years have seen significant improvements, in particular in financial data collection and (to a lesser degree) trade data, however socio-economic data remains problematic. The main source for the latter is the 1999 Household Income and Expenditure Survey (HIES), which has been widely critiqued along methodological grounds, including for having a disproportionately high urban response rate³.

2.1 Geography and population

Located approximately three-quarters of the way between the east coast of Australia and Hawaii (2500km northeast of Sydney), Vanuatu is a Y-shaped chain of 83 islands (65 inhabited) stretching over 650km of the southern Pacific Ocean. It has over 2500 km of coastline with an Exclusive Economic Zone (EEZ) extending over 500,000 sq km (roughly the size of France⁴). Comprised of mostly volcanic-based mountainous islands (with some coastal plains), Vanuatu is situated along both the 'ring of fire' and the 'cyclone belt' of the Pacific – making it extremely vulnerable to external climatic shocks.

The country is divided into six provinces: Tafea (Erromango, Tanna, Aneityum, Futuna and Aniwa), Shefa (Efate and The Shepherd Islands), Malampa (Ambryn, Malakula, Paama), Penama (Pentecost, Maewo, Ambae), Sanma (Santo, Malo, Aore, Tutuba & Bokissa) and Torba (The Torres Islands, Vanua Lava, The Banks Islands and Gaua). The capital city is Port Vila, which along with Luganville on Santo, constitute the two urban centres.

Vanuatu is home to just under 210,000 people (est. 2006), of which the 1999 census placed 80% in the rural areas (highlighting the dualistic nature of society). Gender distribution is roughly equal and population growth is believed to be high in recent years, estimated at 2.9% annually. Over 70% of the populace speak an indigenous language (there are over 100), with the lingua-franca pidgin (known as Bislama) being spoken by a quarter of the country. French and English speakers constitute around 1.5 to 2%.

¹ The information provided in this section is drawn from the Integrated Framework draft DTIS (2007), IMF Article IV Consultation Report (2007), National Statistics Office (NSO) National Accounts of Vanuatu 1983-2001 (2002) and National Accounts of Vanuatu 2006 (2007a), and CIA World Factbook (2007).

² Melanesia includes Papua New Guinea, Solomon Islands and Fiji.

³ NSO is currently undertaking a new comprehensive household and expenditure survey, focussed in particular on rural data collection, to provide a more accurate baseline for future research.

⁴ This includes the Matthew and Hunter islands (east of New Caledonia), which are the focus of a territorial dispute with France.

2.2 Social indicators

As noted above with regards to the 1999 household and expenditure survey, making effective use of social data in Vanuatu is hampered by the lack of a strong baseline and compounded by the subsistence-based nature of the rural populace⁵ (whose 'income' and/or 'wealth' are not easily captured). By and large however the majority of people are not undernourished, enjoy sufficient leisure time and live well⁶.

This notwithstanding, with a Gini coefficient estimated between 0.56 and 0.58 – one of the highest in the world – inequality is clearly a key characteristic of society in Vanuatu. As such, it is likely to play a significant role in mediating the relationship between growth and poverty (Nissanke and Thorbecke 2006). In terms of poverty, the Asian Development Bank (ADB) estimated its prevalence in 40% of the population (of incomes below US\$1 per day in 1993 PPP terms & 1998 prices), jumping to 51% in the rural areas. Taking into account literacy rates, mortality rates and access to roads and telephones, general living standards rank low for the region and access to basic services, above all health and education, could be improved considerably.

In terms of human development (data caveats noted above), the 2006 Human Development Index (HDI) ranks Vanuatu at 119 out of 177 countries. This falls at the lower end of the 'Medium HDI' countries, substantially better than Papua New Guinea and the Solomon Islands. Table 1 provides some comparison with Vanuatu's Melanesian neighbours:

Table 1 – 2006 HDI Values for Vanuatu

	Vanuatu	Solomon Islands	PNG	Fiji
HDI Rank	119	128	139	90
HDI Value	0.670	0.592	0.523	0.758
Life Expectancy at Birth (yrs)	68.9	62.6	55.7	68.0
Adult Literacy [ages 15+] (%)	74.0	76.6	57.3	-
Combined Gross Enrolment Ratio	64	47	41	75
GDP per capita (PPP\$)	3,051	1814	2543	6066
Life Expectancy Index	0.73	0.63	0.51	0.72
Education Index	0.71	0.67	0.52	0.87
GDP Index	0.57	0.48	0.54	0.69
GDP per capita [Rank minus HDI Rank]	-1	18	-15	-2

Source: UNDP (2006)

⁵ The traditional or customary economy is largely, but not exclusively, rural and based around subsistence agriculture, often exhibiting higher capital assets than levels of income. Findings from the initial phase of the new household survey support the view that the importance of the 'kastom' economy has been historically underestimated.

⁶ In 2006 Vanuatu was assessed by UK-based New Economics Foundation as being the 'happiest' country in the world. First amongst 178 countries, the ranking (measuring happiness and environmental wellbeing) was based on Vanuatu's low ecological footprint, reasonable life expectancy and sense of social welfare.

2.3 Macroeconomic trends

Outside of the decade from 1992-2002, relative macroeconomic stability has characterised the Vanuatu economy since independence. Recent years have seen marked improvements following a particularly tumultuous period post-1997, when Vanuatu implemented an ADB-sponsored structural adjustment programme (the Comprehensive Reform Programme or CRP). The relatively large share of GDP coming from agriculture (and even larger importance to overall welfare), combined with volatile commodity prices for its main merchandise exports and high exposure to climatic shocks has injected a consistent degree of volatility in national income figures.

2.3.1 Growth

After significant post-reform contraction of the economy ended in 2002, Vanuatu has seen increasingly healthy real GDP growth in recent years. Real GDP grew just over 6% on average for 2004 and 2005, with 2006 estimated at between 5.5% (IMF 2007) and 7.2% (NSO 2007). This fourth successive year of expansion is considerably higher than the 3.5% average recorded between 1980 and 2000 and is expected to continue into the short-term.

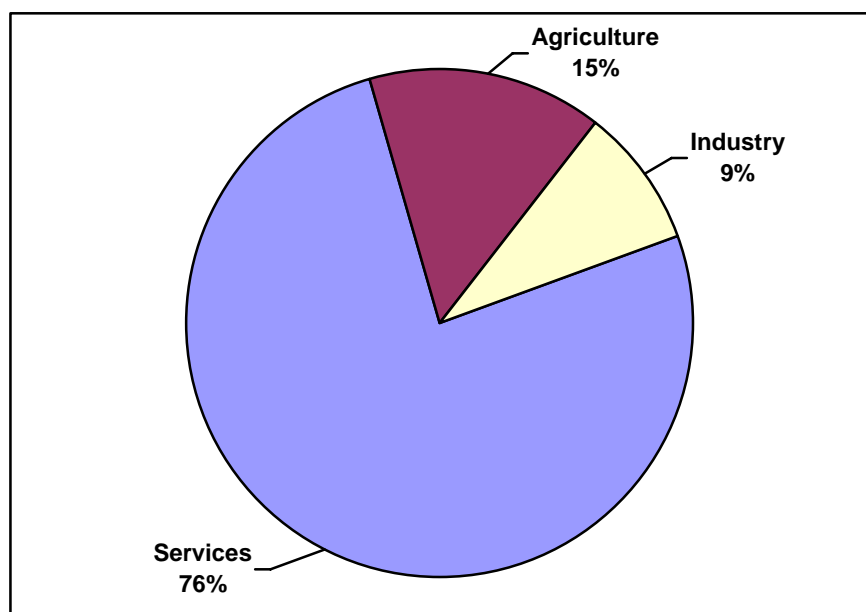
While unreliable population data results in a greater degree of uncertainty in per capita GDP figures, relatively high population growth is believed to have kept per capita GDP growth low or negative until the recent upswing. Estimated at US\$ 1,557 in 2004 puts per capita GDP on the high end of the scale for an LDC, with the implication that if current trends continue, Vanuatu may find itself graduating from LDC status in 2013⁷.

2.3.2 Composition of the economy

The services sector contributes just over three-quarters of GDP (2000-2006 average) (see Figure 1), being attributed with 85% of 2006's overall expansion. This is driven largely by tourism (including hotels and restaurants), construction, transport, communications, and wholesale & retail trade. The latter is thought to account for almost the same as agriculture and industry combined (at roughly 15% and 9% respectively).

⁷ Approximate exchange rate of \$US 1 = VT 110.

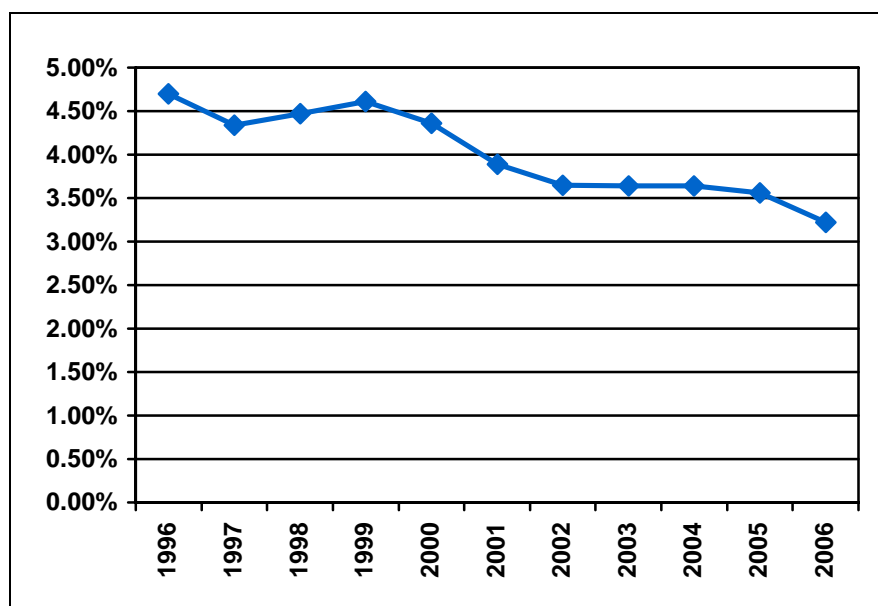
Figure 1 – Average contribution to GDP (2000-2006)



Source: Compiled from National Accounts of Vanuatu (NSO 2007a)

As we can see in Figure 2, this contrasts with the manufacturing sector, which has been in steady decline the past decade, from a peak of almost 5% of GDP down to just over 3% in 2006.

Figure 2 – Manufacturing as % of GDP (1996-2006)



Source: Compiled from National Accounts of Vanuatu (NSO 2002 & 2007a)

Table 2 provides a more disaggregated view of the sectoral composition of the economy. It is important to underscore again that the nature of the traditional economy likely results in an underestimation of its contribution.

Table 2 – Composition of GDP (million Vatu, current prices)

	2000	2001	2002	2003	2004	2005	2006
Custom / traditional agriculture	3,102	3,237	3,340	3,419	3,552	3,676	4,364
Export agriculture	1,995	1,750	1,560	1,667	1,915	1,826	2,180
Copra	716	663	624	619	832	413	342
Kava	436	440	262	263	418	456	673
Beef	409	410	429	471	456	591	856
Forestry and logging	295	169	165	172	128	297	197
Cocoa	138	68	78	140	79	67	107
Coffee	1	2	2	2	1	3	5
Other commercial agriculture	148	144	130	127	121	166	188
Fishing	68	56	43	43	38	53	70
Poultry and dairy	62	69	67	60	64	92	96
Fruits and vegetables	17	19	20	23	20	22	22
Total agriculture	5,245	5,132	5,030	5,213	5,588	5,668	6,732
Manufacturing	1,486	1,328	1,167	1,244	1,341	1,438	1,477
Electricity and water	598	685	701	683	675	810	917
Construction	1,064	1,092	1,094	1,075	1,164	1,317	1,559
Total industry	3,130	3,105	2,962	3,002	3,180	3,565	3,953
Wholesale and retail trade	10,679	10,705	9,219	10,523	11,122	12,611	14,436
Hotels and restaurants	2,741	2,603	2,372	2,163	2,461	2,633	2,940
Transport and communication	4,082	4,166	3,785	4,115	4,704	5,368	5,892
Finance and insurance	2,160	2,724	2,664	2,991	3,225	3,908	4,310
Real estate & business services	1,970	2,053	1,961	2,189	2,547	2,794	3,118
Government services	4,521	4,663	4,825	4,995	4,973	5,147	6,195
Personal services	358	372	383	391	403	422	450
Domestic services	385	408	429	459	485	509	535
less bank charges	1,622	1,806	1,673	1,816	1,825	2,238	2,660
Total services	25,274	25,888	23,965	25,970	28,094	31,154	35,216
Total GDP	<u>33,649</u>	<u>34,125</u>	<u>31,957</u>	<u>34,185</u>	<u>36,863</u>	<u>40,387</u>	<u>45,901</u>

Source: Compiled from draft DTIS (2007) and National Accounts of Vanuatu (NSO 2007a)

2.3.3 Exchange rate

The national currency, the Vatu, has been pegged to an undisclosed transactions-weighted basket of currencies since 1988 (comprising Vanuatu's major trading partners). In recent years it has maintained relatively stability against the Australian and New Zealand currencies and has been deemed "appropriate for Vanuatu's stage of development" in the recent IMF Article IV Consultation Report (2007), with "little sign of ... misalignment at present". With its large import bill, this policy by the Reserve Bank of Vanuatu (RBV) is aimed primarily at ensuring price stability.

2.3.4 Inflation

The stability of prices (and the exchange rate) throughout the 1990s and into recent years is not entirely evident in inflation figures, however these have been criticised for having a strong urban bias and thus providing an inadequate picture. External climatic shocks would also appear to have had a large role in sudden jumps in prices (mostly food), with a resulting impact on inflation.

2.3.5 Balance of payments

With its small export base, Vanuatu has run a consistent trade deficit throughout its history, which has been financed in recent years through services trade (mostly tourism) and inflows of both official development assistance (ODA) and private capital (increasingly for speculative land transactions). A slowdown of exports in 2001 (largely due to a decline of both copra and kava exports to the EU) placed downward pressure on the current account in the ensuing years, however this has been partially recouped on the services and capital flow side. Increased demand for consumer and capital goods imports (combined with higher fuel prices) is expected to offset strong tourism receipts and capital inflow in 2007, with a 65% decline in the current account projected for 2007, down to 13.2% of GDP (see Table 3). With records being set for both tourism and foreign aid in 2007 however, the actual decline is likely to be lower.

Table 3 – Balance of payments (2002-2007)

	2002	2003	2004	2005*	2006#	2007#
Current account	-22.2	-30.0	-23.9	-36.8	-30.9	-55.7
(million \$US)						
(in percent of GDP)	-9.7	-10.7	-7.3	-10.0	-8.0	-13.2
of which: tourism exports (million \$US)	44.1	52.0	67.4	76.1	88.7	93.5
Merchandise exports, f.o.b. (million \$US)	20.1	26.6	38.1	38.1	38.9	40.5
(annual percentage change)	0.7	32.5	43.4	0.0	2.0	4.0
Merchandise imports, f.o.b. (million \$US)	74.6	86.8	106.8	124.7	140.3	170.9
(annual percentage change)	-4.5	16.4	23.1	16.7	12.5	21.8
Gross official reserves (end of period)						
In millions of U.S. dollars	36.4	44.3	62.1	67.6	99.1	118.9
In months of corresponding imports of goods	5.0	5.2	6.0	5.6	7.2	7.1

Source: IMF (2007)

* - projected; # - estimated;

2.3.6 Aid

Accounting directly for over 5% of GDP, Vanuatu is the sixth-highest recipient of per capita ODA among the LDCs (DTIS 2007). Major donors include Australia (up to 50% in recent years), France, New Zealand and Japan, as well as more recently China and the US (via the Millennium Challenge Account⁸). This marked increase in ODA poses some risk to the otherwise stable macroeconomic environment and thus the government will need to be cautious to undertake activities aimed at minimising the likely adverse effects.

2.4 International trade

Founded on the premise of 'Melanesian Socialism', Vanuatu has historically had an inward orientation, focussed primarily on import substituting sectors. As will become evident below, external trade has historically received a rather low priority. Recent moves however in the context of the multi-agency Integrated Framework and more robust engagement in a host of trade negotiations would seem to imply that a shift is underway (though with as-yet uncertain outcomes).

With the absence of any taxes on income or profits, trade taxes have historically been an important source of government revenues, accounting for on average 22% annually of total recurrent government revenue between 2003 and 2005. The decline of importance began in the post-1997 reforms, with the average trade-weighted tariff falling to approximately 20% by 2000 and estimated at 15% in 2006 (Watergall 2007). In 2003, the government introduced a number of excise taxes to help recoup some lost revenue (which further supplemented revenues from the 12.5% VAT introduced in 1998). It is important to note however that Vanuatu's imperfect market structures (in particular in the retail and wholesale sectors) prohibit any significant pass-through of price reductions to consumers, thus undermining potential consumer welfare gains from trade liberalisation.

2.4.1 Direction & composition of trade

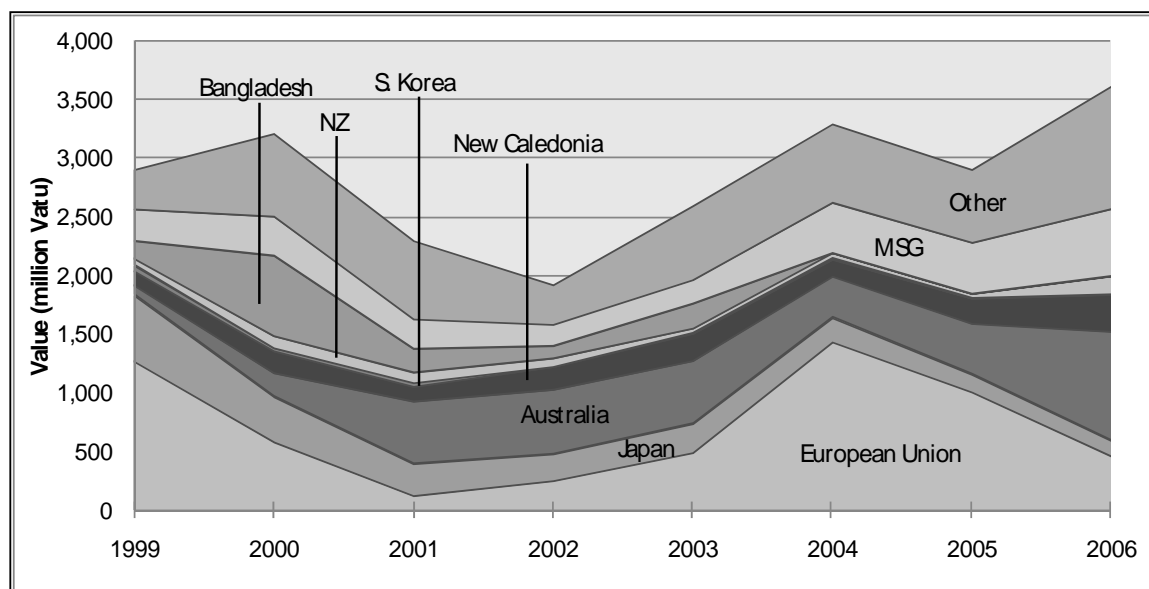
The direction of Vanuatu's merchandise trade has shifted significantly in recent years, with increasing regional flows (mostly Australia, New Zealand and the other Pacific Melanesian countries [MSG]) and decreasing significance of Japan, the EU, and Bangladesh (see Figure 3). The shift in export markets stems largely from decreased copra exports to the EU, Bangladesh and Japan, as well as EU concerns over the safety of kava in 2001, which was subsequently banned by a number of Member States in 2002. Coconut-based exports to the EU have been particularly volatile – though generally declining – due in part to the general decline of overall domestic production and shifting production and export trends between unprocessed copra and semi-processed coconut oil (Welegtabit and Longmore 2006). EU exports returned briefly to historical highs in 2004 (just under 1,500 million Vatu), driven largely by coconut oil, before collapsing in early 2006 as the main processing mill closed⁹.

⁸ The MCC has pledged \$US 66 million for infrastructure projects.

⁹ With the resulting drop in domestic demand for copra, this had the knock-on effect of re-igniting copra exports to Bangladesh and Germany (Welegtabit and Longmore 2006).

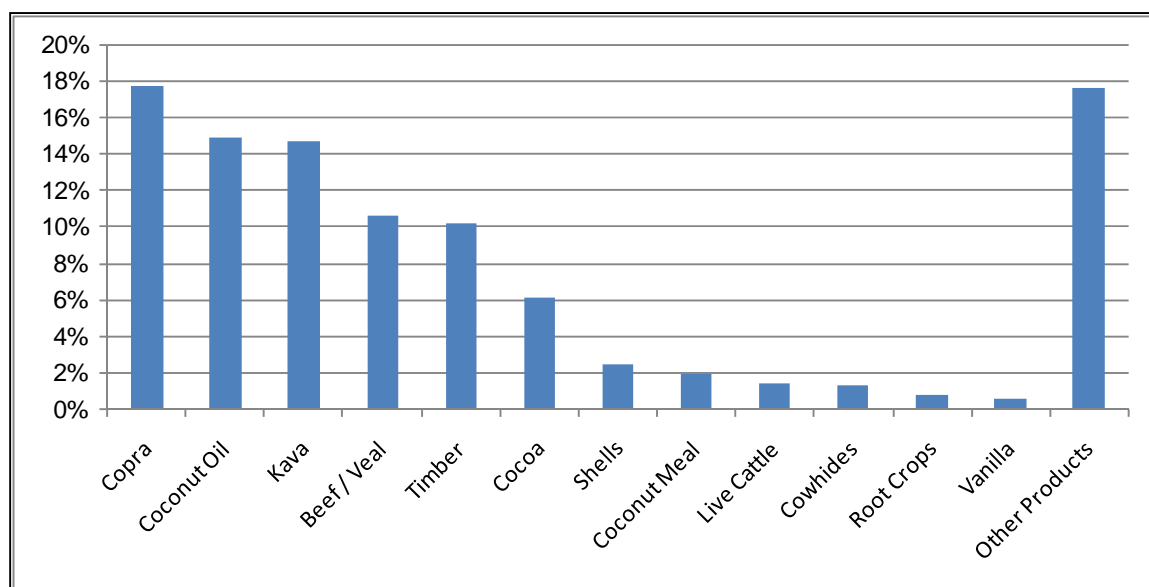
Agriculture exports continue to dominate merchandise exports (hovering just above 80% over the period 1999-2006; see Figure 4), driven historically by coconut products (copra and coconut oil), with the more recent additions of kava, beef and timber. The predominance of agricultural products in merchandise exports is particularly significant considering the fact that the overall welfare of the people of Vanuatu lies largely with the state of the agricultural sector (Welegtabit and Longmore 2006). Indeed with such an undiversified range of exports going to a concentrated number of destinations, the entire Vanuatu economy suffers from high exposure and vulnerability to external shocks.

Figure 3 – Domestic exports by major partner (1999-2006)



Source: Vanuatu National Statistics Office (NSO 2007b)

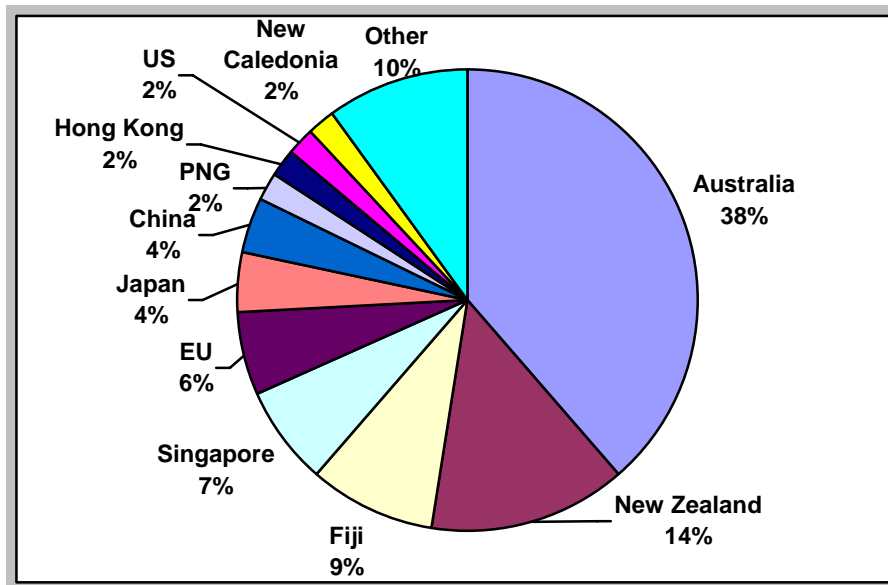
Figure 4 – Domestic exports by major product (as % of total domestic exports; 1999-2006)



Source: Compiled from Vanuatu National Statistics Office (NSO 2007b)

The lack of partner or product diversification characterised with exports is largely mirrored with imports, although the latter has exhibited a greater degree of stability (and growth). Again highlighting the importance of regional trade, Australia, New Zealand and Fiji combine for over 60% of imports (average 2003-05; see Figure 5), with EU imports having been in decline in recent years.

Figure 5 – Imports by partner (2003-05)



Source: Compiled from Vanuatu Customs database (DCIR 2006)

Regional dynamics are even more significant when considering import duty revenue. On average, between 2003 and 2005, Australia alone generated over 50% of import duty collected (largely from fuel, alcohol and tobacco) and along with New Zealand and Fiji, constituted approximately 70% of annual duty revenues¹⁰. This concentration is also present from a product perspective, where a combination of the top 10 products by import value and by import duty collected (totalling 14 separate products; see Table 5) account for almost 35% of the value of imports and over 50% of duty revenue. Such a concentration of duty generation across a small group of products and countries has important implications on possible priorities in terms of future trade negotiations (on which we return later).

¹⁰ While the implementation of the MSG Trade Agreement is likely to lower Fiji's contribution post-2005 (when the reduction of applied duties on the sensitive list commenced), reports of origin misclassification likely imply that a proportion of revenue 'generated' by Fiji imports are actually coming from ANZ. Thus more effective customs administration could mitigate MSG-related duty losses.

Table 4 – Top imports for home consumption as % of total duty and value (2003-05)

Product	% of total value	% of total duty
Fuels	8.0%	13.3%
Pharmaceutical products	7.5%	2.5%
Rice	4.6%	1.6%
Jet fuel	2.8%	0.4%
Diesel vehicles	2.5%	1.9%
Motor spirit	1.8%	6.3%
Cement	1.5%	0.2%
Wheat	1.2%	0.4%
Cigarettes	1.2%	15.0%
Motor vehicles (transport >= 10)	1.0%	0.8%
Frozen chicken wings	0.9%	1.2%
Wine	0.6%	2.4%
Waters	0.5%	3.4%
Beer	0.2%	1.7%
Total (top 14 products)	34.2%	51.2%

Source: Compiled from Vanuatu Customs database (DCIR 2006)

On trade in services there is unfortunately a dearth of detailed data available outside that provided on its contribution to GDP in Tables 2 and 3 (p. 9-11). We reiterate the importance of tourism however, both in terms of the direct receipts it generates (growing annually at 12% in recent years as compared to 2% for merchandise exports), as well as the indirect spillovers in other services sectors, such as wholesale & retail trade and construction.

3. Linking Vanuatu's trade-related development priorities and policy objectives – finding incoherence

The following section starts our analysis of Vanuatu's national development strategy, the trade-related priorities it sets out and our investigation into policy (in)coherence (see Box 1). By first providing an overview of the main trade-related development priorities – or TRDPs laid out in the national development strategy, we shift to investigate the nature of incoherence in terms of the support provided to these by the policy objectives in a number of trade and trade-related domains.

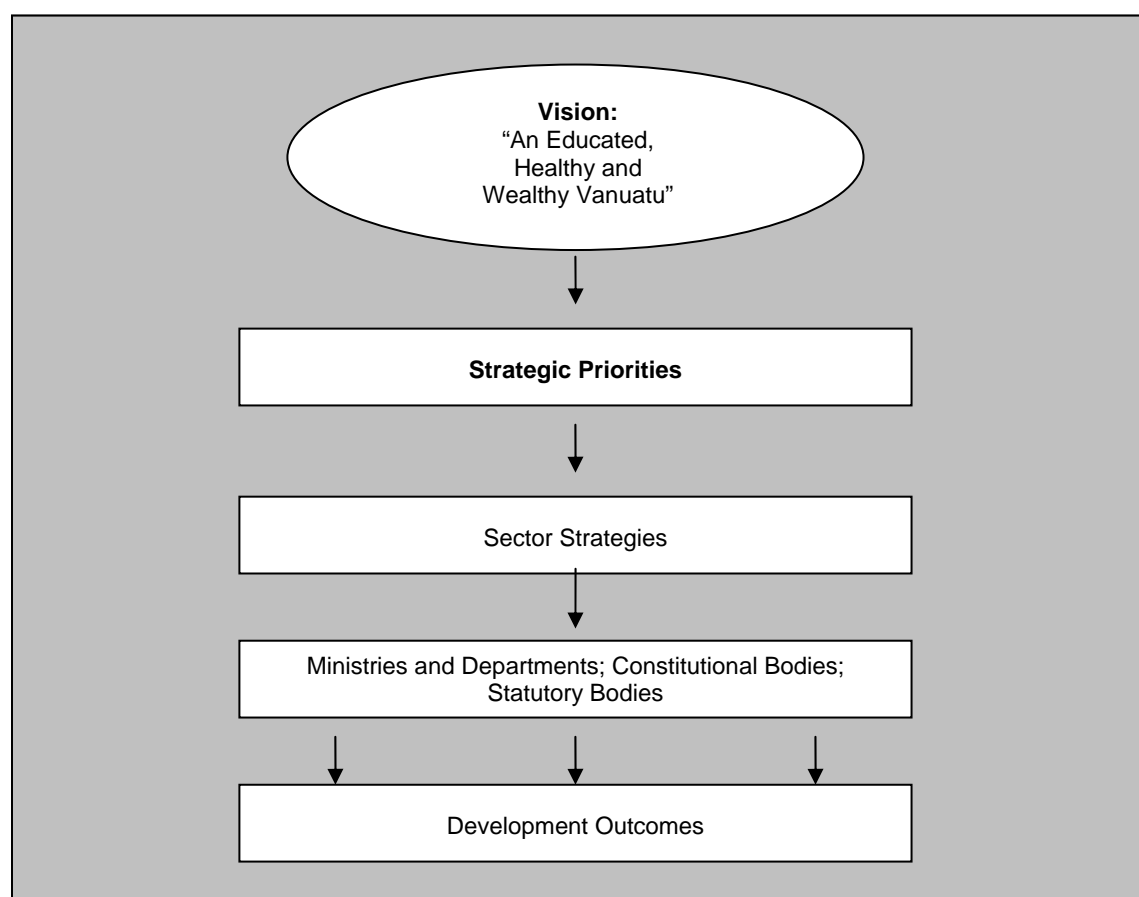
3.1 Trade-related development priorities in Vanuatu's national development strategy

It is helpful to set the (relatively recent) historical context with regards to the 1997 'Comprehensive Reform Programme' (CRP), an ADB-sponsored structural adjustment programme. Gay (2004) provides a review of the CRP, highlighting its inappropriate focus, lack of national ownership and poor implementation – all of which ensured results that were not only inadequate, but largely incoherent and contradictory to initial objectives. In particular, he touches on the incoherence between a programme ostensibly aimed at addressing a balance of payments weakness, yet in practise focussed not on the specifics of the productive sector, but rather on a host of governance-heavy measures. While the latter arguably bore some fruit in terms of modernising the machinery of government, the precipitous economic decline of 1998-2001 implies little positive impact on economic fundamentals (though Gay is quick to recognise the inherent lack of a counterfactual to ascertain whether things would have been better or worse in the absence of the CRP).

The main trade-related priority specified in the CRP is related to 'encouraging the private sector to lead economic growth'. This is largely summed up in the objective of 'a more open economy', to be promoted by encouraging increased FDI and greater competition in the offshore financial sector. Gay cites that the only other current account-focussed intervention was the advocacy of acceding to the WTO and negotiating other regional trade agreements. Rather than embedding such actions into a robust trade policy framework (focussed rightly on building supply-capacity to offset the trade deficit), the piecemeal approach impeded the emergence of a coherent and sequenced plan of trade-related activities, aimed at better situating Vanuatu to capture tangible benefits from potential liberalisation (and foster a more sustainable BOP situation).

Nearly a decade later, the CRP, along with various Business Forum outcomes and the Rural Economic Development Initiative, fed into the ‘Priorities and Action Agenda 2006-2015’ or PAA (Vanuatu 2006), the main document currently outlining the government’s National Vision and (macro) strategic development priorities. The PAA is also accompanied by a Medium Term Strategic Framework (MTSF), which is to “guide priorities and the development of policy as well as implementation of policies and the monitoring of development outcomes”. That the latter is still under development underscores the fact that the articulation of Vanuatu’s specific development strategy and related priorities remains a work in progress. Broadly, the National Vision is for “an educated, healthy and wealthy Vanuatu”¹¹ and (building on the CRP) is premised on the need for greater economic growth, led by the private sector, operating in a supportive and enabling business environment, focussing on the key sectors of agriculture, forestry, fisheries and tourism.

Figure 6 – (Abridged) Policy Development and Implementation Framework



¹¹ It continues: “By 2015 Vanuatu will have achieved a significant increase in real per capita incomes, along with steady growth in levels of employment. Within the region, Vanuatu will be among the leading countries in achieving the MDGs in education, health, environmental management, and other key social indicators. Public sector reforms will have raised standards of governance, levels of productivity in the civil service, and will have resulted in higher standards of services and managerial accountability. Through continuing structural reform, Vanuatu will have established an effective enabling environment to sustain the significant private sector growth, which it aims to achieve in output and employment.”

In terms of the policy development and implementation framework (see Figure 6), as noted above, the PAA provides the Vision and Strategic Priorities, which are to guide (using the MTSF via the Department for Economic and Social Planning or DESP) the content and overall direction of sector strategies. These sector strategies are intended to be detailed road maps for each sector, providing the requisite details to achieve the Strategic Priorities. The implementation of the sector strategy is the responsibility of the respective Ministry in charge.

One of the main critiques of this process raised during consultations for this study is the absence of an effective mechanism to mediate between DESP and the Department of Trade¹² (or other departments dealing with trade-related issues), with the former being said to have only lukewarm interest in international trade¹³ and the latter playing largely an advisory role in most matters relating to the production and trade of goods and services.

Box 1 – Policy coherence

Policy coherence is defined here as “ensuring policies are complementary rather than contradictory and that the impacts of policies are in tandem (i.e. lead to positive development outcomes).” The objective of policy coherence is not to eliminate incoherence but to ensure that policies are directed at a country’s development priorities (to the extent possible given the constraints of necessarily competing objectives and interests).

A key challenge for policy coherence, or in other words a source of incoherence, stems from the inherent multiplicity of objectives that arises in different policy domains. Hence we speak of ‘multiple objective incoherence’. On a more procedural level, one can also envisage incoherence arising within or between organisations because of overlapping functions or poor communications – what can be called ‘operational incoherence’.

In terms of the domains in which these types of incoherence can arise, it is important to distinguish horizontal incoherence (between domestic policy areas) and vertical incoherence (between domestic policy areas and external policies).

Source: Stevens and Phillips (2007)

The following seven ‘national strategic priorities’ flow from the National Vision and serve to structure the PAA:

1. Private Sector Development and Employment Creation
2. Macroeconomic Stability and Equitable Growth
3. Good Governance and Public Sector Reform
4. Primary Sector Development (natural resources and the environment)
5. Provision of Better Basic Services
6. Education and Human Resource Development
7. Economic Infrastructure and Support Services

¹² The Dept of Trade, Industry and Investment (DTII) falls under the Ministry of Trade, Industry and Tourism.

¹³ The concern was raised various times during interviews with civil servants, donors and suppliers of TA. Unfortunately DESP’s Trade Sector Analysts was unavailable for consultation during the in-country visit.

Despite its common (and justified) critique for lacking specificity and actual prioritisation of actions (Bazeley and Mullen 2006), the PAA is an improvement over the CRP in terms of providing a more substantial 'trade-related' foundation for the national development strategy. It does however fall short in terms of elaborating on specific trade priorities, preferring instead to focus more explicitly on priorities for improving the productive sectors (and thus more indirect 'trade-related' issues). While such 'trade-related' issues can often be defined to encompass virtually anything related to the economy, we focus here on the four italicised strategic priorities above, where the greatest direct relevance to trade can be discerned. As such, the ensuing review focuses on highlighting the key trade-related development priorities (TRDPs) in the PAA.

To do so, and help navigate the elements covered, Table 5 outlines the PAA's key TRDPs and related policy objectives and strategies, grouped around the following five themes:

1. Promoting FDI;
2. Increasing the volume and value-added nature of exports and resulting producer incomes;
3. Addressing market structure concerns, particularly in agriculture and infrastructure services;
4. Revisiting the tax structure (e.g. duties) as well as re-prioritising expenditures (e.g. duty exemptions and subsidies); and
5. Assisting producers to build supply-side capacity to export by lowering the 'costs of doing business' and providing trade facilitation services (includes quarantine, standards, marketing, and credit, etc.).

With the time to unpack some of the key strategic priorities and connect the linkages not necessarily made explicit in the document itself, it becomes evident that the Government of Vanuatu does aim (at least on paper) to support a range of priorities and activities quite relevant to trade.

Table 5 – Trade-related development priorities in Vanuatu’s PAA

Main TRDPs (sectoral focus: agriculture/livestock, forestry, fisheries and tourism)	Policy Objectives	Strategies
1. Promoting FDI	<ul style="list-style-type: none"> • Reducing administrative barriers to Foreign Direct Investment • Promoting Vanuatu as an investment destination 	<ul style="list-style-type: none"> • Reviewing and expanding existing tax base to make it more attractive to investment, including an Export Incentive Scheme • Improved marketing of Vanuatu investment opportunities and products including tourism
2. Increasing the volume and value-added nature of exports and resulting producer incomes	<ul style="list-style-type: none"> • Lowering costs of doing business • Providing better support services to business • Ensuring a conducive environment for increased commodity exports • Maintaining a competitive real exchange rate and low inflation • Sustainably raising incomes from production for the domestic and export markets • Increasing the volume and value of beef exports to an increasing number of higher value overseas markets • Improve tourism 	<ul style="list-style-type: none"> • Promoting more competitive exports • Providing support services to small and micro enterprises including encouraging the development of small scale niche market activities in the rural areas • Clarifying the role of the private sector in commodity trading by reviewing the role of the Vanuatu Commodities Marketing Board (VCMB) • Increasing productivity in traditional root crops, livestock and high value crop production • By the most innovative and cost-effective means, extending electrification, communications services and improved water supplies to rural areas • Increasing tourist arrivals and targeting high income and niche-market tourists
3. Addressing market structure concerns, particularly in agriculture and infrastructure services	<ul style="list-style-type: none"> • Lowering costs of doing business • Ensuring a conducive environment for increased commodity exports • Ensuring the provision of competitively priced, quality infrastructure, utilities and services, via public enterprises or private sector partnerships and competition • Encouraging the development of competitive private sector involvement in utilities and services 	<ul style="list-style-type: none"> • Effective oversight and regulation of utilities • Promoting more competitive domestic markets • Clarifying the role of the private sector in commodity trading by reviewing the role of the VCMB • Reducing the cost of power, water and telecommunications services, particularly of electricity and communications (including internet) • Improving the regulatory framework to more effectively enforce contract conditions, and encourage additional competition in these sectors where possible

Main TRDPs	Policy Objectives	Strategies
<p>4. Revisiting the tax structure (e.g. duties) as well as re-prioritising expenditures (e.g. duty exemptions and subsidies)</p>	<ul style="list-style-type: none"> • Re-prioritising expenditures, reducing debt and minimising the subsidies paid to public enterprises • Minimizing subsidies for public utilities 	<ul style="list-style-type: none"> • Reviewing and expanding existing tax base to make it more attractive to investment, including an Export Incentive Scheme • Re-prioritising expenditures towards development and non-salary expenditures • Exploring other tax options and improving compliance to raise revenue • Eliminating subsidies in the ports
<p>5. Assisting producers to build supply-side capacity to export by lowering the 'costs of doing business' and providing trade facilitation services (includes quarantine, standards, marketing, and credit, etc.)</p>	<ul style="list-style-type: none"> • Lowering costs of doing business • Improving access to rural financial services 	<ul style="list-style-type: none"> • Maintaining and improving quarantine and other trade facilitation services • Better research on traditional food crops; more effective extension services; dissemination of improved planting material; improving access to credit • Improving quarantine services; encouraging private sector development of marketing and post harvest handling; identification of markets in collaboration with private sector • Improved capacity to meet higher value overseas beef markets requirements; a marketing and branding strategy for Vanuatu beef exports • Providing efficient and cost effective air transport services to passengers and cargo traffic both domestically and internationally • Maintaining and upgrading existing maritime transport infrastructure • Improving operational efficiency in the ports • Increasing available tourism facilities (urban and rural) and promoting development in the outer islands • Enhancing the quality of tourism services (including via accreditation and training programmes)

On first review, as noted above, trade policy proper received little attention. Despite numerous allusions in the text to shifting emphasis from import substitution to export orientation and the need to facilitate increased exports in a range of sectors, tariff policy and trade negotiations receive scant mention (found only in the section on private sector development). Here we find only references to CRP-inspired trade tax reforms and ongoing discussions in various negotiating fora (WTO, PICTA and PACER, though notably nothing on EPAs). There is a brief mention of the need for export incentives to promote “the new policy of export orientation”, but nothing to imply recognition that for these various priorities to be achieved, the associated activities cannot be taken in a piecemeal fashion, but rather must form part of a robust *and coherent* trade policy framework. The above, foreshadowing later discussions on the lack of any formal trade policy in Vanuatu, is emblematic of the absence of any meaningful mainstreaming of trade issues into Vanuatu’s development priorities.

On the macroeconomic side, maintaining a competitive exchange rate is touched on a number of times, which of course carries significant trade implications, acting as the intermediary between world and domestic prices. Re-prioritising expenditures towards development (including minimising subsidies) and exploring options to increase revenues is also highly relevant, especially in context of the incoherence we discuss later between such priorities and the design and implementation of the duty exemption scheme.

We also see much discussion on increasing exports (and associated producer incomes), in particular in tourism, agriculture and fisheries. Similarly, we find a number of statements referring to supply capacity considerations (though thin in terms of actual substance), and a relatively more robust treatment of trade facilitation measures. Issues related to quarantine and the capacity to comply with standards set in key export markets also factor prominently.

Underpinning the push for more competitive exports is the need to address uncompetitive market structures, especially in agriculture and some key infrastructure services (namely telecommunications, power, water, and electricity). With agriculture forming the backbone of Vanuatu’s exports and contributing at least 15% to GDP (recalling that this is likely understated), this sector is of key importance not only to trade, but to the general livelihoods of most ni-Vanuatu (both in the traditional and cash economy). In this context, long-standing concerns are restated with regards to the role of the state-run marketing board (VCMB) in supporting monopolistic and/or monopsonistic market structures for certain key commodities.

Similarly, reducing the cost and improving the efficiency and regulation of private-sector and state-run monopolies in economic infrastructure and support services is another essential trade-related theme (being one of the most important underlying features supporting trade, production and development more generally). Maritime transport services is worthy of additional mention, in that the sector plays a key role in facilitating internal and external trade, being the primary method by which key crops are transported from the rural and outer islands to markets. All the more so in that specific activities at the main wharves (e.g. stevedoring) have been attributed with a disproportionate responsibility of the high overall transport costs facing exporters in the country (DTIS 2007).

3.2 Policy objectives in trade and trade-related areas – targeting incoherence

We now turn to focuses on the prevalence and nature of incoherence in terms of the support provided to key TRDPs by the objectives of a number of trade and trade-related policies. This includes incoherence both within domestic policy areas (horizontal incoherence) and between domestic and external policy areas (vertical incoherence) (see Box 1 above). The specific policies under investigation cover trade, investment, tourism, and agriculture & livestock.

It must be highlighted at the outset that there is a clear absence of explicit policy statements in many of the areas discussed below – including most notably trade and agriculture. This, in and of itself, constitutes a type of general incoherence considering the emphasis in the PAA on private sector-led growth and increased (mostly agricultural) exports. Furthermore, it impacts the ability to assess incoherence with specific TRDPs (incoherence being a relational concept), thus shifting some analysis to Section 4, where we can assess incoherence with the impact and implementation of policies and measures. Where relevant however, we will proxy policy objectives based on actions pursued (or avoided), in other words a type of ‘revealed policy objective’.

3.2.1 Trade policy

As noted earlier, Vanuatu has no official trade policy. This is probably the apex of general horizontal incoherence considering the TRDPs discussed, though one highlighted for amelioration in the efforts of the IF process to mainstream trade. Similarly there exists a significant degree of vertical incoherence in terms of internal and external political pressures to be a ‘good global citizen’ and make commitments at the highest political level to negotiate a myriad of trade agreements, despite the diversion of scarce human and financial resources for unknown returns.

That is not to say however that there are no policy pronouncements on trade or policy objectives that can be inferred. A common reference in this regard begins with the Communiqué from the 2004 National CRP Summit (Gay 2005). Under the heading ‘Trade, Commerce, Industry and ni-Vanuatu Business Development’ the following recommendations are listed:

- The Summit acknowledges that trade is important to grow the economy and heavily emphasises that creating a local market mechanism to promote local trade should come before we enter the international market.
- The Summit also acknowledges that Vanuatu is part of the international community, and it must take an active part in the many regional and international agreements such as PICTA [Pacific Island Countries Trade Agreement], the WTO [World Trade Organisation] and the EPA [Economic Partnership Agreement].

This highlights two clear trade policy objectives, entering into trade agreements and building a local market mechanism to facilitate trade. While the latter is aligned with the TRDP of increasing the volume and value-added nature of exports and producer incomes, the manner in which it is stated does not give the impression of prioritising increased exports per se, but rather offers a hint of residual anti-export bias. That trade agreements receive little more than a sentence or two in the PAA (and no explicit mention under policy objectives or strategies) highlights a key horizontal incoherence, likely of an operational nature due to the lack of engagement of the Department of Trade, Industry and Investment in the formulation of the PAA. It is also likely an artefact of the historical bias against external trade lingering in other areas of the government.

Contrasting the attention given to these two key arenas of trade policy in Vanuatu is insightful. The government arm ostensibly tasked with trade policy, the Department of Trade, Industry and Investment (DTII) is effectively consumed with activities related to preparing and negotiating international trade agreements, with virtually no time or resources available for activities related to

export development or promotion (or industrial policy more generally).¹⁴ Further aggravating horizontal, operational incoherence is that DTII is often perceived as a marginal agency in most trade (and trade-related) policy discussions.¹⁵ It has no clear role in setting tariffs or in designing positive incentives for producers or investors. Returning to our point on anti-export sentiment, and as noted by DTII (2005), the Trade Minister's formal powers are almost exclusively situated in protectionist instruments. This includes the Import of Goods (Control) Act (which provides discretionary powers to deploy a range of dated quantitative restrictions), the VCMB (which effectively sanctions monopolistic and/or monopsonistic treatment of certain commodities and levies export duties) and the list of investment areas reserved for ni-Vanuatu.

Considering Vanuatu's founding history based on 'Melanesian Socialism' it is unsurprising that in practice, external trade is often positioned in a negative light and given little priority. This does not negate however the clear incoherence between this state of affairs and the TRDPs of increasing exports and producer incomes, including assistance to enhance supply capacities. Fortunately, the process surrounding the IF (and perhaps as importantly, the manner with which Vanuatu's IF has been implemented so far), is indicative of aspirations (at least in some corners) to rectify this incoherence and re-focus on important non-negotiating priorities. Indeed developing an explicit trade policy (as part of this re-focussing) is a key recommendation in the draft DTIS (dealt with in greater detail in Section 5 below), which places science, technology and innovation at the forefront of trade policy (especially with respect to export development and promotion activities).¹⁶

Two additional areas where the absence of trade policy is (horizontally) incoherent with stated TRDPs relates to temporary labour mobility and trade defence mechanisms. Temporary labour mobility is a promising new area of services exports, with great potential to support a number of TRDPs (increased exports and incomes, promoting FDI and tourism via contact with ni-Vanuatu abroad, etc.).¹⁷ The topic has been a particular focus of ni-Vanuatu policymakers recently (with new legislation pending) in light of New Zealand's 2006 workers scheme for low-skilled agricultural labourers, of which Vanuatu was one of the first 6 Pacific countries to gain eligibility. While schemes of a low-skilled nature do not as-yet factor formally into trade negotiations (more akin to preferences), skilled and semi-skilled professions do fall, in terms of mode 4, under possible negotiations on temporary movement of natural persons in the international trading system. In that respect, the topic takes on some characteristics of vertical incoherence, in that it also has the dimension of needing to ensure synergies between a forthcoming policy on labour mobility with the willingness of trading partners to open their markets to mode 4 service suppliers (in particular in the more accessible and relatively less politically sensitive semi-skilled domain [as compared to unskilled]). This also has implications in terms of standards and mutual recognition of qualifications (i.e. policies around technical, vocational education and training).

¹⁴ Investment policy falls under the Vanuatu Investment Promotion Authority (VIPA; see 3.2.2)

¹⁵ This was stressed in interviews with a number of civil servants. It was noted however that the process underpinning the IF was an attempt to change that. The annual budget for DTII was reported at VT 24 million for 2007, just over USD\$ 200,000, a significant increase over VT 15 million in 2005 (DTII 2005).

¹⁶ While Vanuatu apparently has an Export Development Strategy drafted (Vanuatu 2002), there is no mention of it at all in the PAA, MTSF or related documents. It similarly finds no mention in the DTIS. The author has been as-yet unable to ascertain whether in fact this policy has been officially adopted.

¹⁷ Potential benefits for the Pacific, in particular for unskilled labour, were resoundingly supported in the World Bank's study *At Home and Away: Expanding Job Opportunities for Pacific Islanders Through Labour Mobility* (World Bank 2006)

On trade defence mechanisms, especially in light of increasing trade liberalisation, Vanuatu is in need of policies and legislation to enable the government to legitimately protect itself against unfair trading practices. This is essential to ensuring the incomes of producers (a key TRDP) are not harmed by a flood of anti-competitively priced imports. Closely related to the TRDPs surrounding market structure, this area of policy also ties into the need for the development of broader competition and consumer protection policies (which have important knock-on effects for transmitting the 'gains from trade' to consumers via the price channel, in particular in the retail distribution services sector).

Looking at the policy landscape in terms of vertical incoherence reveals a number of items worthy of discussion. We can consider, for example, DTII's predominant focus on trade negotiations (in effect a revealed trade policy objective). This highlights, at least from one perspective, elements of multiple objective vertical incoherence, in that it has often been noted that Vanuatu does not require additional market access, but rather needs to concentrate on putting in place the building blocks to export and benefit from the broader economic reforms, of which trade liberalisation is but one.¹⁸ Yet, while it is true that the bulk of Vanuatu's current and conceivable (merchandise) exports received duty-free treatment (MFN and/or preferential), there are some highly relevant market access-related rules that can figure prominently in trade negotiations and are fundamental to export development and promotion (for example, rules of origin and health & food safety standards that can effectively govern actual entry to overseas markets).

Similarly, if we step outside merchandise trade and consider trade in services, and in particular labour mobility, there is an argument to be made that Vanuatu is very much in need of additional market access (though similarly plagued by supply capacity constraints to take advantage of it in practice). And with the Aid for Trade (AFT) debate having taken centre stage at the WTO in 2007 (albeit with uncertain outcomes), alongside related adjustment concerns in the context of EPAs, trade negotiations have at least the potential to become a revitalised avenue to address the (arguably more important) gamut of supply-side concerns. This highly complex situation calls for intensive efforts at ensuring a coherent approach when considering what and where to focus scarce negotiating resources (something we revisit in Section 6).

In that regard, while the PAA alludes to joining the WTO, continued domestic resistance (within the private sector and elements of government), demonstrates another area of vertical, multiple objective incoherence. This is of course not to say, by any means, that Vanuatu should accept commitments misaligned with its national development interests, however it must also account for the fact that it has gone through extensive reforms to qualify for WTO accession and received little in return by choosing not to join (DTIS 2007). As well, the underlying justification for resistance should be examined, in particular the vested domestic interests in wholesale and retail distribution services which oppose the commitments made in Vanuatu's drafts GATS schedule (WTO 2001). Conversely, the unwillingness of the US to consider re-negotiating certain sensitive services commitments, and thus facilitate Vanuatu joining the WTO demonstrates vertical incoherence in light of both the US' rhetoric of wanting marginalised countries to join the WTO and commit to trade liberalisation, as well as their aid policies via the MCC, which is to invest over \$US 60 million over five years in infrastructure in the country.

Keeping with partner-side policies, the vertical multiple objective incoherence on the part of the EC and EU Member States to make meaningful concessions in such areas as rules of origin, mode 4 and adjustment assistance – the key offensive areas for Vanuatu (and most PACPs), contributed, in part, to Vanuatu not participating in the initial signing of the interim EPA with the EU.¹⁹ This is incoherent with Europe's claims around EPAs being 'tools for development' and 'aimed at

¹⁸ Analysis reviewed for this study offers that Vanuatu does require additional market access (and not simply because of its LDC status, which it may lose in 2013) (Gay 2004; DTII 2005; DTIS 2007).

¹⁹ Indeed all but two Pacific ACP countries opted not to sign the interim EPA in late 2007, which did not include any commitments on services (see Primack 2008).

supporting regional integration' and arises because of multiple objectives being sought by different EC Directorates and EU interest groups (i.e. Trade, Development, Fisheries and Taxation & Customs Union). A prime example here sees EU commercial fishing interests, who benefit from the distortions imposed by existing fisheries rules of origin, superseding DG Development/Trade's 'stated' objective of using the EPA to promote expanded and more diversified trade between the ACP and the EU.²⁰ While the interim EPA did tweak rules of origin for some fishery products for the Pacific (processed tuna; HS chapters 1604 and 1605), the exclusion of chapter 0304 (cuts of fresh chilled and frozen tuna) greatly undermined this potential benefit for countries, like Vanuatu, with no existing processing capabilities. Similar in mode 4, domestic objectives surrounding immigration impeded the EC's ability to offer meaningful commitments to the Pacific on labour mobility access – though this is still to be focus ongoing negotiations in 2008 towards a comprehensive EPA.

3.2.2 Investment policy

In contrast to its trade policy, Vanuatu has a robust and modern-day investment regime whose objectives are largely coherent with and supportive of the PAA's TRDPs, including those generally related to FDI and its sectoral priorities (tourism, agriculture and services). Responsibility for investment policy falls under the Ministry of Trade, Industry and Tourism (MTIT), which presides over the Vanuatu Investment Promotion Authority (VIPA). VIPA was born out of CRP-inspired reforms in 1998 aimed at creating a 'one-stop-shop' for investment. VIPA's primary role is the promotion of FDI and, as per their website, aims to "expeditiously facilitate, promote and foster foreign investment in Vanuatu and to generate greater economic prosperity for the people of Vanuatu".²¹

Developed with assistance from the World Bank's Foreign Investment Advisory Service (FIAS), the National Investment Policy (Vanuatu 2005) is intended to "clarify and enhance understanding of the Vanuatu Government's policies on investment by investors, both foreign and domestic, and by government officials". It addresses, inter alia, sectoral priorities, investment guarantees, incentives and regulations, approval procedures, issues surrounding land, employment, residency, importation and exportation, monetary issues, environmental protection and overall investment promotion and facilitation. Key cross-cutting themes include joint ventures with local private sector firms and the localisation of skills to nationals, although anecdotal evidence obtained during consultations would indicate that loopholes in the requirements (along with enforcement capacity issues) have impeded success.

In terms of sectoral priorities, outside the general categories of tourism, agriculture and services, VIPA's website also highlights:

- tourism: accommodation, recreational services, inter-island cruises, game fishing and scuba diving, ecotourism;
- agriculture: plantation/estate agriculture²², export crop diversification and expansion, ranching, forestry;
- fisheries: aquaculture, fish farming, a variety of sea foods;
- manufacturing: coconut fuel and consumer goods (soft drinks, bread, furniture, clothing);
- technical, vocational, education and training (TVET): skills development and training (formal/informal economy)

²⁰ See Campling et al. (2007) for a lengthy discussion on the benefits of Cotonou ROO for the EU distant water fleet and resulting challenges posed to ACP fishery exporters.

²¹ <http://www.investinvanuatu.com>

²² Including cattle, coconut, cocoa, coffee, kava, ginger, squash, and root crops.

Part 2, Schedule I of the VIPA Act (Vanuatu 1998) (see Annex I) maintains a list of activities restricted to ni-Vanuatu, which does include some of the major export sectors, aiming to “protect the interests of citizen investors”. If there is one area however to pinpoint in terms potential horizontal (multiple objective) incoherence it relates to the reserve list, and whether the restrictions it contains (and underlying objectives) have been effective in practise. As flagged in the draft DTIS (2007), the frequency of assessment of the reserved list and its impacts on the economy has to-date been insufficient (and in particular the thresholds on the quantity of output and/or value of transactions and assets).

The classic example cited in this debate is that of inter-island shipping, where investments in coastal shipping vessels of less than 80 tonnes are reserved for ni-Vanuatu, except vessels used for tourism. This limitation however, combined with the absence of domestic investors has effectively rendered the sector underserved, compounding the high-cost nature of transportation services and constraining the ability of producers in the outer islands to get their production to market (internally or externally). As such, despite the complementary objectives of wanting to promote FDI, restrict certain sectors for local investors and promote efficient transportation (infrastructure) services and increased exports, the results are clearly contradictory.

3.2.3 Tourism policy

As discussed earlier, tourism is a key priority area for the government, both in terms stimulating overall growth, but also in ensuring such growth in equitably distributed (in particular outside the two urban centres and into the outer islands). As noted in the National Investment Policy (Vanuatu 2005), key objectives for tourism include using it to conserve Vanuatu's environmental and cultural heritage, and engaging locals to the greatest extent possible. The key sector policy document is the lengthy (250 page) Tourism Development Master Plan 2004-2010 (Vanuatu 2003), with the Vanuatu Tourism Office (VTO) and National Tourism Development Office (NTDO) serving as the key government institutions (under the ambit of MTIT).

The core objectives of the strategy laid out in the Tourism Development Master Plan (Vanuatu 2003) are:

- Promote strong economic growth through sustainable tourism development
- Generate substantial foreign exchange, local income and employment
- Promote balanced regional tourism development
- Promote greater participation of local people
- Sustain local cultures/customary practices
- Promote greater community awareness of tourism benefits
- Promote national integration through tourism

These objectives above appear complementary and coherent with the multitude of TRDP references to tourism, and the cluster of goods and services that feed into the sector, including general and specific activities to develop/promote tourism exports. However, a review of more recent tourism-related policy statements and documents (DTIS 2007), along with direct discussions with stakeholders, demonstrate a more singular focus – that of increasing visitor arrivals. While increasing arrivals is essential to achieving the wide-ranging objectives set out for the tourism sector, it would appear (horizontally) incoherent to have such a singular target in mind, especially when the actual target – at 150-200'000 by 2017 – would imply at least a doubling of current figures.²³ One would have to question whether achieving such numbers (irrespective of the actual possibility) could possibly be done and remain coherent with some of the objectives outlined above, such as sustaining local cultures and customary practises.

²³ Non-resident arrivals for 2006 were put at just under 70'000 (a 10% increase over 2005 and a 35% increase over 2003).

As a result, the sector is characterised as being “confused”, lacking a clear vision and practical policy guidance (DTIS 2007). A recent study undertaken for Airports Vanuatu Ltd (AVL 2007, cited in DTIS 2007) stressed that “[t]here is no strong definition (either in a policy sense or in an investment sense) of what tourism product Vanuatu should be vigorously developing” and that filling this policy gap was paramount. This was, offered the study, to be followed by a thorough review of the overall branding and marketing strategy. Stakeholders consulted supported this call, levying criticisms on VTO for the types of tourists being marketed to, whose activities tend to exacerbate the unbalanced development of the sector and limit local linkages and employment (in that these tourists tend to seek out resorts around the capital of Port Vila and spend a large proportion of funds on imported goods, contributing to significant leakage in the sector).²⁴ This represents consequently a horizontal multiple objective incoherence within the tourism policy itself, as well as with tourism-related TRDPs.

3.2.4 Agriculture and livestock policy

Despite agriculture being the sector of primary importance both to exports (and thus a key foreign exchange generator) and to livelihoods (with the large majority of the population living in rural areas and engaged in subsistence/cash crop production), there is no explicit agricultural policy in Vanuatu. As with trade policy, this represents a significant horizontal incoherence. As such, it is difficult to undertake an assessment of whether policies in this domain coherently support Vanuatu’s TRDPs.

That said the Ministry of Agriculture, Quarantine, Forestry and Fisheries (MAQFF) does have a set of policy objectives outlined in its current Corporate Plan (cited in DTIS 2007). These include:

- Increasing the cash incomes of smallholders and building sustainable livelihoods in primary industries
- Facilitating larger and more commercially-oriented investment and carefully managing foreign involvement in Vanuatu’s resource-based primary industries
- Ensuring effective government regulation and organization/managerial infrastructure
- Strengthening international partnerships with donor agencies
- Increasing revenue collection within the Ministry
- Improving extension services

These objectives align closely with the TRDPs discussed earlier, though are fairly thin in terms of specifics. The last of these objectives above points to an especially important artefact of previous policy incoherence, with the 1997 CRP resulting in a virtual decimation of MAQFF’s capacity to provide extension services (for which some observers have attributed, at least in part, the precipitous decline of agricultural production (and exports) from 1998-2001.

²⁴ Bazeley and Mullen (2006) cite estimates of up to 80% leakage (redirection of sector revenues back offshore) for Efate-based tourism (Port Vila), though they note the figures are disputed and likely in the 50-75% area.

4. Pinpointing illustrative examples of incoherence in action

The analysis so far has uncovered various examples of horizontal and vertical incoherence between the trade-related development priorities (TRDPs) in Vanuatu's stated national development strategy and the objectives of a number of trade and trade-related policies. We shift in this section to delve deeper into policy incoherence, in particular to identify some specific illustrative examples of where incoherence between *the implementation and impact* of trade and trade-related policies and TRDPs are prevalent.

Recalling from Section 3.1, key TRDP themes include:

1. Promoting FDI;
2. Increasing the volume and value-added nature of exports and resulting producer incomes;
3. Addressing market structure concerns, particularly in agriculture and infrastructure services;
4. Revisiting the tax structure (e.g. duties) as well as re-prioritising expenditures (e.g. duty exemptions and subsidies); and
5. Assisting producers to build supply-side capacity to export by lowering the 'costs of doing business' and providing trade facilitation services (includes quarantine, standards, marketing, and credit, etc.).

Using these illustrative examples, the analysis will demonstrate how specific measure(s) or action(s) lead to outcomes that are incoherent with key TRDPs. In doing so, the nature of the incoherence will be discussed, as well as its magnitude and pervasiveness. Possible underlying causes will also be highlighted.

4.1 The structure of import duties and the duty exemption scheme

4.1.1 The structure of import duties

As touched on briefly in the overview on international trade, Vanuatu has a historical reliance on import duties, due largely to the absence of income, corporate or capital gains taxes and the consequent limited tax base. While this reliance on duties has decreased post-CRP, it has done so relative to other trade taxes, which include the introduction of a 12.5% consumption tax (VAT) in 1998, along with some specific excise taxes in 2003.²⁵ Though the average trade-weighted tariff is estimated to have declined to 15% in 2006 (Watergall 2007), increases in 2007 on highly-traded products (namely alcohol, tobacco, rice, and automobiles & parts) have likely increased this figure.

²⁵ Pre-CRP import duties represented approximately 50% of total government revenue (incl. grants), but have declined since the 1998 reforms to approximately 30%. Compensating for the reduction, VAT now accounts for nearly 35% of this figure (DTIS 2007, citing World Bank 2002 & MFEM).

Based on a seminal study by Gay (2005), the policy measure of interest is the structure of import duties across a range of goods. This is because in a small country like Vanuatu, domestic production is highly dependent on imported intermediate goods, each of which faces their own duty which adds to the price of the final good. By comparing the value-added of a sector at domestic prices versus the value-added in international prices, Gay calculates the 'effective rate of protection' (or ERP; see Box 2) for a range of key products in the economy. In doing so, he is able to ascertain the true extent (or effective rate) of protection being accorded, as compared to what is otherwise indicated by the nominal duty alone.²⁶ Such an exercise is perfectly suited for our purposes of assessing the prevalence of (horizontal) incoherence between the government's stated priority sectors and other sectors/products, both in terms of actual protection afforded by the applied import duties and the associated degree of value-added contributed to the local economy.

In his study, Gay investigates a range of key products in the economy covering select manufacturing/processing industries (chicken²⁷, fibreglass, beer, ice cream, juice and toilet rolls) and agricultural sectors (copra, cocoa, beef, and coffee).²⁸ By calculating the price of the imported inputs as a percentage of the final price (both before the nominal tariff is applied, i.e. at international prices, and after the nominal tariff is applied, i.e. at domestic prices), he arrives at an estimate of the actual value-added contributed by domestic production. In other words we can weigh its relative contribution to TRDPs such as increasing the value-added nature of exports and raising incomes from production for the domestic and export markets.

²⁶ While the study was done in 2005, the relative stability of the exchange rate, inflation and import duties over the past two years provides sufficient weight to the continued relevance of the findings. Where individual import duties have changed (e.g. chicken), the author has updated the calculations and analysis.

²⁷ While chicken is not a manufacturing industry per se, the degree of transformation involved in domestic production (and required inputs) leads Gay to classify it here for analytical purposes.

²⁸ Prices are derived from in-country interviews undertaken with the various producers and/or VCMB, MFEM, and DCIR in 2005.

Box 2 – Effective Rates of Protection (ERP)

The concept of effective rates of protection (ERP) shows how looking at the tariff on a final good may misrepresent the true rate of protection. Production usually involves the import of intermediate goods used during processing, goods which themselves carry a tariff. The phenomenon of tariff escalation occurs where the price of a final good reflects the tariff levied on the multiple goods involved in its production. The effective level of protection takes into account the extent to which tariffs are embedded into the cost of purchased inputs. Corden defines it as the proportion of variation in an industry's value-added attributable to the tariff system. Whilst ERP studies are usually used to reform the tax structure, they can also be used to show how tariff policy may appear to be working in a certain way, while the practical outcome is different.

Formally the ERP is the difference between the value added in sector X at domestic prices and the value added in sector X at international prices:

$$ERP = \frac{V_D - V_I}{V_I} \quad \text{where } V_D = \text{domestic value-added and } V_I = \text{international value-added.}$$

In an industry with a large number of expensive inputs, each of which carries a high tariff, (or an industry which destroys value) it is possible to have negative protection, which means that the tariff structure undermines economic efficiency.

The concept is particularly revealing in a small economy like Vanuatu, where the manufacturing base is small and therefore most inputs into production are purchased from abroad. The government may think it is protecting sector X but in fact it may be undermining sector X and unwittingly prioritising sector Z.

Other sources of protection could also be included, such as distance from major markets, which raises the CIF price of inputs and final goods by varying degrees. Only intermediate inputs have been used rather than working out the average capital used per unit of output, while domestic input costs are not considered. Furthermore the method used will be relatively basic; normally the data are fed into a general equilibrium model.

A number of criticisms have been raised, such as the problem that the concept of ERP ignores any substitution or reallocation effects of tariff reform. Given a reduction in a tariff on a given input, firms may allocate resources toward that particular area. Further, domestic goods may not be perfectly substitutable for foreign goods – in fact in Vanuatu complete commensurability between local and imported goods is rare. Vanuatu-made furniture, for example, may be made of unique woods and use particular techniques, marking it out as different from imported furniture.

For these reasons the concept is not one-hundred-percent accurate – it gives a rough guide as to the effectiveness of tariff policy rather than a definitive answer. Nevertheless, as pointed out by Greenaway and Milner (2003: 455), it is “more useful to be approximately right than precisely wrong.”

References: Corden, W. M. (1966) 'The Structure of a Tariff System and the Effective Protection Rate', *Journal of Political Economy*, 74, 221-37; Greenaway, D. and C. Milner (2003) 'Effective Protection, Policy Appraisal and Trade Policy Reform', *The World Economy*, 26(4): 441-456

Source: Gay (2005)

Tables 6 and 7 compare Gay's results (updated for Jan 2007 duty amendments) for value-added contribution between manufactured/processed and agricultural products before and after the duty on imported inputs is applied.

Table 6 – Manufactured/ processed value-added (before and after duty)

	Before tariff	After tariff
Chicken	-20%	11%
Fibreglass	52%	63%
Beer	78%	87%
Ice cream	40%	57%
Juice	21%	43%
Toilet roll	7%	34%
Average	30%	49%

Table 7 – Agricultural value-added (before and after duty)

	Before tariff	After tariff
Copra	80%	79%
Beef	89%	91%
Cocoa	56%	63%
Coffee	83%	86%
Average	77%	80%

On aggregate, we can see that agricultural products almost always provide greater value addition than manufactured/processed goods. More specifically, beer, beef and coffee add the highest value (beef and copra the highest exported products), while chicken, toilet roll and juice contribute the lowest value-added. The higher value-added of agricultural exports is perhaps unsurprising considering their often lower requirements for imported inputs. We return to these results later when discussing the ERP, and subsequently the allocation of duty exemptions (i.e. subsidies) across the different products.

Tables 8 and 9 reproduce/update the results on effective rates of protection.

Table 8 – ERP for manufacturing/ processed products

	Nominal rate of protection	Effective rate of protection
Chicken	35%	-171%
Fibreglass	30%	58%
Beer	70%	89%
Ice cream	40%	100%
Juice	40%	195%
Toilet roll	40%	571%
Average	43%	140%

Table 9 – ERP for agricultural products

	Nominal rate	Effective rate
Copra	0%	-2%
Beef	35%	38%
Cocoa	20%	36%
Coffee	25%	30%
Kava	0%	0%
Average	16%	20%

We can see that while on average the nominal rate of protection for the group of manufactured products is 43%, the average effective rate of protection is 140%. In other words (if we remove the two outliers), consumers are being forced to pay on average 65% extra to sustain otherwise inefficient and unprofitable manufacturing firms – which as we saw in Table 7, often add very little value to the economy. Of course averages hide important nuance, for example, the additional effective protection given to beer appears to make (coherent) economic sense in light of its value-added contribution we saw above. On the other hand, the enormous protection afforded toilet roll seems unfounded (and incoherent) with the relatively low value added it offers.

Contrast this with the agricultural sector, where the nominal protection rate for the selected products is 16% versus the marginally higher ERP of 20% (i.e. a 4% additional cost premium to consumers) and the degree of value-addition is at least 63%. Recall further from Sections 2.3 and 2.4, that agriculture historically constitutes 80% of merchandise exports and contributes at least 15% of GDP (in reality higher), whereas manufacturing contributes only 3% of GDP (with a consistent downward trend since 1996). Such analysis demonstrates clear horizontal multiple objective incoherence between the impact of the current duty structure and a variety of key TRDPs. By offering a far greater degree of relative protection to manufacturing, the government is in fact undermining the sector identified throughout the PAA as its most important – both in terms of exports and, via livelihoods, in terms of poverty reduction. Its policies are also having the perverse impact of promoting in some instances economic activities with a relatively lower value-added nature, in direct contradiction to the TRDP of increasing higher value-added nature of production and exports. Similarly, it is incoherent with the TRDP explicitly targeting duties, that of revisiting the tax structure. In doing so, and forcing consumers to pay a premium on locally produced products, they are affecting a welfare transfer from consumers to a select group of inefficient producers, diverting otherwise scarce resources away from firms and households who could potentially be investing in expanding their own supply capacity and/or export development.

In that the conclusions above are only reinforced when delving into the duty exemption scheme, we consider these additional elements first, before considering some possible explanations as to the causes of this incoherence.

4.1.2 Duty exemption scheme

As in most developing countries, Vanuatu operates a duty exemption scheme that exempts select firms from paying certain trade taxes (duties, VAT and/or excise). Widely documented (notably in Millar 2003 and Gay 2005), the aim of the scheme is to assist particular sectors/firms by providing an implicit production subsidy (in terms of forgone taxes), which in combination with the maintained duty for substitute products, shields them from competition (indeed at times, as we saw above, at a rate far greater than the nominal duty would imply).

The value of exemptions for 2004, 2005 and the first quarter of 2006 are shown in Table 10. While exemptions dropped by 50% in 2005, preliminary data from 2006 (in line with quarterly trends for 2005) project annual figures exceeding 2004, at over 2,600 million Vatu.²⁹

²⁹ Final figures for 2006 were not accessible.

Table 10 – Total exemptions (VT million)

Year	Exemption
2004	2,037
2005	1,017
2006 (Q1 only)	658

Source: DCIR various

Unfortunately the customs data available for 2005 and 2006Q1 does not break down the data based on exemptions codes, so our disaggregated view is available only for 2004 (Gay 2005 and DCIR), which paints the following picture:

Table 11 – Select exemptions, by sector (2004)

Item	Exemption	% total exemptions
Fuel for electricity generation (070)	301,063,364	15%
Manufacturing/processing (010)	104,663,012	5%
Tourism (005)	41,445,974	2%
Fisheries (009)*	6,310,561	0%
Forestry (035)	3,202,426	0%
Agriculture (031)	2,720,531	0%
Livestock (033)	1,878,662	0%
Inter-island shipping (040)	29,235,409	1%

Note: (0xx) denotes exemption code

* - data sources differ, DCIR shows 9,600,262

Table 11 shows that the bulk of commercial duty exemptions in 2004 were directed towards fuel for electricity generation (in other words as a subsidy to the monopoly electricity provider UNELCO), with a total of 2.7% going to tourism, fisheries, forestry, agriculture and livestock combined.³⁰ Total exemptions for fuels in 2004 (HS 27) totalled 383,954,092 or 19% of total exemptions for the year, which includes almost all exemptions for inter-island shipping and 18% of the exemption allocation for manufacturing/processing. This grew just slightly in 2005 to 399,069,607 or 39% of total exemptions, followed by vehicles (HS 87) at 11%. While we return to the unique UNELCO situation below, we note that providing fuel exemptions for inter-island shipping would be coherent with attempting to stimulate inter-island and international trade, including tourism.

Keeping in mind the TRDPs 'priority sectors', we find exemptions for manufacturing were over 2.5 times agriculture and just under 40 times those for tourism (Gay 2005). Indeed, manufacturing received 1.8 times the support provided to tourism, agriculture, fisheries, forestry, and livestock combined. Such a fact is staggeringly contradictory when considering that agriculture and services comprise over 90% of GDP, with tourism alone thought to have contributed 85% to the expansion of GDP in 2006. As with agriculture generally, this also carries significant poverty implications, raising important questions about the extent to which policies on import duties and duty exemptions are coherent with efforts to alleviate poverty.

On a disaggregated level (see Table 12), Gay (2005) compiles information on the exemptions provided in 2004 to the firms considered in the ERP analysis above.

³⁰ The underlying data shows us that the largest exemption (approximately 50% of the total) was for water imported under the 'tools of trade and professional equipment' exemption, which potentially derives from the filming of the reality TV show 'Survivor Vanuatu' in the summer of 2004.

Table 12 – Select exemptions, by firm (2004)

Company	Exemption
Fibreglass Vanuatu	590,212
Cellovila	730,449
Apco	2,721,822
Switi	3,998,913
Toa Farm	--
Vanuatu Brewing	7,845,573
Vanuatu Beverages Ltd.	11,080,010
Total	26,966,979

Sources: Gay (2005) citing: companies and DCIR

The above serves to reinforce earlier comments regarding sectoral and firm prioritisation. For example, Vanuatu Beverages Ltd. receives the highest exemption of those surveyed, yet provides some of the lowest value-addition (only 43% after duty) and has the second highest effective rate of protection (at 195%, i.e. consumers pay a 195% price premium). While not producing for export, one would be pressed to ascertain how such circumstances are coherent with the TRDP objectives of promoting competitive domestic markets or prioritising expenditures. On the other hand, while the TRDPs do prioritise agriculture and tourism, certain manufacturing firms are creating important benefits relatively effectively and efficiently. Take for example Vanuatu Brewing, which receives the second highest exemption of those surveyed and benefits from a relatively high effective protection (89%), but also provides the highest value-addition (87%). The latter, while outside the TRDPs sectoral priorities, would seem an example of getting the numbers right (incoherence or otherwise).

By far the largest recipient of exemptions however is UNELCO, the private sector monopoly provider of electricity,³¹ servicing primarily the two urban centres of Port Vila and Luganville. Its concessionary contract extends until 2031 in the former and 2010 in the latter. Castalia and Network Strategies (2004) cite it as among the best performing utility company in the Pacific in terms of quality of service, labour productivity and system loss. However, in that it sets tariff rates to recover full costs from the consumer (i.e. no subsidy), it also provides some of the most expensive electricity in the region.

Helping to further entrench the monopolistic position of the firm, this is a questionable 'prioritisation' of government expenditures and is horizontally incoherent with the TRDPs related to re-prioritising expenditures towards development, minimising subsidies to public utilities and encouraging private sector competition in the sector. While it could be argued to be coherent with the objective of reducing the costs of power, the monopolistic position of the firm is likely to prohibit the subsidy being fully passed through to the consumer (which would have at least helped to re-shift some of the welfare transfer back to consumers). Indeed the absence of the de facto subsidy would likely increase electricity prices, such that removing the exemption could negatively effect production and trade in the two economic hubs. This logic would not hold however in the rural areas, where most agricultural production occurs, in that UNELCO does not operate in these regions. As such, we find a complex situation whereby the bias against rural areas (and thus the majority of agricultural producers) in favour of urban manufacturing is incoherent with the TRDP of increasing the volume and value-added nature of exports, while at the same coherent with supporting mostly urban tourism.

³¹ UNELCO is also the monopoly water provider.

Taking what we've seen above with respect to the structure of import duties and the impact of the duty exemption scheme, we have a clear case of horizontal multiple objective incoherence. The value-added/ERP calculations and analysis of exemptions demonstrate sectoral priorities contrary to those highlighted in the PAA and various TRDPs. These measures also contradict the specific TRDPs of revisiting the tax structure and re-prioritising expenditures towards development and are inconsistent with the TRDP focus of increasing the volume and value-added nature of exports in agriculture and tourism. Such dynamics are only reinforced by the continued high levels of protection, which amplify calls for additional exemptions. Nor are they assisted by the highly discretionary manner in which exemptions are provided (Millar 2003), which has since been increased with a 2007 amendment giving applicants the right to appeal an exemption determination directly to the Minister (DTIS 2007). While the case could be made that the structure of duties and exemptions aim to help increase supply capacity for exports – itself an essential TRDP – the value-addition calculations, along with the fact that most manufactures produce for the domestic market, makes this unlikely.

Another negative spillover from the exemption scheme, as drawn out in the DTIS (2007), is that the administration of the scheme constitutes a significant burden on the Department of Customs, DTIT and the respective line ministries who are responsible for submitting applications for firms in their respective sectors. Senior management of the customs department reported that dealing with company and individual exemptions takes up an estimated 60 to 70 percent of their time in meetings and paperwork. In such circumstances, it would be clearly inconsistent with the broader PAA strategic objective of increasing efficiency in public administration.

This brings us to the question as to why such pervasive multiple objective incoherence exists in this policy area. In simple terms, it is political economy at play – competing interests aim to sway government policy and actions towards their favour. All the more so in Vanuatu, with its history of import substitution and 'Economic Self-Sufficiency', the entrenched power held in the hands a small – and organised – group of manufacturers is likely difficult to overturn. Furthermore, while in most recent history government has been relatively stable (in power since 2004), the 1990's were turbulent times politically and one would expect politicians to be highly apprehensive of removing the special treatment afforded to this small but strong political constituency. There is, as such, a problem of collective action, in that the consumers who lose the most from these measures are far more dispersed and less organised than the manufacturers, and thus less able to advance their interest. Lastly, the psychological attachment of having a manufacturing sector, irrespective of its actual contribution to the economy, should not be overlooked.

4.2 Stevedoring

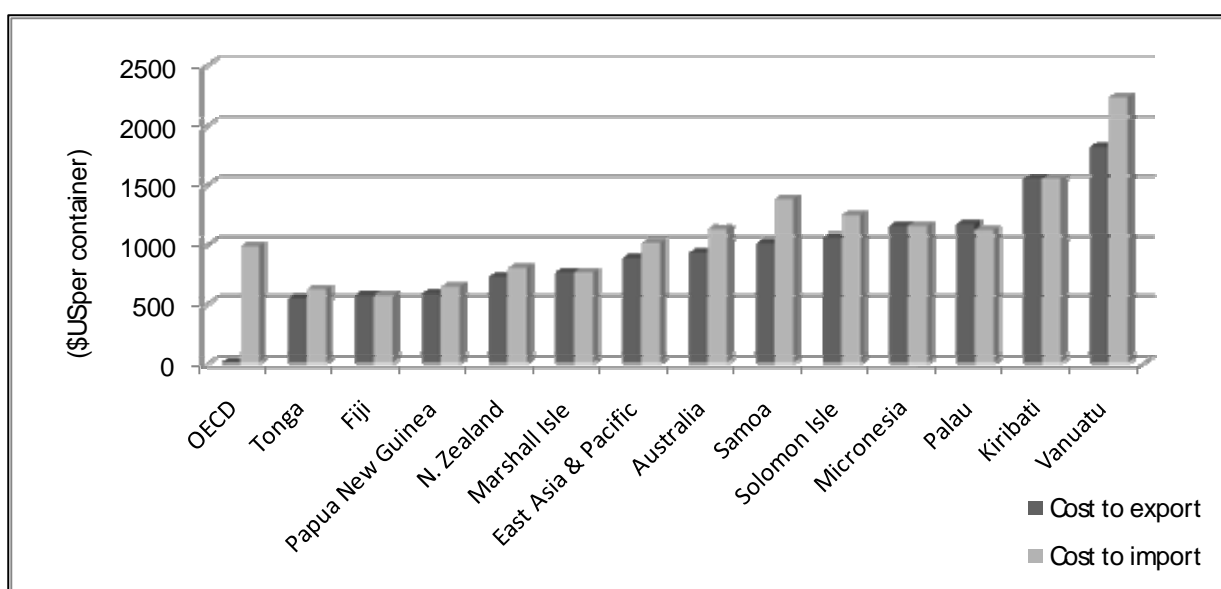
In a geographically dispersed environment like Vanuatu – and the Pacific more generally – the constraints posed by transportation are endemic and pervasive.³² So widely accepted as a key constraint to economic growth – receiving repeating mention in the PAA, the often aggregated discussion can draw focus away from specific components feeding into these broader 'transportation costs'. In this regard, the DTIS (2007) has uncovered some interesting nuance with respect to charges at the port (in particular stevedoring),³³ such that the combination of the government's involvement and contrasting policy objectives as outlined in the PAA serve as a significant horizontal multiple objective incoherence.

³² In Bazeley and Mullen's (2006) study of constraints to Vanuatu's productive sector, they identify transportation issues, along with absence of scale, as two 'obvious and immovable' binding constraints. Preferring however to focus on key inefficiencies in existing value chains, they do flag policy and organisational inefficiencies contributing to the cost of inter-island transport such that it could pose a binding constraint to future growth.

³³ Stevedoring refers to the activities surrounding the process of loading or unloading cargo ships.

As noted above, the tendency when considering transportation charges in a remote region like the Pacific is to assume the challenges afflict all countries in the region similarly. They are all relatively far from their import and export markets and face varying degrees of dispersion. However, data on the costs of importing and exporting³⁴ from the World Bank’s ‘Doing Business’ database show that such costs differ widely in the Pacific, both on aggregate and in terms of their composition. Figure 7 reveals that even relative to similarly constrained and remote countries, Vanuatu ranks highest in the region in terms of costs associated with importing/exporting.

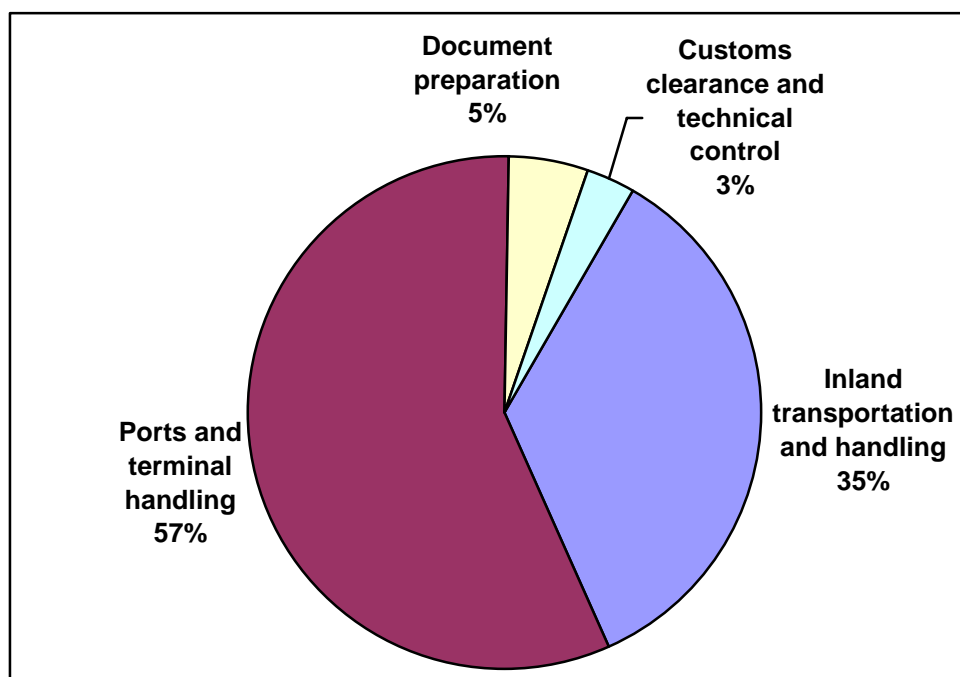
Figure 7 – Trading across borders: import/export costs in the Pacific



Source: World Bank (2007)

Decomposing these procedural costs in Figure 8, we can see that Vanuatu’s costs are largely attributable to port and terminal handling charges, and to a lesser extent inland transportation and handling.

³⁴ Figures on ‘Trading Across Borders’ include the costs and procedures involved in importing and exporting a standardized shipment of goods by sea freight (either from entry port to final destination or factory to exit port). Every official procedure involved is measured (in time and cost) – starting from the final contractual agreement between the two parties, and ending with the delivery of the goods (World Bank 2007).

Figure 8 – Trading across borders: procedural costs to import/export in Vanuatu

Source: World Bank (2007)

By contrast, port fees in 2007 for neighbouring Kiribati and the Solomon Islands (as a percentage of overall procedural costs) accounted for only 36% and 37% respectively (World Bank 2007). It would thus appear that despite facing similar constraints and conditions surrounding size and dispersion, Vanuatu fares worse than its neighbours in this area. Furthermore, comparing the 2007 figures with the previous year (the latter documented in DTIS 2007), the situation seems to be worsening, with port charges having increased by 10% relative to the other components since 2006 (up from 51%).

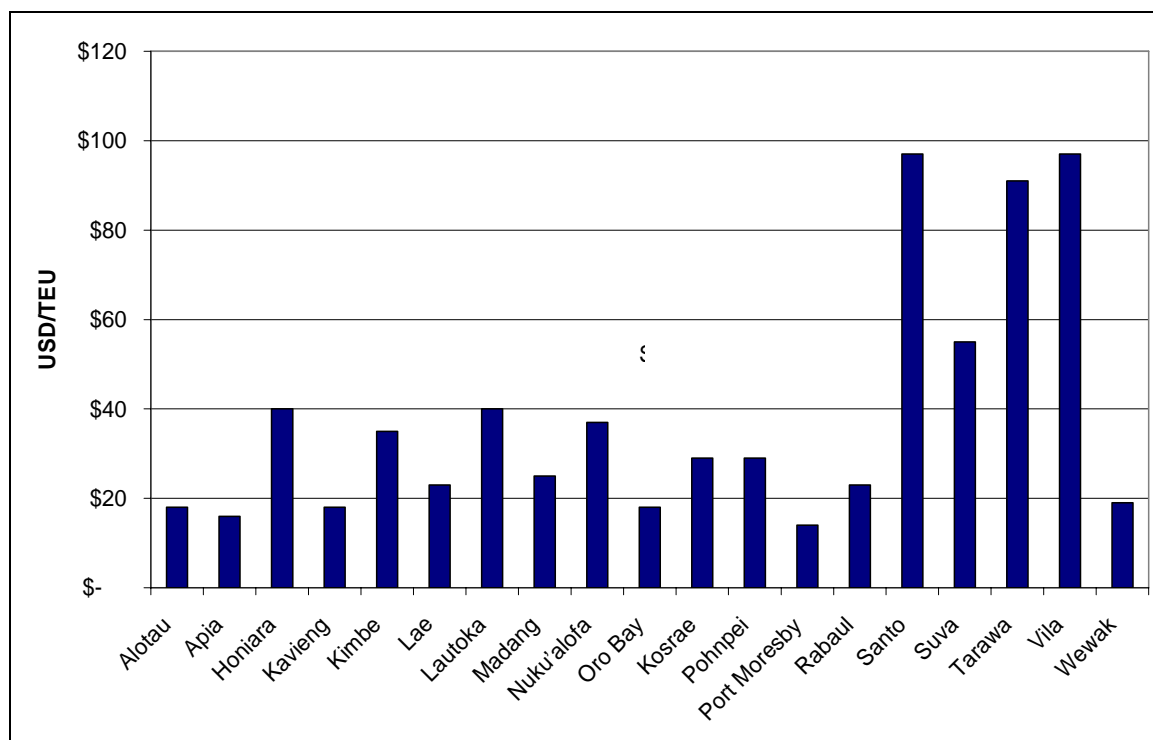
Further decomposing the underlying factors in port and terminal handling fees, it becomes clear that the fees charged in Vanuatu for stevedoring are significantly higher than elsewhere in the region.³⁵ Figure 9 reproduces a chart from a recent ABD study (2007), showing Vanuatu's two facilities at the upper end of the cost scale – between 2-2.5 times more expensive than the average.

The genesis of incoherence surrounding stevedoring charges lies in the fact that the government of Vanuatu provides concessionary contracts for stevedoring services at both the Santos and Port Vila ports.³⁶ The incoherence is particularly pronounced at the Port Vila wharf (which deals mostly with imports), where the government is a joint shareholder in the operating firm, Ifira Wharf and Stevedoring Limited (IWS) (DTIS 2007) and thus has direct influence in the provision of services. As such, our analysis below will concentrate on the Port Vila wharf and imports more generally (though with obvious knock-on effects for exports due to Vanuatu's high import-dependence, in particular in tourism).

³⁵ DTIS (2007) cites widespread dissatisfaction amongst port users for such services in both Port Vila and Luganville – the former being Vanuatu's main import facility and the latter the main export facility.

³⁶ The formal monopoly does not technically apply to container transfers however the practices and fees at the Port Vila port have effectively eliminated competition across this range of services as well (DTIS 2007).

Figure 9 – Stevedoring costs in the Pacific



Source: ADB (2007) citing data from AusAID 2004, attributed to Vanuatu MFEM (2003)

The fees set for stevedoring services in Vanuatu are dictated by the concessionary contracts with the government. As such, the government has a direct role in allowing these costs to be amongst the highest in region, both in its role as government regulator and as part shareholder. In terms of the time required for service delivery, despite stipulations in the IWS contract for a target of 15 movements per hour, current services are said to operate at approximately 7 movements per hour (DTIS 2007). Hence the lack of contractual enforcement on the part of the government also contributes to the costs and delays associated with importing, further compounding the overall costs of doing business (both for tradables and non-tradables).

The result, as outlined above, is extremely high stevedoring costs and extended delays in shipping. These delays further increase transportation charges – compounding the costs of importing and exporting – as shipping companies are forced to delay arrivals at subsequent ports, passing on the additional costs to both producers and ultimately the final consumer (DTIS 2007).

This outcome is incoherent with a number of TRDPs, in particular as related to lowering the costs of doing business, for which promoting better transport services and infrastructure is an explicit objective (under private sector development). Similarly, in terms of economic infrastructure and support services, the continued provision of a monopoly is incoherent with the objective of promoting competition to help ensure competitively priced, quality infrastructure services in this area. Indeed in the latter, improving operational efficiency at the ports and eliminating subsidies is an explicit objective (itself an obvious incoherence with the ongoing state of affairs as permitted by the government’s direct actions).

These impacts, and associated incoherence, are not solely limited to the import side of the economy either. With Vanuatu's high import-dependence, the inflated stevedoring charges undermine the competitiveness of a range of export sectors, in particular the tourism sector which tends to import a high percentage of its inputs. This consequently adds an additional layer of incoherence, in this case with respect to increasing the volume and value-added nature of exports.

With government as regulator, shareholder and user, this outcome demonstrates a clear case of multiple objective incoherence. Here the government sits in direct conflict, with actions aimed at maximising the returns it receives as a shareholder in IWS, yet at the same time claiming, by way of the PAA, that it places a high priority on reducing the costs of doing business and providing more efficient and competitive trade facilitation services. Such an obvious contrast between the impact of policies and stated TRDPs would imply a strong political economy dimensions underlying this incoherence.³⁷ The conflict of interest on the part of the government would seem to manifest in a lack of political will to undertake reforms. Similarly, with the Port Users Committee disbanded (DTIS 2007), it also represents an inability of importers (and others impacted by the resulting high costs) to take collective action by demanding better services and that the government use its position as shareholder to elicit the needed reforms. This outcome would also not appear to arise from a lack of information on the incoherence or constraint posed, as the issue factored explicitly in the PAA itself, as well as the 4th National Business Forum Matrix (though the work undertaken in the DTIS does bring some new insights to bear).

4.3 Vanuatu Commodities Marketing Board (VCMB)

The Vanuatu Commodities Marketing Board – or VCMB – was established in 1981 and tasked with stabilising prices for 'prescribed' commodities (initially copra, but later expanded to cocoa and kava), while also managing the development, marketing and export of these products. It was also to coordinate activities on quality standards. To pursue these objectives, it was granted a range of powers, which have fluctuated over time, but have included monopoly rights to purchase prescribed commodities, fix their purchase prices, and sell them abroad. Controlling the most important agricultural sectors in the economy – covering on average over 50% of exports (1999-2006), with the right to add additional products at ministerial will, it has perennially been a controversial institution in the Vanuatu political landscape.

VCMB's powers have been amended numerous times, but most importantly, in 2003 (on the verge of financial collapse), two key powers were changed. Firstly, with no support from donors or surpluses of its own to provide funding, price stabilisation activities were suspended (at inception, VCMB managed undertook this using EU STABEX funds) (Gay 2005). Secondly, its monopoly authority to purchase and export prescribed commodities was officially revoked. However, this was replaced with exclusive rights to issue licenses to new private-sector entities wanting to purchase and/or export these commodities, effectively keeping control over market structures in these sectors well within its grasp. To fund this and its other ongoing activities (including inspection, quality control and grading), it was allowed to levy marketing and inspection fees (acting effectively as export duties), which have been set at 6% for cocoa, US\$880 for copra, and upon it being re-listed as a prescribed commodity in 2006, 5% for kava (DTIS 2007).³⁸

³⁷ The DTIS (2007) notes a 2004 decision by the Ombudsman that the extension of the IWS concession was granted illegally.

³⁸ Kava was previously a prescribed commodity from 1987 to 1997.

These reforms to VCMB, whilst welcomed in most quarters, did little to remove the persistent horizontal multiple objective incoherence. Like the CRP, the PAA (written three years after the above reforms) states as an explicit objective to review the role of the VCMB as part of clarifying the role of the private sector in commodity trade. The effective maintenance of monopoly/monoposony powers (now to extend licenses to purchase/export rather than undertaking these directly) and the charging of what are equivalent to export duties is contradictory to the TRDP of wanting to encourage an environment conducive for increased commodity exports and more generally increasing the volume and value-added of exports and resulting producer incomes. Indeed, the duties charged to the trading companies are likely to ultimately be paid by producers (i.e. a welfare transfer from farmer to trader), as these costs are factoring into buying prices. This results instead in a dampening of incentives to producers and their resulting productivity (contrary to the TRDP of wanting to increase productivity in high value crops) and thus a decline in exports. Box 3 on kava, having been listed, de-listed and re-listed as a prescribed commodity is indicative of the incoherent outcomes.

Box 3 – The changing fortunes of the kava industry

Kava is a traditional crop originally used for ceremonial purposes but now consumed socially as a relaxant. A significant export market was developed in the 1990s, with kava being sold into the European Union, Fiji and New Caledonia. The VCMB was granted control over kava marketing in the late 1980s through to 1997, with kava being declared a “prescribed commodity”. Throughout this period, a maximum of 105 t of kava was exported annually from Vanuatu. From 1998 to 2005, the marketing of kava was deregulated, resulting in an average of 775 t being exported annually, and peaking at over 1200 t in 2002. In 2006, kava was again listed as a prescribed commodity, with marketing responsibilities returned to the VCMB.

Source: Bazeley & Mullen (2006)

While the charges levied are not export duties on paper, in practise they act as such because the services provided in return are deemed to be of little or no value. In particular the VCMB’s role in monitoring standards and grading the prescribed commodities have been questioned by a range of industry participants and observers who note the inefficient, expensive and anti-competitive service it provides (Landell Mills 2005). In fact, many of these activities are done now by VCMB strictly for internal purposes, with the required quality assurance document for export being provided by the Vanuatu Quarantine and Inspection Service (VQIS), within the Ministry of Agriculture, Quarantine, Forestry and Fisheries (MAQFF) (DTIS 2007). This is all the more incoherent with the stated TRDPs surrounding agriculture and export when considering that the margins charged by VCMB were exorbitantly high, representing a significant proportion of the marking margins for all three prescribed commodities (Welegtabit and Longmore 2006).

The lack of coordination between the VCMB, which falls under DTII, and the MAQFF is indicative of horizontal operational incoherence. Despite VCMB policies impacting the most important agricultural sectors, MQAFF has no formal role in determining VCMB policies and operations (Landell Mills 2005). This absence of coordination is contradictory to the prioritisation of agriculture as one of the engines for prosperity in Vanuatu.

The lack of policy consistency with the VCMB, for example allowing and then banning the purchase of prescribed commodities internally has had some particularly unexpected and incoherent consequences. In 2005, the VCMB changed its policy to monopolise the internal purchase of commodities, leaving a number of Chinese traders unsure about the legality of purchasing commodities internally (Welegtabit and Longmore 2006). Of the view that they could no longer purchase these products from outer island producers, who would then have traditionally purchased a range of consumer goods with their earnings in return, a number of traders suspended their services. As a result of the VCMB's policy inconsistency, inter-island shipping services decreased significantly, increasing the challenges of remote producers to get their products to market (and earn associated incomes), as well as reducing the availability of commodities (mostly copra) for direct export and/or processing (DTIS 2007). The impact of VCMB policies in this regard clearly serves as another example of horizontal multiple objective incoherence with the TRDPs of increasing export volumes and lowering the costs of doing business, in particular with respect to affordable transport services.

During in-country consultations, the view was often put forward that the VCMB is widely accepted amongst local stakeholders to be outdated and inefficient, providing negative value-added to the economy and the agricultural sector at large. Gay (2005) goes as far as saying:

The VCMB currently performs only a marginally useful role, one which could better be achieved by existing government departments. The levy on exports is effectively a tax that disincentivises a sector the government should be doing everything in its power to promote. In sum, the VCMB should be abolished.

Indeed, it was reported during consultations that one donor agency in Vanuatu has notified the Office of the Prime Minister that if he were willing to commit the political will to meaningfully reform the VCMB – no matter what that involved, as long as it addressed the widely-held deficiencies – they would fund it. Such commitment raises the important question of why... why has the VCMB operated for so long in a manner wholly incoherent with a range of objectives in Vanuatu's most important sector (in terms of exports and, via livelihoods, overall welfare)?

While no one seems able to pinpoint any specific historical reason, like in previous instances, the challenges of 'interest capture' and collective action result in those benefiting from the incoherence being well-organised and politically influential, while those paying the price are dispersed without effective recourse to make their view heard (and implemented). Fortunately, with the push catalyzed by the donor offer to fund a reform programme, alongside the prioritisation of such reforms in the (draft) IF Action Matrix, it would appear as though there is renewed technical and political will to rectify this incoherence in the near-term.

Perhaps helping to expedite this in the minds of government officials, and touching quickly on an element of vertical multiple objective incoherence, the question is raised as to whether Vanuatu's forays into international trade negotiations will have a potential effect on their ability to maintain the VCMB as is. While the WTO Working Party Report for Vanuatu's accession (WTO 2001) raises no significant concerns over the body (though reforms since 2001 may raise some new questions), the matter is more likely to arise in the context of bilateral discussions. Indeed the interim EPA signed with Papua New Guinea and Fiji explicitly prohibits "any duties, taxes or other fees and charges imposed on or in connection with the exportation of goods to the other Party, or any internal taxes, fees and charges on goods exported to the other Party that are in excess of those imposed on like products destined for internal sale..." (EPA 2007). Thus while the exact language above potentially retains a window to maintain some elements of the VCMBs charges (as long as they are imposed on like products destined for internal sale), were Vanuatu to join the EPA at a later date, the EC would likely press them on this matter. Furthermore, potential future negotiations with Australia and New Zealand could also see disciplines in this domain.

5. Untying the ropes of incoherence – achieving the most with the least

The analysis so far has revealed elements of horizontal and vertical incoherence between Vanuatu's TRDPs and a range of trade and trade-related policy objectives. It has similarly delved into a number of illustrative examples where incoherence between the implementation and impact of these policies and TRDPs are prevalent. The following section now considers potential interventions aimed at minimising this incoherence, with a view to prioritising high-impact areas where the government has a relatively larger ability to elicit change. There is, as such, a bias towards prioritising horizontal incoherence, in particular of an operational nature (which is easier to 'fix' than navigating the different public and private interests associated with multiple objective incoherence). In undertaking the above, the analysis will account for costs and benefits that could arise as a result.

5.1 Priority 1 – Strengthening the institutional capacity for informed trade policy and negotiation decision-making

If Vanuatu is to identify and formulate coherent trade policy within a framework that adequately reflects its national interests and feeds, as appropriate, into its international trade negotiations, then it must clearly address as an urgent priority the significant horizontal operational incoherence surrounding the manner in which such policies are determined. Furthermore, to ensure trade policies (and negotiations) can appropriately shape – and be shaped by – trade-related policy concerns, it must promote enhanced mainstreaming of trade issues into these related policy discussions, as well as into the national development strategy more generally. Doing so would not only address the direct horizontal operational incoherence in trade and trade-related policy-making, but also lay the foundation for confronting the gamut of multiple objective incoherences (horizontal and vertical) touched on above. Such dynamic spillover effects from undertaking this strengthening of the institutional capacity for informed trade policy and negotiation decision-making clearly make this a top priority. Indeed when stakeholders were asked to list what they viewed as the most important incoherence surrounding trade policy in Vanuatu, the response was most often put in terms of operational incoherence in the policy formulation and implementation process.

Such an intervention needs to start with the Department of Trade, Industry and Investment (DTII), which has long been aware of the absence of a “proper planning and decision-making framework” for its work (DTII 2005). From there, it can branch out to the myriad of relevant government ministries, departments, and parastatal agencies that should to be involved in the formulation of trade policy proper (and whose own policies must be equally informed, and coherent, to the extent possible, with those in trade). This particularly holds for the Department of Economic and Social Planning (DESP), which resides in the Ministry of Finance and Economic Management (MFEM). Such efforts must also cast the net as wide as possible, taking into account the needs and priorities of the private sector, civil society and other relevant stakeholders, including donors (so as to match resources accordingly). Bazeley and Mullen (2006), in underscoring the lack of sufficiently inclusive, consultative or evidence-based policy-making, cite this as a key ‘policy inefficiency’ in Vanuatu.

These comments are unlikely to come as a surprise to someone familiar with trade policy-making in Vanuatu and align with core recommendation contained in the draft DTIS (whose National Validation Workshop is to take place in early 2008). As highlighted throughout the extensive (draft) study, “mainstreaming trade and improving the economic contribution of trade require institutional change” DTIS (2007). Based on the significant government efforts being put into the DTIS, and the IF more broadly, this fact appears to be recognised at the highest levels of government, with the IF process being viewed as a timely window of opportunity to catalyze needed reforms.

The primary vehicle for undertaking this intervention, as being recommended in the draft DTIS, is a well-funded and re-invigorated National Trade Facilitation Committee (NTFC) to be charged with the formulation of a trade policy framework for Vanuatu. The NTFC could operate under a new Department of External Trade within the Ministry of Foreign Affairs (MOFA). This would effectively involve moving the trade negotiating team out of DTII and allowing a more effective division of labour with the Ministry of Trade, Industry and Tourism (MTIT), who could refocus its energies on key areas related to export development, promotion and improving the supply capacity of producers. While splitting such responsibilities could arguably increase the potential for incoherence across the Ministries, done within the context of an effective and inclusive NTFC, led by the better-funded MOFA, such risks could be mitigated.

In pursuing this, the original NTFC (established in mid-2005) could expand its representation (including greater participation from the private sector and civil society; see Table 13). Based on the outcomes of the approved DTIS, it could then spearhead the prioritisation of activities to be undertaken. It could additionally convene and/or re-establish other trade-related consultative bodies, such as the CODEX committee, the VIPA board on investment, and the Port and Airport Users Committees (DTIS 2007), further helping to reduce operational incoherence. Importantly, it could also help provide a feedback mechanism for more specific and focussed TRDPs being incorporated into future revisions of the PAA and related national development strategy documents.

Table 13 – Proposed National Trade Facilitation Committee

Mandate	Membership	Tasks
<ul style="list-style-type: none"> ▪ To establish the enabling environment for dialogue with stakeholders on trade issues ▪ Consultations on trade issues at regular intervals ▪ Research and Analysis ▪ Workshops and Seminars 	<ul style="list-style-type: none"> ▪ Minister for Trade (Chairman) ▪ Government Departments (Heads of Department Level) ▪ Chamber of Commerce ▪ Women’s Affairs Department ▪ Civil Society ▪ Academia 	<ul style="list-style-type: none"> ▪ Provide input into the way bilateral, regional & multilateral trade agreements are enacted. ▪ Melanesian Spearhead Group ▪ WTO ▪ EPA ▪ MDGs ▪ ITC ▪ WIPO ▪ PICTA ▪ PACER

Source: DTIS (2007)

In this manner, a revamped DTII could help take the lead, via the NTFC, to alleviate first and foremost the general incoherence resulting from the absence of a trade policy. It could similarly assist in catalyzing the same in agriculture (contributing, at the very least, to setting the trade context for such discussions). By doing so, it would also place the negotiating elements of DTII and the industry/commerce elements (virtually non-existent to date, but spearheaded anew by MTIT) at the forefront of helping to guide trade policy-making in the country. Such a mechanism could then help to develop and/or refine specific policies and measures in a range of trade and trade-related areas, such as those identified above in agriculture, tourism, labour mobility, trade defence and investment.

Undertaken in an inclusive and transparent manner, DTII and the NTFC could also promote the needed stakeholder buy-in to attempt to tackle longstanding reforms and decrease the extent of multiple objective incoherence in key policy areas (such as those highlighted above). From a more informed policy-making position, Vanuatu could also be empowered to better negotiate trade agreements that promote their offensive interests and protect their defensive ones. Such institutional strengthening could thus lay the foundation for addressing vertical incoherence as well (e.g. prioritising where and with whom to push for additional market access (services/labour mobility) and where to pursue trade-related capacity building and adjustment assistance (including Aid for Trade)).

The benefit of expediting this process, while at the same time ensuring it is executed effectively is clear. Vanuatu has a pervasive coordination failure when it comes to trade policy-making and without addressing this, its capacity to address specific challenges (and incoherences) will perennially be undermined. However such a fundamental re-deployment of the institutional infrastructure surrounding trade policy does not come without its costs.

In political terms, it is important to recall the days of the largely ineffective CRP reforms post 1997, which resulted in a great deal of socio-economic and political upheaval. As a result, there is a strong mistrust of externally imposed reforms throughout the public service (who will be largely responsible for implementing such actions), and the country more generally. Fortunately the imperative of national ownership in the design and implementation of these reforms is stressed throughout the (draft) DTIS and reports to-date would indicate that the IF process has very much been driven by the Vanuatu government (including in the selection of its lead author and many of the chapter consultants, themselves ni-Vanuatu or external advisors who have lived for numerous years in Vanuatu). Provided this remains in the process of approving the IF action matrix and setting out its implementation, and that these achievements can be transmitted effectively to the public, there is certainly the opportunity to minimise possible political costs.

Assessing the fiscal costs involved with such an institutional re-fit is beyond the scope of the current paper, and would need to be determined in the context of discussions with the relevant stakeholders themselves. In terms of funding, such a move would likely require more than the IF alone could offer, highlighting the importance of engaging bilateral donors and related processes (e.g. AFT) (we return to this point in Section 6 below). What does seem clear however is that the expected benefits in the medium to long-term would render the efforts more than worthwhile.

5.2 Priority 2 – Rationalising import duties and reforming the duty exemption scheme

If one were to prioritise however high-impact interventions targeted at reducing a specific incoherence, an exemplary candidate would be the package of revising the structure of import duties and the duty exemption scheme. As demonstrated above, the impacts of existing policies in these two areas are strikingly incoherent with the TRDPs of increasing the volume and value-added nature of exports in agriculture and tourism, as well as that of revisiting the tax structure and re-prioritising expenditures towards development. Similarly, the DTIS chapter on trade facilitation lists such reforms as the top priority for customs reform and the fourth highest priority for trade facilitation and promotion more generally (DTIS 2007).

To elicit the greatest impact on incoherence, interventions in these areas should be taken in tandem (hence their treatment as such above). For example, with government revenues decreasingly dependent on import duties, one avenue for addressing the demand for many of the inefficient and misguided exemptions is via the rationalisation of import duties. In other words, lowering duties for select products will dampen the demand for exemptions. Spillover benefits could also be captured by eliminating those duties on products where the entire amount is returned to the importer(s) via the scheme (eliminating an administratively costly but revenue neutral procedure) (DTIS 2007).

Considering the discussion around effective rates of protection (ERP) and the unintended discrimination against those sectors prioritised across the TRDPs (which often provide higher domestic value-added), specific duty amendments could be undertaken as part of a broader re-evaluation of all import duty rates (i.e. the re-evaluation envisaged by the PAA in 2003). Indeed the ERP analysis paves the way for a better understanding of the gap between nominal and effective rates of protection and can be used to help inform Vanuatu decision-makers about the level of nominal tariffs that should be set to elicit a desired effective rate of protection. Gay's work should serve as the template for this, which should be updated and expanded (based on further firm-level surveys) to cover additional products and producers.

Other possible reforms include drastically reducing the exemption scheme to only essentials, though this is likely to prove costly in the short-term vis-a-vis both political support as well as a re-adjustment in the affected sectors (Millar 2003 offers some initial suggestions in this regard). Again Gay's study provides the foundation for navigating such decisions, on which updated and expanded work could assist (i.e. prioritising exemptions to those firms/sectors providing higher domestic value-added and local employment). Removing those exemptions that sit in blatant contradiction to the government's stated priorities (and provide little domestic value-added) would be obvious initial targets (e.g. juice and toilet roll).

Other reforms to the duty scheme could include annual exemption limits (per sector and/or importer) as well as amending the criteria for approval to ensure a more coherent match between exemptions granted and stated priorities (i.e. targeting exemptions towards agriculture and tourism) (DTIS 2007). Improving enforcement capacity to reduce fraudulent exemption claims could also prove helpful. A corollary reform would be to rescind the recent amendment giving the Minister of Trade an effective veto on the decision by Customs and instituting mandatory publishing of the rationale for decisions undertaken. In terms of a more appropriate (and time-effective) mechanism for considering exemption requests, the mandate could be shifted to the revamped National Trade Facilitation Committee (NTFC) suggested in Section 5.1 above. The latter would likely result in significant efficiency improvements, not only at Customs, who could be freed from managing the system to focus on its core activities, but also in the relevant line Ministries, whose role could be tailored to function with the NTFC context.

Any effective treatment of the exemption scheme however must address the single largest beneficiary (i.e. the recipient of the largest welfare transfer from consumers to producers) – the electricity operations of UNELCO. The continued fuel cost subsidisation of their activities is incoherent with the TRDPs of re-prioritising expenditures, such as minimising subsidies for public utilities, as well as encouraging competitive private sector participation in the sector. Here the government will need to work collaboratively with the firm to find innovative avenues to reduce fuel costs (and thus the demand for the exemption). Biofuel has been one option highlighted in such discussions.

Whichever of the technical options it seeks above however, the government will need to commit the political will to confront the strong interests that have to-date prevented it from more effectively rationalising the exemption scheme and duty structures (the aim of the latter not being to reduce duties for their own sake, but rather to do so in an informed manner such that net welfare benefits are maximised, especially in light of imperfect market structures). While doing so is politically sensitive (due to a persistent public view that the government is still highly dependent on such duties), it is conceivable that public support could be rallied with a concerted awareness campaign around the distortions introduced by the current system (possibly tying into efforts as garnering support for broader trade reforms).³⁹ Similarly, the requisite buy-in from affected producers and others in the government can ideally be generated by an inclusive policy-making process centred on the NTFC.

Aside from potential political costs, it is difficult to assess the fiscal requirements to implement the interventions above, however similar support to the revenue section in Customs has been estimated in the draft DTIS recommendations at €600,000 over three years.

³⁹ Trade and related issues receive regular attention in the main newspapers and could be used as part of an educational campaign around such reforms.

6. Establishing coherent trade negotiating strategies

With the main priorities for reducing incoherence having little to do with trade negotiations per se, it is clear that a great deal of groundwork is required for Vanuatu to *first* establish a robust and integrated trade policy framework, upon which it can determine its trade negotiating priorities and guide a coherent negotiating strategy. In doing so, a re-vamped National Trade Facilitation Committee (NTFC) would be essential for bringing together all relevant stakeholders – including key domestic interest groups (public and private) – educating them on the possible implications of trade agreements and helping to ensure the strategy is consistent with the TRDPs outlined in the PAA and related documents. In addition to the NTFC feeding important information into setting negotiating objectives, it could also assist the government to assess the evolution of the negotiations and evaluate the costs and benefits of the final offer on the table once the negotiations were completed. A transparent and inclusive process as such, which took the effort to keep the public informed, would be far more likely arrive at both more coherent policy and trade negotiating strategies.

Consequently, improving the orientation of trade policy, as well as the mechanics of the decision-making process, should be the first priority for Vanuatu, with trade negotiations largely moving to a second order priority. This view notwithstanding, when considering what objectives need to be established in developing a coherent trade negotiating strategy, the most important is to determine what it is that Vanuatu seeks from its trade negotiations.

6.1 Defining an offensive agenda and the *quid pro quo*

An essential component of ensuring a trade negotiating strategy is coherent with a country's development priorities is to first know what it is one seeks to achieve. As such, it is imperative to be able to define and articulate an offensive agenda and determine where and how it can best be pursued. Conversely, the government must know what it is it seeks to protect in the negotiations (and why) – the defensive agenda. It must also be recalled that despite the 'development' rhetoric so often found today in the discourse on trade negotiations, the fact remains that little of value comes for free and thus the *quid pro quo* or trade-off must be properly defined. Lastly, this requires an understanding of where your negotiating partner's offensive interests lie, and if possible, where there is room for manoeuvre. For all these elements, precision and specificity is imperative.

While it is beyond the scope of this paper (or any external TA) to specify answers to the above in precise terms, one can speculate on some relevant considerations.

The starting point is what can be achieved from the negotiations. For an LDC such as Vanuatu, the answer is not straightforward. Traditionally, trade negotiations have focussed on market access issues for goods and services (commitments and related rules) and 'behind the border' measures covering, for example, subsidies, investment-related measures, intellectual property regimes, safeguards, etc. However, it is often the case – at least in the multilateral context – that LDCs are exempt from many of the latter rules concerning domestic regimes, and in terms of merchandise export market access, tend to receive better terms in preferential agreements and/or bilateral FTA/RTAs (though less so in services, if included at all). On the import side, LDCs generally share the obligation to constrain the upper limits of (most of) their import duties ('bound rates') and make at least some commitments on trade services, though they seem likely to be exempt from further reducing duties or making significant additional services commitment in the current Doha negotiations at the WTO. In the bilateral RTA/FTA context with a developed partner however, GATT Article XXIV dictates that they are responsible to 'eliminate duties on substantially all trade' vis-a-vis goods trade and GATS Article V provides that any agreement must have

‘substantial sectoral coverage’ and provide for eliminating ‘substantially all discrimination’. Other considerations include providing the basis for predictable relations between trading partners in the form of the rules-based system itself, as well as providing impetus to support domestic reforms that might otherwise be difficult due to domestic political economy dynamics.

For Vanuatu then, at least while LDC status is maintained,⁴⁰ market access for trade in goods appears not to be a major priority. However, as touched on in Section 3.2.1, while Vanuatu does not require additional goods market access per se, there are some highly relevant market access-related rules that would constitute key offensive concerns, in particular related to rules of origin and health & food safety standards that can govern effective market entry to overseas markets (irrespective of the duty faced). Similarly, on trade in services, and in particular labour mobility, there is an argument to be made that Vanuatu is very much in need of additional market access.

Providing the impetus to support domestic reforms is also a potentially significant factor for Vanuatu in terms of what it may want to achieve, in particular in light of the frequent references in the analysis above to domestic political interests blocking progress on well-known and recognised policy deficiencies. Perhaps with its history of political instability, a key objective could also be locking in important reforms to help immunize them from future tampering. By and large however, it would seem that the current environment in Vanuatu is focussed on reforms for its own right, although in absence of internationally binding commitments, there is nothing to stop this from changing.

Considerations such as these are essential for helping to guide not only what Vanuatu attempts to achieve from its trade negotiations, but where it does so (on which we return below). On the other side of the coin, Vanuatu needs to have a sense of what it may want to protect in the context of trade negotiations. The most common considerations are lost government revenue resulting from lower import duties, as well as more generally constrained policy space to pursue future public policy objectives. While our analysis did show that import duties were decreasing in relative significance to government revenue, they still constitute a key revenue generator in a limited tax base, income-tax-free environment. Giving up the ability to generate this revenue from import duties over time is thus an even more important consideration given the absence of alternative revenue sources (unless it decides to forgo its tax-free status), with potentially significant implications on the ability of the government to undertake social poverty-related expenditures.

While the potential trade-offs Vanuatu may be willing to make can only be defined domestically, it must be reiterated that these should be determined in the context of inclusive multi-stakeholder deliberations, with a clear sense of what could be achieved in return. Again, precision and specificity are imperative.

6.2 National interests in bilateral, regional and multilateral negotiations

Prioritising and advancing national interests in bilateral, regional and multilateral negotiations should be established via an inclusive and iterative process with key Vanuatu stakeholders. There would appear however to be sufficient insight from the preceding analysis to support further speculation.

In terms of the WTO, Vanuatu may consider, as suggested in the draft DTIS, attempting to build consensus on renewing its accession talks, with the aim of ensuring a package of commitments that are in the country’s best interest. The reality is that Vanuatu has already adopted most of the legislative requirements for WTO entry (constituting a significant proportion of the costs associated with joining). By maintaining its status as a non-member, they obstruct the capturing of any potential benefits, which includes a role in shaping negotiations on key global trade issues and

⁴⁰ As noted earlier, *ceteris paribus*, Vanuatu is likely to graduate from LDC status in 2013.

accessing a host of technical assistance and support. It is important to note in this regard that the commitments for tariff bindings in goods would not imply significant reductions in applied rates (DTII 2005), hence minimising a key perceived costs of advancing the process. Similarly, on services, while this is the main area where concerns derailed accession in 2001, there is potential to make use of specific commitments to help address domestic interests and advance important reforms. Lastly, the advancing Aid for Trade (AFT) initiative – which as a non-member Vanuatu sits largely outside – may open additional avenues for Vanuatu to better address supply-side constraints, which pose the greatest obstacle to meaningfully increasing production and trade.

On the EPA, while an interim agreement on trade in goods was signed in late 2007 between the EU and Papua New Guinea and Fiji, it would appear to hold little benefit for Vanuatu at this time. That Vanuatu has so far indicated it will not sign the goods component because it does not align with its current needs is demonstrative that some of the considerations highlighted above are already filtering into decision-making processes. With talks on trade in services scheduled to take place in 2008, Vanuatu would do well to remain engaged and attempt to achieve certain objectives, in particular with regards to labour mobility and mode 4. In terms of adjustment and implementation assistance, while the Pacific (alongside the rest of the ACP) had pushed for additional financial support, the interim EPA does not include any concrete provisions in this area. Whether that will change in the move towards comprehensive EPAs is as-yet unknown. Vanuatu should monitor these developments accordingly and incorporate them into their final calculus of whether signing on is in their best interest.

On the proposed expansion of PACER with Australia and New Zealand (often termed PACER-plus), we recall that imports from the two trading partners account for over 60% of Vanuatu's annual import duty revenue, and thus eliminating duties on 'substantially all trade' implies potentially high costs in terms of forgone duty revenue, as well as competitive pressures to import-competing firms. Benefits from PACER would be highly dependent on market access-related measures (such as rules of origin and SPS/TBT provisions) and the inclusion of temporary labour mobility. A comprehensive adjustment package that can assist Vanuatu confront challenges to trade facilitation is another potential benefit, for which the Regional Trade Facilitation Programme (RTFP) was originally established.⁴¹ As such, Vanuatu should monitor any emerging progress on these negotiations closely, with a view to attempting to help shape the discussions and arrive at an agreement that meets its key objectives.

Regional integration, in the form of PICTA and the MSG-FTA are likely arenas within which Vanuatu would want to prioritise its efforts, as these have the potential to serve as incubators for further liberalisation in the medium-term (DTIS 2007). Being agreements that are exempt from the WTO requirement to eliminate duties on substantially all trade, the pace of liberalisation on trade in goods can also be slower and better sequenced to the developmental needs of the country. While neither currently includes services, there are discussions underway, with a view to negotiations, which could also serve as a learning ground on making binding commitments in services. A slower pace could allow time, for example, for market structure reforms to take effect, such as the plans to eventually expand the forthcoming Utility Regulatory Authority (URA) into a full-fledged competition authority. This offers a potential avenue to address key anti-competitive practices across the economy (e.g. retail sector) which impedes consumer gains from liberalisation by capturing the saved import duty in the form of greater profits. Gaining experience in these important areas could also have the knock-on effect of dampening resistance to further commitments, such as the WTO, the latter of which is more likely to lead to efficiency-enhancing trade creation effects.

⁴¹ Commenced in 2005, the RTFP is designed to help Pacific Island Countries integrate into the global economy and benefit from increased trade. A key critique however has been that it lacks sufficient funds to be effective.

Lastly, in terms of bilateral negotiations, a high priority has been suggested (Gay 2005, DTIS 2007) on increasing trade with the French Overseas Territory (OCT) New Caledonia, Vanuatu's closest geographical and cultural neighbour. Being a large agricultural importer with highly protective import duties, there is significant potential for Vanuatu to benefit from either entering into an FTA with New Caledonia directly, or working to include them in either the MSG or PICTA agreements (DTIS 2007).

6.3 Complementary actions

In terms of complimentary actions to be undertaken to support and help finance the interventions listed above (and beyond), the IF serves as an obvious catalyst (though it is no panacea). The process, if it continues to advance as it has to-date, provides an imminent window of opportunity to re-organise how Vanuatu deliberates and decides on trade and trade-related policy issues and start to address a wide range of operational and multiple objective incoherences. However, on its own, the IF resources brought to bear are insufficient. As such, it must also ideally rally other (bilateral) donors, helping to ensure coherence on their part in terms of priorities and objectives in future activities in the country.

As touched on earlier, there is also a dimension to ongoing trade negotiations that factor into considerations on mobilising adequate financial resources to address the most pressing obstacle to production and trade – namely building supply-side capacity. In particular, adjustment funds that may emanate from bilateral and/or regional negotiations could also help support needed interventions, including for example assistance in establishing a competition authority (as requested by the Pacific under EPAs) and the augmentation of the regionally-based RTFP. Equally as relevant is the Aid for Trade initiative, as alluded to earlier, which could help funnel additional assistance to areas such as institutional capacity building and targeted trade facilitation-related projects.

These points above again highlight the complex dynamic surrounding trade negotiations, which must be given fair consideration to comprehensively assess as many of the potential costs and benefits as possible. In doing so, as with the gamut of recommendations above, Vanuatu will need to ensure effective use of a revamped NTFC to properly deliberate on these complex issues and ensure a balance between taking the time to advance needed domestic reforms, while ensuring a healthy incremental approach to future liberalisation. It will be essential to account for the optimal sequencing of these objectives, bearing in mind that as a small market, with a small industrial base, there is potentially much to gain from liberalisation, including on the import side. Indeed while there need to be significant improvements in export performance, the majority of gains from liberalisation are likely to be generated on the import side, though this is dependent on more competitive market structures to transmit the gains throughout the economy. In other words, Vanuatu must determine the pace and place where liberalisation is beneficial for its own sake, rather than advancing on the perception of being 'forced' by some external agenda.

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Annex I – VIPA Act 1998 Reserve List

Annex I – VIPA Act (1998) Reserve List	
1.	Tourism
(a)	Local tour agent if the annual turnover is less than VT 20million
(b)	Local tour operator if the investment is less than VT 50 million
(c)	Commercial cultural feasts (Melanesian, Polynesian etc.)
(d)	Guest houses if the number of beds is less than 50 or less than 10 rooms or annual turnover is less than VT 20 million
(e)	Bungalows if the annual turnover is less than VT 30 million
(f)	Hotels and motels if the total value of the investment is less than VT 10 million or the annual turnover is less than VT 20 million
2.	Trade
(a)	Export of sandalwood in stick and chips form
(b)	Local trading of sandalwood
(c)	Export of seeds and other minor forest products
(d)	Second hand clothing shops
(e)	Export of kava in root, chips and stick form
3.	Manufacturing
(a)	Manufacture of handicraft and artefacts
4.	Services
(a)	Kava bars
(b)	Open air vendors
(c)	Mobile shops
(d)	Door to door sales
(e)	Road transport operators - public taxi and bus services
(f)	Private security services including security guards
(g)	Category F of Business Licensing Act No. 19 of 1998 of less than VT 5 million turnover per year
(h)	Retail shops including general merchandise trading shops where the annual turnover is less than VT 30 million, excluding specialty shops
(i)	Coastal shipping of less than 80 tonnes, excluding vessels used for tourism purposes
(j)	Electricians and electro-technicians meeting prescribed standards
(k)	Residential building and construction meeting prescribed standards
5.	Fishing
(a)	Fishing within archipelagic waters within the meaning of the Maritime Zones Act [CAP 138] and the first 6 nautical miles of the territorial sea within the meaning of that Act

Appendix I – Abbreviations and acronyms

ACP	African, Caribbean and Pacific Group of States
ADB	Asian Development Bank
AFT	Aid for Trade
ANZ	Australia and New Zealand
AVL	Airports Vanuatu Ltd.
BOP	Balance of Payments
CRP	Comprehensive Reform Programme
DCIR	Department of Customs and Inland Revenue
DESP	Department for Economic and Sectoral Planning
DTII	Department of Trade, Industry and Investment
DTIS	Diagnostic Trade Integration Study
EPA	Economic Partnership Agreement
ERP	Effective rate of protection
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade (WTO)
HDI	Human Development Index
HIES	Household Income Expenditure Survey
HS	Harmonised System
IF	Integrated Framework
IWS	Ifira Wharf and Stevedoring Limited
LDC	Least Developed Country
MAQFF	Ministry of Agriculture, Quarantine, Forestry and Fisheries
MFEM	Ministry of Finance and Economic Management
MFN	Most Favoured Nation
MOFA	Ministry of Foreign Affairs
MSG	Melanesian Spearhead Group
MTIT	Ministry of Trade, Industry and Tourism
MTSF	Medium Term Strategic Framework
NSO	National Statistics Office
NTDO	National Tourism Development Office
NTFC	National Trade Facilitation Committee
OCT	Overseas Countries and Territories (EU)
PAA	Priorities and Action Agenda
PACER	Pacific Agreement on Closer Economic Relations
PICTA	Pacific Islands Country Trade Agreement
PPP	Purchasing Power Parity
RBV	Reserve Bank of Vanuatu
RTA	Regional Trade Agreement
SPS	Sanitary and Phytosanitary measures
TBT	Technical Barriers to Trade
TRDP	Trade-related Development Priority
UNDP	United Nations Development Programme
URA	Utilities Regulatory Authority
VAT	Value Added Tax
VCMB	Vanuatu Commodities Marketing Board
VIPA	Vanuatu Investment Promotion Authority
VQIS	Vanuatu Quarantine and Inspection Service
VT	Vatu (Vanuatu currency)
VTO	Vanuatu Tourism Office
WTO	World Trade Organisation

Appendix II – List of people consulted

Name	Title	Organisation
Adela Issachar		Research and Training Division, National Tourism Development Office
Alick Berry	Project Manager	Chamber of Commerce & Industry Vanuatu
Christopher Bleakly	Programme Officer	AusAID 'Growth for Governance Program'
Daniel Gay	Consultant and DTIS Team Leader	Independent (former ODI Fellow)
Jimmy Rantes	Senior Industrial Development Officer	Department of Trade, Industry and Investment
Joanne Asquith	Sector Analyst	Department of Economic and Social Planning, Ministry of Finance and Economic Management
John Colwick	Development Programme Coordinator	NZ Aid
Kunal Patel	ODI Fellow	Budget Section , Ministry of Finance and Economic Management
Linda Kolpoi	General Manager	Vanuatu Tourism Office
Marakon Alilee	Director General	Ministry of Trade, Commerce, Industry, Tourism, Investment & Business Development
Nikunj Soni	Executive Director	Pacific Institute of Public Policy
Peter Bazely	Consultant	Peter Bazeley Development Consulting
Roxanne	NSA Programme Coordinator	Vanuatu Association of NGO (VANGO)
Roy Mickey Joy	Director/WTO Focal Point	Ambassador designate to EU and ACP States, Department of Trade, Industry and Investment
Taman Malosu	Manager	Industrial Support Division, Department of Customs and Inland Revenue
Timothy Sisi	Principal Trade Officer	Department of Trade, Industry and Investment
Tony Burns	President / General Manager	Vanuatu Hotel and Resort Association / Le Lagon Resort an
Yurendra Basnett	ODI Economist	Department of Trade, Industry and Investment