

Vanuatu

Economic Opportunities Fact-Finding Mission

Peter Bazeley and Ben Mullen

On Behalf of AusAID and NZAID

July 2006

Peter Bazeley Development Consulting
School House Farm, Blackdown
Beaminster, Dorset, DT8 3LE, UK
tel: +44 (0)1460 30297
e-mail: peter.b@zeley.com

and

Uniquet Pty Ltd
University of Queensland
St. Lucia, QLD 4072, Australia
tel: +61 7 3365 7054
e-mail: b.mullen@uniquet.com.au

Acronyms

ADB	Asian Development Bank
AusAID	Australian Agency for International Development
CRP	Comprehensive Reform Program
DARD	Department of Agriculture and Rural Development
DESP	Department of Economic and Sector Planning
DG	Director General
DoF	Department of Finance
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FSA	Farm Support Association
GIP	Government Investment Program
GoV	Government of Vanuatu
IDS	Institute of Development Studies, UK
JICA	Japan International Corporation Agency
MCA	Millennium Challenge Account
MDGs	Millennium Development Goals
MFEM	Ministry of Finance and Economic Management
MTEF	Medium Term Expenditure Framework
MTSF	Medium Term Strategic Framework
NGO	Non Government Organisation
NSO	National Statistics Office
NZAID	New Zealand's International Aid & Development Agency
PAA	Priorities and Action Agenda, 2006 - 2015
POPACA	Projet d'Organisation des Producteurs pour la Commercialisation Associative
REDI	Rural Economic Development Initiative
STIs	Sexually Transmitted Infections
VAC	Vanuatu Agricultural College
VCCI	Vanuatu Chamber of Commerce and Industry
VIT	Vanuatu Institute of Technology
VQLD	Vanuatu Quarantine and Livestock Department
VARTC	Vanuatu Agriculture Research and Training Centre

Acknowledgements

We are extremely grateful to the many people in government, the private sector and the development community who generously gave us their time and opinion during the mission and after, both formally and informally. We know from our own experience in Vanuatu just how many consultants come through asking the same people the same questions, and admire your patience. We are particularly indebted to Thomas Bangalini, DESP's Sector Analyst for Natural Resources and the Environment, for the immense effort he put in to our visit in setting up a very full and wide-ranging programme of meetings, for accompanying us throughout, and for his insight.

Vanuatu

AusAID & NZAID Economic Opportunities Fact-Finding Mission

Peter Bazeley¹ & Ben Mullen²
July 2006

This Report

1. We were fielded by AusAID (PB: 26 May to 14 June '06) and NZAID (BM: 6 to 26 June '06) to initiate dialogue with the Government of Vanuatu (GoV) over potential areas of support to economic growth from productive sector³ priorities established in the Government of Vanuatu's *Priorities and Action Agenda 2006 - 2015* (the 'PAA'). Terms of Reference are at Attachment 8.
2. Accompanied by DESP, we met with government departments and officials, private sector operators and their industry bodies in the agriculture, forestry and tourism sectors, and talked to NGOs and civil society organisations. We maintained close dialogue with AusAID and NZAID, and consulted other donors and their projects in Vila and elsewhere. We visited Epi (PB) and Santo, as well as agriculture and tourism operators on Efate. Key documents⁴ were reviewed. A list of persons met is at Attachment 7.
3. In this report:
 - ➡ **Part 1** talks about conceptual issues of 'growth' and managing agriculture's contribution to growth in particular;
 - ➡ **Part 2** discusses constraints to productive sector growth in Vanuatu; and
 - ➡ **Part 3** outlines a way forward.
4. Supporting information, including a brief overview of the PAA, an update of recent sector analyses and some preliminary concept notes / TOR for immediate support, is provided in the following attachments:

¹ Peter Bazeley Development Consulting. E-mail: peter.b@zeley.com

² UniQuest Pty Ltd. E-mail: b.mullen@uniquet.com.au

³ Our Terms of Reference deemed the 'productive sectors' to be agriculture, fisheries, forestry and tourism.

⁴ Notably: the PAA (May 2006), MFEM; Vanuatu Economic Development Strategy Stage 1 (2005), NZAID; Policy Issues in the Agriculture, Fisheries & Forestry Sectors (2002), ADB/AusAID; Baseline Study of the Trade Situation & Business Environment in Vanuatu (2005), DTII Transtec.

Attachments:

- A1 Update on Vanuatu's Productive Sectors
- A2 Review of the PAA, 2006 - 2015
- A3 GoV Development Policy & Planning Mechanisms
- A4 Concept Notes for Short- to Medium-term Initiatives
- A5 Draft ToRs for Follow-up Mission
- A6 Economic data
- A7 List of Persons Met
- A8 ToRs for the Mission
- A9 Key References

➔ Part 1:

Growth Concepts

5. Growth is essential to underpin the livelihoods, employment, goods and services that Vanuatu's expanding population requires and to reduce existing levels of hardship. Without growth, there will be increasing unemployment and joblessness, deteriorating standards of health and education, the development of intractable poverty and societal frustration and, potentially, social instability.

6. While growth is in itself not a sufficient condition for the betterment of people's livelihoods and the expansion of services, it is undoubtedly a necessary one. Countries with higher overall levels of growth usually have higher levels of growth among their poor and less well-off.

7. There has been much work on the role and characteristics of growth in developing countries. Although most of the literature relates to definitions of poverty that may not apply absolutely in Vanuatu, the underlying principles probably do. While there is no 'silver bullet' in the creation of growth, empirical international research⁵ suggests that there are four major pillars to achieving economic growth, in almost any environment:

⁵ See, for example, 'Pro-Poor Growth in the 1990s – Lessons and Insights from 14 Countries' (2005) ('Operationalizing Pro-Poor Growth Research Program', Agence Française de Développement, BMZ German Development, UK Department for International Development and The World Bank).

I. Strong incentives for private investment

- ✓ Private investment creates employment and raises productivity⁶.
- ✗ But high costs and risks deter investment at all levels (urban and rural, nationally, internationally): for example high costs of utilities, transport and communications, as well as conflict, unenforceability of contracts, corruption and rent-seeking.

II. International economic links

- ✓ International links speed the transfer of knowledge and technology, boost trade and promote wider economic opportunities.
- ✗ Poor information and communication, policy barriers to trade (including high tariffs) and geographical isolation compromise international economic linkages.

III. Broad-based access to assets (natural, physical, human, social and financial) and markets (including labour markets)

- ✓ Distributes the benefits of growth more widely and achieves faster overall growth by capturing the productivity and initiative of a larger percentage of the population.
- ✗ Distance and poor transport and communications limit access, as do policy, institutional and social obstructions (such as monopolies, over-regulation, and disorganised and fragmented industries), disputed entitlements, and ethnic and gender discrimination.

IV. Low levels of risk and vulnerability

- ✓ Reduce the number of people slipping back into hardship and poverty (and the social and economic consequences of that) from more sustainable livelihoods during economic shocks and cycles, poor health and climatic variations.
 - i. Risk and vulnerability is increased by poor education, economic instability, reliance on single crops and markets, as well as climatic conditions and natural disasters.

But not all forms of growth are good for the majority

8. In crude terms, broad-based growth across the majority of the population can - at household level - be achieved through widespread wage employment, through sustained reduced costs of living, or through increased non-wage economic activities. But formal wage employment is unlikely to touch the majority of Vanuatu's population even in the medium to long term, and the cost

⁶ Throughout this report the terms 'productivity' and 'production' applies to the output of the tourism sector as equally as they do to outputs from natural resource management.

of living in Vanuatu's *formal* economy is likely always to remain relatively high due to issues of scale and geography. So - if it is to touch the majority of the population - economic growth must therefore derive in the main from the activities of the majority of the population themselves, which are principally natural-resource based and rural.

9. Growth within just a small (Vila-based) segment of the population is unlikely to trickle down to much of Vanuatu's rural population, unless there is sufficient economic growth in that segment to enable high levels of remittances, or of industry taxation, income redistribution and social expenditure. (The latter usually only a feature of oil- and mineral-based economies.) In practice, hardship and poverty has rarely been reduced through redistribution of income, but rather through broad-based economic growth in which the wider population is engaged.

10. Narrowly-based growth, in which the benefits are retained only by a small proportion of the population, would lead to deepening **inequality**. Inequality is an inevitable feature of most market economies, to some extent, and some aspects of inequality are in fact positive – for example on overall savings rates (assuming those funds remain on-shore) and for the purposes of creating incentives for productivity. It is also possible where there are high levels of income inequality for there to be positive growth at the aggregate level but negative growth amongst the poorer part of the population. High levels of inequality are bad for growth, as they create conflicts, social tensions and instability.

11. The *Gini Coefficient* is a measure of income inequality; zero representing perfect income equality and 1 representing infinite income inequality. The global average is about 0.4. A Gini Coefficient above 0.5 is thought to be a significant impediment to stable and sustainable growth. Vanuatu's Gini coefficient has been calculated⁷ at between 0.56 and 0.58 – the highest in the world. However such an aggregated metric for Vanuatu needs to be interpreted cautiously in that most people's livelihoods are partly derived outwith the cash economy.

12. Where there is very high inequality consideration needs to be given to pursuing strategies that do not just contribute to overall growth, but which *disproportionately* benefit the less well-off ... but without compromising any essential role that any more robust segment of the economy plays. (For example, parts of the large-scale commercial agriculture sector in Vanuatu play an essential role in maintaining the critical mass, processing capacity and export markets on which the wider smallholder sector depends.)

13. **Leakage** in some sectors may also be significant and will reduce the net benefit of that sector to economic growth. 'Leakage' is the proportion of the gross contribution of that sector to the economy that is redirected offshore (or never makes it onshore) in the form of expenditure on offshore or imported

⁷ Deutsch and Silber (0.56); FAOStats and The World Bank (0.58)

goods and services, and/or the repatriation of profits and capital appreciation to overseas owners and shareholders. Some estimate leakage from E-fate-based tourism to be as high as 80% - although objective analysis of the economics of the tourism sector is thin, and figures are disputed⁸.

Agricultural growth is important, but presents particular challenges

14. Although the relative importance of agriculture tends to decline as a country's economy grows, strong agricultural growth has been an essential feature of most countries' early post-independence development. Agricultural growth is typically disproportionately good for the poorest segments of the population: every 1% increase in per capita agricultural output reportedly leads to a 1.6% increase in the incomes of the poorest 20% of the population⁹.

15. But beyond the impact on agricultural growth on rural livelihoods, higher rural incomes and cheaper food increase the demand for goods and services produced outside agriculture. Strong linkages or multipliers between agricultural growth and the wider economy, when in place, have then allowed developing countries subsequently to diversify their economies to sectors where growth is faster and labour productivity and wages are higher. Conversely, where agricultural productivity has only grown slowly, non-farm activities have invariably also tended to grow slowly, and low levels of off-farm employment persisted¹⁰.

16. But while agriculture seems essential to early phases of economic development, securing robust agricultural growth has often proved difficult in the absence of major shifts in domestic demand. (As was seen, for example, in the 'Green Revolution' in Asia). In many developing countries, post-independence agricultural productivity has actually declined, per capita.

17. More recent analysis of the often disappointing performance of agriculture in developing countries¹¹ has emphasised the long-term (perhaps 15 to 30 year) phasing of national agricultural development, and the **importance of appropriately sequenced and coordinated policy and institutional adjustments over such a period.**

⁸ A *Pro-Poor Tourism Partnership* study on tourism in developing countries suggested that leakage might typically be 75% where hotels and airlines are foreign-owned. The *Overseas Development Institute* found that a more representative figure for leakage is approximately 50% of the total cost of a tourist package. (id21 insights #62, June 2006.) Figures are in reality likely to be extremely variable and resort-specific.

⁹ Gallup, Radelet & Warner (1997) CAER Discussion Paper No. 36, Harvard Institute for International Development, Boston.

¹⁰ DFID (2005) 'Growth & Poverty Reduction: the role of Agriculture', Department for International Development, London

¹¹ See, for example, 'New Directions for African Agriculture', IDS Bulletin Vol. 36 No. 2, June 2005, Institute of Development Studies, Sussex.

18. Initially, where there are few market linkages, subsistence farming is the only rational choice for the rural population. At such a phase of economic development policy will need to focus on securing access to markets for the rural population in the absence of mature private-sector-led marketing chains. But as more robust private-sector linkages develop, policy will need - for example - to shift to supporting (as opposed to undermining or crowding-out) efficient private-sector led growth while safe-guarding equitable development and controlling undesirable features of market distortions, monopolies and monopsonies¹². The need for, and role of, state intervention in markets, for example through commodity marketing boards, will need to shift – not as matter of economic principal *per se* but as a dynamic response to maturing markets and institutions over time.

19. While agricultural information and technology ('extension') will be important, many other determinants of agricultural productivity, invariably falling outside of the remit of a Ministry of Agriculture, will need to be addressed: land, labour, taxation, trade regimes and currency valuation, energy, commodity tariffs and protections, etc. All this in the context, too, of shifting external market dynamics and requirements.

20. Thus, getting agriculture's contribution to economic growth right is not a matter of applying a single, sweeping, new policy paradigm, or of introducing a new wonder-crop, but of accurately assessing agriculture's current state of maturity in terms of its linkages into the wider economy, the efficiency and effectiveness of its institutions and the nature of any market failures, and of reviewing, shaping and sequencing long-term policy in response – across different parts of government, the private sector and civil society. But such long-term perspectives often run counter to political and donor pressures to obtain tangible results within the lifetime of much shorter planning cycles: more sophisticated policy processes need to be developed.

Economic growth implies productive sector development at scale

21. The realisation of robust, broad-based, economic growth will not be achieved through isolated gains in productive sector output in particular industries or geographic locations, but by broad-scale improvements to the environment which enables major segments of the population to derive their livelihoods. That said, however, it is important to acknowledge the crucial role that just a very small number of commercial-sector operators play in maintaining critical mass and core productive and processing capacity. Broader-based growth must not compromise their viability: rather it must focus on strengthening linkages between the majority population and the essential productive core of the agriculture and tourism industries.

¹² Situations where there is only one buyer.

22. Impacting at scale implies a considerable shift in the development paradigm that has typified Vanuatu's post-Independence period, which has centred on a plethora of donor-driven projects, often transactional¹³ rather than transformational, and rarely creating impact beyond their immediate locale. Transactional projects have undoubtedly often been useful, and many have had considerable impact on citizens' lives and livelihoods – but not at sufficient scale to make a dent in national GDP figures. It would be logistically impossible, as well as unaffordable, to achieve sufficient project coverage to do so. Concepts of 'pilot projects' to be replicated through other institutional mechanisms rarely fulfil their promise in the absence of more fundamental shifts in policy, governance and finance.

23. Development planning and assistance needs to move from a paradigm of justifying projects on the basis of their individual merits¹⁴ to **more systematic configuration of cross-sectoral public policy and investment over time for the purposes of achieving a sufficiently significant growth outcome**. The two paradigms are very different, and require different processes.

24. While we do recommend some shorter-term transformational investments (Attachment 4), **the emphasis of our argument is on strengthening capacity for the analysis of productive sector performance, and the indigenous generation of robust, evidence-based and appropriately sequenced and coordinated policy and public expenditure over the long term**.

25. The currently very high transactions cost of projects is discussed further at 63 to 68 below.

➡ Part 2:

Constraints to Productive Sector Growth

26. Vanuatu can produce. Its productivity has provided for a stable and peaceful independent nation whose economy has, taken over time, remained relatively sound. Its agriculture has supported a rapidly growing population¹⁵ and

¹³ I.e. the direct provision of goods and services as an end in itself, as opposed to promoting and supporting improvements to the enabling environment. Transactional projects can typify the non-sustainability of aid and can undermine efforts to manage public expenditure more comprehensively.

¹⁴ Even if they do fit comfortably within medium-term frameworks such as the PAA.

¹⁵ Although growth of Vanuatu's formal GDP has not been spectacular, it must be realised that its traditional, largely non-monetarised, rural economy has successfully supported a 90% increase in the rural population since Independence (from about 95,000 in 1980 to an estimated 180,000 now).

it has enjoyed significant export revenues from – again over time - a diversified base. Infrastructure and utilities are expanding and are generally very reliable.

27. Its most understated productive-sector success is the massive response within its traditional (island) economy to a rapidly growing population. Historically, Vanuatu's traditional economy has supported populations that were much higher again.

28. In terms of the modern economy, Vanuatu has also had some remarkable successes in converting its assets into macro-economic growth, with some not insignificant inward investment and foreign exchange earnings since Independence. Individual commodities have waxed and waned, and foreign investors have come and gone at different times for different reasons, but in broad terms there remains a relatively robust core of productive capacity that has seen through the peaks and troughs of commodity prices, and varying degrees of support from government. Not least it has maintained productive sector viability in the face of the high costs and low returns (compared to world prices) inherent to Vanuatu's geography and scale of production (see 31 below).

29. But the overall growth rate is not enough to support development among such a rapidly increasing population. It also seems likely that a greater proportion of future generations will wish to enter the modern economy and be more dependent on investment and employment.

Comparative advantages and disadvantages

30. Vanuatu enjoys significant comparative advantage in several productive sectors, which it has successfully exploited for decades:

- ✓ A relatively (to the population) massive and - with proper husbandry - productive land resource;
- ✓ A generally very favourable climate for agriculture (with some limitations), supporting year-round pasture and crop production (including forestry);
- ✓ Pre-existing commercial-sector agricultural investment and processing infrastructure;
- ✓ Relatively low incidence of agricultural pests and disease, naturally quarantined from the neighbouring countries;
- ✓ A unique natural and cultural environment attractive to tourism;
- ✓ A maritime environment with useful (if limited) fish stocks;
- ✓ Sea ports;
- ✓ A stable, comparatively well-educated, society and abundant labour.

31. However, Vanuatu's inherent comparative advantages are probably negated by inherent disadvantages:

- ✗ Very small size with none of the economies of scale in inputs (including fuel and utilities), processing or markets enjoyed by competitors;
- ✗ Geographical fragmentation with high internal transport and communication costs;
- ✗ Geographical and economic isolation from large markets;
- ✗ High fixed costs of providing governance and essential services per unit of population;
- ✗ Unique economic and social challenges in the interface between the 'traditional economy' and the 'modern economy';
- ✗ Perennial cyclones, which produce occasional economic and societal shocks and restrict the range of viable crop and tree species.

32. Vanuatu has also had relatively little success in productive sector innovation in terms of new crops, commodities and processing. There have been many grand schemes and great new hopes, but few if any have proved better or (sustainably) more profitable than the crops and commodities that have repeatedly shown themselves to be well-suited to Vanuatu's challenging physical and economic environment: copra, cattle, cocoa, and to a lesser extent coffee and spices, as well as a particular brand of tourism. Kava, perhaps the most traditional crop of all in Vanuatu, has been developed from a minor domestic crop to a major export commodity (in Vanuatu terms) over a 20 year period. A lesson has to be, as in so many other business environments: stick to what you do best.

33. So, in a physical and natural environment that is probably 'advantage-neutral' overall, and with no compelling evidence that there are many unexploited new niche commodities and products to be explored, how can we enhance the performance of the productive sector such that it contributes more to economic growth?

Growth Diagnostics

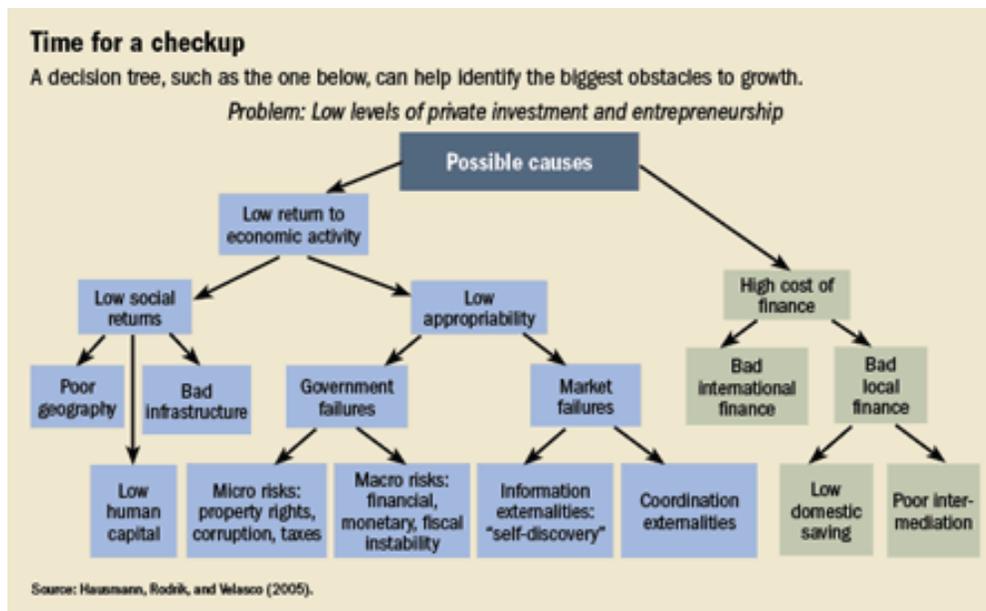
34. Contemporary growth literature¹⁶ highlights the extremely variable, seemingly non-linear, results achieved from the adoption of Washington Consensus policies¹⁷ in developing countries over the last 15 years and the difficulty in selecting appropriate policy prescriptions for any given social and

¹⁶ See for example Hausmann, Ricardo, Dani Rodrik, and Andrés Velasco: *"Getting the Diagnosis Right"*, Finance & Development, Vol. 43 No. 1 (March 2006), International Monetary Fund.

¹⁷ The maintenance of macro-economic stability, creation of sound business environments, enforcement of property rights, integration with the world economy, etc.

economic environment. Economic policies that have worked well in one country have failed, or even had negative effects, in another. An argument put forward is that, faced with massive policy reform agendas across multiple sectors and institutions, governments have either tried to do everything at once (with consequently insignificant effect on anything) or have selected reforms and investments that were not, in fact, crucial to their country's economy. *Binding Constraints* theory encourages countries to figure out the one or two *most binding constraints* on their economies and to concentrate policy and institutional reforms on solving those.

35. *Binding Constraints* theory starts by assessing the most fundamental inhibitors of growth – high cost of and/or low returns to investment – and



develops analytical decision trees from that. (See figure below.)

36. This mission was not equipped to undertake such growth diagnostics at the macro-economic level: it is something a World Bank team will be pursuing later in the year. However, as regards the productive sector, we did not in fact find a *Binding Constraints* approach particularly helpful: the really binding constraints on the productive sectors (geography and scale) are both obvious and immovable. And an important tenet of binding constraints theory – that currently observed economic activities are by definition probably not suffering from *binding* constraints – suggests that there are, in fact, few such *critically* binding constraints on the productive sectors.

37. That is not to say, however, that several of the classic constraints to growth are not present: several of the boxes in the figure above would have to get a tick in Vanuatu, including some of the higher-level ones of poor geography, bad infrastructure, [sometimes] low appropriability and contract enforcement, and market failures.

38. Given, therefore, that the picture is one of some immovable constraints (geography and size) on one hand but sustained productivity – albeit at suboptimal levels – from agriculture and tourism on the other, our analysis has erred towards one of recognising **multiple inefficiencies throughout existing value chains**, rather than the identification of *binding constraints* or missed opportunities. These are discussed further at 46 to 68 below, but we first mention some caveats:

Some caveats

39. Property rights, in particular **land tenure**, clearly represent a critical issue in any discussion of productive sector growth. However, as the issue of land will be looked at comprehensively in the run-up to the Land Summit later this year, this mission was not expected to examine land issues.

40. A review of **transport** was beyond the scope of this mission, but high costs and poor quality of domestic (inter-island) transport is clearly a major issue, if not a binding constraint. It may well serve to limit the extent to which growth can be based more broadly than on the economies of Efate and south-east Santo. It warrants further, separate, analysis. If the costs of domestic (inter-island) transport cannot be reduced through the removal of policy and organisational inefficiencies then a major constraint to equitable growth could endure. Such a scenario might suggest the need for a radical rethink of how efficient, technologically-advanced, fit-for-purpose, inter-island transport is financed in terms of both capital and recurrent costs.

41. It will be interesting to see what the impact of the imminent Millennium Challenge Account (MCA) investment in infrastructure will be. There is likely to be a significant difference, in terms of growth outcomes, between infrastructure investments that effectively link a greater proportion of the population to the economy and those that merely improve the quality of existing infrastructure. The MCA focuses, in the main, on the latter.

42. The issue of **human capital** is also an interesting one in Vanuatu: although it would be counterintuitive to imagine that Vanuatu doesn't need to invest in education, *growth diagnosticians* would be interested in the level of [formal-sector] under-employment of educated people and might need to consider whether certain forms of education have run ahead of economic growth. (Para 60 below relates to this.)

43. We were repeatedly struck by long recognised, but mostly anecdotal, evidence of an apparently **non-linear production response to increased demand** in Vanuatu. That is to say that when demand for agricultural products is strong and prices rise there sometimes follows an unexpectedly flat – or sometimes even negative – supply response. The explanation usually given is that once school contributions have been paid (and they can be paid more effortlessly when prices are higher), there is subsequently a very low value attached to the return on additional labour and investment in productive-sector activity, at least within the traditional economy. A robust production response only reappears when returns to labour and investment are *especially* high - such has been the case with kava recently.

44. Finally, and perhaps linked to this phenomenon, the importance of Vanuatu's **traditional economy** (and its interface with the modern economy) must be included in any analysis of growth and the outcomes of growth. Many of the functions of 'modern' growth – well-being, stability, equity, social cohesion and sustainable livelihoods for an expanding population – are also well provided for through Vanuatu's strong and deeply held customary values, including its custom economy. That this traditional economy is now also institutionalising customary forms of currency, savings and exchange strengthens the need properly to incorporate it into the analysis. Some groundbreaking work is being done in association with the Cultural Centre on the traditional economy and its role in future Vanuatu society: it should be supported.

Multiple Inefficiencies throughout the Value Chain

45. Our assessment is, therefore, that generating additional, broad-based, growth from the productive sectors is:

- a) Not *critically* inhibited by binding constraints, because there are successful, sustainable and expanding productive-sector enterprises in both the commercial and smallholder sectors, now as there have been for decades; and
- b) Not an issue of finding a new commodity or of identifying new niches *per se*, because a.) productivity from existing crops and commodities could be significantly increased if society felt the incentive to do so and b.) Vanuatu has little or no comparative advantage in pioneering such new enterprise - although that may flow from improved economic efficiencies generically (see below).

46. Rather we see the impediment to accelerated and broader-based growth to be multiple **inefficiencies** – in the economic¹⁸ sense – throughout the value

¹⁸ *Economic inefficiencies* are situations where waste, friction or other undesirable economic features are present which could be changed such that everyone gains, or so that someone gains while noone else loses.

chain, both in the private and public sectors, including at the interface with policy (and also with the interface with donors). And efficiency throughout the value chain is essential to Vanuatu's ability to compete in international markets, given the other – immovable – constraints it faces in terms of geography and lack of any economies of scale.

47. We have grouped these inefficiencies as follows:

Policy Inefficiencies

48. Vanuatu's policies have over time resulted in a reasonably stable productive sector that has fared better than many of its Pacific island neighbours. The productive sector is however relatively conservative and risk adverse, concentrating on well-established technologies and commodities: policies have generally worked against expansion and innovation. Such restraint in the productive sector will probably not allow Vanuatu to overcome its inherent comparative disadvantages in competing against others, in an increasingly globalised marketplace, who are better served by geography and who enjoy considerable economies of scale. To compete in the productive sectors, Vanuatu needs to perform at its most efficient, and that includes efficiency and effectiveness in policy-making and implementation.

49. We received a consistent message across most of our interviews with stakeholders. The critical issues, stakeholders tell us, are not so much that there are 'bad' policies *per se* but that:

- Policies are **inconsistent** and **too short-lived**
 - Resulting in lack of confidence and long-term investment¹⁹ in new productive sector initiatives. Productive sector activity (both agriculture and tourism) typically has a long lead-time before return on investment is achieved, so producers²⁰ need to feel confident that something for which there is a supportive enabling environment now will still have a supportive enabling environment in 5 or more years' time. (The 'enabling environment' might, for example, relate to economic parameters such as tariffs²¹ and exchange rates, or institutional ['rules of the game'] issues such as access to assets, taxes and business licences, and the enforceability of contracts, or organisational issues such as the quality and availability of services.)

¹⁹ We of course include here the type of investment smallholders make in productive sector activity, too.

²⁰ Including tourism 'producers'

²¹ The 'Baseline Study of the Trade Situation and Business Environment in Vanuatu' (May 2005), Daniel Gay / Transtec, discusses among other things how Effective Protection Rates in Vanuatu grossly distort the viability – and benefits to the economy – of various industries and productive sector activities.

- Policy-making is **not sufficiently inclusive, consultative or evidence-based**
 - Resulting in, stakeholders say, policies that are not sufficiently nuanced to the needs and requirements of productive-sector growth led by private-sector investment and trading.
- Policies and policy-making are **poorly understood** by stakeholders
 - Opaque policy-making processes result in – especially in a small community – misunderstanding, misinformation and suspicion about policies and their impact on different segments of the population.

50. An observation is that there is a gap – at least in the formal structures and workings of government, but probably less so in informal networks – between the executive and the political component of policy-making. That gap may be the result of a number of things:

- The fact that, in the political environment that has endured for much of Vanuatu's post-Independence history, the 'drivers of change' in terms of economic and social policy stem from, in the first instance, the need for immediately tangible and relatively short-term reaction to constituents' concerns, rather than evidence-based advice from the executive.
- Within the regular functioning of the executive, there is relatively little commissioning of robust, long-term sector analysis or policy studies, and very little scenario-planning around future policy and public investment options. There is precious little capacity to do so: the Department of Economic & Sector Planning (DESP) is in fact pre-occupied with other things, notably the oversight of a multitude of often relatively small development projects. The sole sector analyst for natural resources and the environment in DESP has over 200 such projects on his books, and DESP as a whole over 900. (Discussed further in Attachment A4, Note 1, below.)
- That while external development partners often do instigate policy and other analyses through short-term consultancies, these can suffer from:
 - Lack of ownership by, and involvement of, government and other stakeholders;
 - The debate – and even the information – effectively remaining largely within donor institutions;

- Being narrowly focused or sector-specific, dogmatic²², or just plain wrong.
- Poor quality and quantity of data and information.

51. A key recommendation of this report is that, in order to achieve robust growth from the productive-sectors, **more indigenous, consultative and evidence-based policy-making processes needs to be supported**. This is not new: the Comprehensive Reform Programme articulates this need, and ambition, clearly. However it has not been achieved because such a process of reform has not been adequately resourced and supported. Such a process requires considerable management and investment of time and cannot be something that is delegated to units of government that are already overstretched. In Part 3, below, we discuss how such a process could be supported and strengthened.

Inefficiencies in the Supply of Public Goods

52. The supply of essential goods (such as infrastructure) and services (such as education and agricultural information) becomes a *public good* where the market will not supply them efficiently or effectively – because of *market failures*²³ that are reasonably universal and usually predictable²⁴. However, for a number of reasons, market failures are much more likely to occur in a small and immature economy such as Vanuatu's than in the larger and more robust economies in which most public good theories were developed. There needs to be careful assessment of market failures and the required scope and scale of public goods in the productive sectors in Vanuatu: it has enormous bearing on the form, function and funding of public institutions in the productive sector and is relevant to the upcoming review of the Comprehensive Reform Programme.

53. We were repeatedly told how the aftermath of the 1993 civil service strike, followed by the Comprehensive Reform Programme's 'right-sizing' exercise in the mid '90s, resulted in a failure in the delivery of public goods in support of the productive sectors, to which there has been inadequate adjustment or recovery. The most critical shortcomings would appear to be:

- Virtual collapse of agricultural extension, information and smallholder marketing-support services.
 - As an example of the impact of this, in the early '90s – as a result of concerted efforts by the then Department of

²² In the sense of pursuing of contemporary development theory.

²³ Classically where there are externalities (spill-over effects on wider society), asymmetries of information and moral hazards, lack of economies of scale, and where society values 'merit goods' (such as universal primary education) beyond the market.

²⁴ For further reading see, for example, 'The Theory of Externalities, Public Goods, and Club Goods' (1996) by Richard Cornes and Todd Sadler, Cambridge University Press.

Agriculture to provide smallholders with skills, information and access to markets – the Santo abattoir was exporting 7 or more containers of beef per month, of which over 50% was derived from smallholder cattle. Nowadays the Santo abattoir exports 2 to 3 containers a month, of which only 5% is derived from smallholders – with supply (not markets) being the limiting factor.

- Lack of ability to consistently enforce property and access rights and restrictions.
 - Particularly with respect to fisheries and forestry.
- Only marginal capacity to oversee sanitary and phytosanitary controls and certification in support of agricultural exports and protection of imports.
- Sub-optimal (in the view of the industry) destination-marketing in the tourism sector and inadequate support for provincial tourism initiatives.

54. If there is to be broad-based growth then the majority smallholder / rural population has to be engaged and linked-in to markets. However, at this stage of Vanuatu's economic and private-sector development, supporting such engagement and market linkages remains in many areas a public good²⁵.

Private Sector Inefficiencies

55. Vanuatu, and the Pacific nations more generally, have always sustained themselves through private sector activity and entrepreneurship – whether that be self-sufficiency in food through smallholder agriculture or the economic activity of foreign investment and trading. However, much of that trading was, historically, relatively exploitative and did not face the kind of external competition that today's global markets present. In terms of modern-day norms of innovation, operational efficiency and corporate social responsibility, Vanuatu's private sector is – with some exceptions – relatively immature.

56. It is also very small. The principal commercial producers that provide the critical mass and market linkages in both agriculture and tourism barely exceed single-digit numbers. This makes industry organisation and representation of industry to government difficult, partial and subject to inevitable personalisation and perceived conflicts of interest.

²⁵ Paradoxically one reasonably efficient market linkage between outer island produces and international markets has been compromised by new policies on island trading: no longer able to retail general goods and stores on the outer islands, itinerant (predominately Chinese) traders have stopped making the regular shipping runs during which they also bought copra and other island produce.

57. However, to compete, Vanuatu's private sector needs to become better organised, skilled and equipped, develop what economies of scale it can, work to improve quality, market its products more collectively and see better to its long-term future and the human and physical assets on which it depends. There are examples of this²⁶, but they are few.

58. Monopolies and monopsonies remain a common feature of Vanuatu's private sector, perhaps inevitably, but tend to be crudely regulated. A number of public-private partnerships exist – some of them quite innovative and successful, but some certainly not. In some cases there is ambiguity over the public-good purpose of government investments in private sector activity.

59. Development needs to get a better handle on private sector inefficiencies, consider how best to support adjustments to its operating environment such that it becomes better organised and more responsive to market demands, and seek to supply the private sector with the incentives – and perhaps sanctions – needed to promote broad-based and sustainable growth.

60. One particular message to us from the private sector (both agriculture and tourism), was the need for more demand-driven training and skills programmes – notably apprenticeships and skills accreditation schemes. While this mission was not equipped to assess human resource requirements for productive sector growth, it is an example of the kind of growth diagnostics issue discussed at 42 above and the extent to which development of the human resource needs to match – and neither overtake nor lag behind – economic development.

Infrastructural Inefficiencies

61. Geographical fragmentation and low population densities imply high infrastructure costs per head of population, and often the non-provision of infrastructure. Inter-island transport, in particular, needs to be efficient if the productive sector is to engage the rural population. We were not qualified to undertake a review of the domestic transport sector, and such reviews have been undertaken previously. However, our comment at 40 above that inefficiencies through i.) the use of old equipment and technology ii.) market-distorting protections in inter-island transport may in fact represent a *binding* constraint to broad-based growth from the productive sector needs further analysis.

62. Neither were we qualified to examine energy costs, which were in any case reviewed in 2004²⁷. However recent bench-marking studies have concluded that electricity generation and roll-out in Vanuatu is relatively efficient and of high quality – although among the most expensive in the Pacific. Further, oil-based energy is inevitably going to imply high, and rising, costs. Energy pricing

²⁶ The Vila abattoir, for example.

²⁷ Regulatory Review for the Government of Vanuatu (2004), Castalia and Network Strategies

more generally is distorted by numerous exemptions and concessions. Tourism will be relatively energy-dependent and intensive; agriculture, forestry and fisheries less so.

Donor inefficiencies

63. Vanuatu is fiscally highly donor dependent, with a disproportionately high level of donor activity as well as a significant NGO and civil society presence, not withstanding the small population and even smaller government resource. With so much to do and so little with which to do it, and at some variance with aid modalities elsewhere, aid and development in Vanuatu is still exceedingly small-project-orientated and supply-driven. There are over 900 projects currently listed in the Government Investment Programme database²⁸. Any discussion about any new initiative revolves around the need for 'a project'.

64. Projects continue to have an important role to play in development processes, and we now know more about when they do and don't add value. But an overdependence on supply-driven project modalities invariably results in fragmented development, undermining and/or over-stretching of government processes and capacity, lack of ownership, and competition for human and infrastructural resources – sometimes even between donors. But most importantly, project coverage can never be wide enough itself to impact at sufficient scale in terms of achieving broad-based growth that engages the majority of the population. Such transformation must be the function of properly resourced and sequenced reforms in public policy and cross-sectoral expenditure.

65. Although implementation is the responsibility of line ministries, oversight of, and donor accountability for, this huge array of projects, and the configuration of the overall project portfolio, rests with DESP - which cannot possibly do that job properly with its handful of sector planners and preoccupation with purely administrative matters.

66. While informal networks are strong, formal mechanisms for donor coordination are weak in Vanuatu and are not, as they should be, managed by government as opposed to the donors themselves.

67. Strong supply pushes and minimal capacity to manage such a large portfolio of projects inevitably results in a culture of '*gate-keeping*' development rather than proactively *configuring* development. Effectively, the system is one of checking that external or ministry-proposed projects can be justified within the scope of broad development frameworks such as the PAA (and if so approving them if somebody is prepared to fund them) rather than a more deliberate process of assessing how the total resource envelope (including donor resources) can best be configured and deployed to achieve desired outcomes.

²⁸ Although many of these are not active, or even funded.

68. A model in which government is more firmly in control (in terms of both decision-making and resources), a properly constructed Medium Term Expenditure Framework and more effective donor coordination are required to enhance the efficiency and impact of development assistance on economic growth. Elements of this are discussed below.

➡ Part 3:

A Way Forward

69. So ... our conclusion is that:

- The concept of *binding* constraints may not be the most applicable to Vanuatu's productive sector, although growth diagnostics may later reveal imbalances in infrastructure, human and economic development. (And transport reform almost certainly warrants further examination within the context of efficient inter-island transport being a prerequisite to broad-based growth.)
- Instead we have constructed an argument around the need for Vanuatu to overcome its inherent and immovable competitive disadvantages (geography and scale) by reaching greater levels of *economic efficiency* throughout the value chain.
- We have highlighted policy inefficiencies, inefficiencies in the delivery of public goods, private sector inefficiencies, infrastructure inefficiencies and donor inefficiencies as important.
- In order to address these, more robust, locally-owned and transparent analysis of constraints to growth, and of policy and public investment options, needs to be generated and propagated. In part this can be achieved by freeing up existing analytical resources and strengthening units such as DESP – both in terms of resources and ways-of-working – but it will probably also require some new mechanisms.
- A deeper and more quantitative understanding is needed of the private sector and its strengths and weaknesses in contributing to broad-based economic growth. This implies a more responsive relationship between government and the private sector – again probably implying new institutional mechanisms – and the determination of how policy and public investment can best be configured to support robust but equitable private-sector led growth. It also suggests a need for better sector performance data and information.

- Donors too must play their part in improving the efficiency and coherence of aid and modalities of aid, which are currently disproportionately preoccupying.

70. These issues will not be addressed through 'business as usual' – either on the part of government or through conventional projects.

71. We discussed a number of options as regards how to move forwards. Certainly capacity-building in units such as DESP is warranted (and a concept note for this is outlined in Attachment 4, Note 1). However we also need to generate higher-level policy processes that properly engage ni-Vanuatu 'big thinkers', that can provide analysis and opinion that is widely respected, and that can engage with the political components of policy-making as well as they can engage with productive sector stakeholders. **A structured, home-grown but nonetheless properly resourced and supported process that provides for this deeper and wider dialogue, analysis and effort is required, focusing on adjustments to public policy and investment in support of more rapid and broader-based growth from the productive sectors.**

72. Such analysis of constraints, issues, policy and public investment options would require the ability to commission studies and think-pieces, which must be owned by and deposited within Vanuatu's own policy-making institutions.

73. One suggestion is the creation of a high-level 'think-tank' appropriately resourced and supported to carry out this function, including the commissioning of policy analyses and studies. This was generally well received, although several warned that such things had been tried before.

74. Where such a think-tank would be located, and to whom it would report, needs further discussion – although the choices are limited and probably centre on the Prime Minister's Office. Conceptually support for such a think-tank fits well with, and could be resourced from, AusAID's Governance for Growth initiative, although multi-donor buy-in would be advantageous.

75. Simultaneously there needs to be some thought go into the role and function of DESP, and probably also the Department of Strategic Management, in supporting more robust sector and economic analysis and the assessment of policy and public investment options. Even with further capacity-building in these units, this will not be achieved while DESP is pre-occupied with its plethora of small projects. Ways need to be explored for delegating the resourcing, administration and oversight of small projects to, for example, a contracted-out Small Projects Management Unit funded from donor funds.

76. Dialogue also needs to be deepened with important parts of the private sector – particularly the tourism sector - with a view to exploring ways in which government can construct a more enabling environment for growth with better linkages between the established commercial sector and the wider population.

77. This mission was not able to map these concepts out in detail, in part because of its scheduling, but principally because these are concepts which need consensus among, and the support of, senior management before prescribing fixes. Our recommendation is that the immediate next steps, following general approval of the concepts, are to:

- Validate and refine the arguments set out in this report through further discussion with politicians, senior management in government, civil society and the private sector;
- Align proposals with the Governance for Growth initiative and the potential to host within that framework the kind of process of dialogue and policy reform outlined above;
- Mount an externally facilitated multi-stakeholder workshop (and/or more focused workshops) to reach agreement on priorities for, and approaches to, developing more robust, transparent and evidence-based policy for the purposes of supporting productive sector growth. This to include explication of elements of growth theory (the sort of topics presented in this report) and the particular requirements for broad-based growth of agriculture and tourism in Vanuatu.
- Develop Concept Notes for, and define the funding requirements of, support to such processes – the emphasis probably being on *process*.

78. These next steps should be implemented immediately, not least so as to capture the involvement of, and debate being generated by, other current policy initiatives such as the review of the CRP and the ADB's work on a Medium-Term Strategic Framework. However, a meaningful process will itself – quite properly - take time to unfold.

79. In the meantime, principally in response to donor imperatives also to consider short-term programming, we also recommend a number of immediately doable transformational investments that would strengthen and support activities essential to sustaining current productive sector activity (Attachment A4). These concept notes have been prepared based on a rapid analysis of the current status of the productive sectors, examination of the principal planning mechanisms, and discussions with a limited number of stakeholders. In many ways this approach perpetuates the supply-driven model of development that we criticise above. Our recommendations on longer-term and more deeply embedded analytical and planning processes will ultimately facilitate more indigenous and holistic development planning recommendations.

Attachment 1: Update on Vanuatu's Productive Sectors

Detailed reviews of the productive sectors have been undertaken by the ADB in 2002 and 2003, "Vanuatu: Policy Issues in Agriculture Fisheries and Forestry" and "Vanuatu - A Private Sector Assessment: Issues, Challenges and Policy Options", respectively and more recently by the European Union in 2005, "Baseline Study of the Trade Situation and Business Environment in Vanuatu". These documents provide excellent back ground to the issues faced by the productive sectors. Our analysis is that relatively little has changed since these reports were published. Vanuatu's fertile soils and generally favourable climate gives it the potential to produce a wide range of agricultural, forestry and fisheries products for both domestic and export markets. However, Vanuatu's island geography and susceptibility to severe cyclones, in addition to its small size and distance from markets results in relatively few products for which it has a competitive advantage over larger neighbouring countries. Brief notes are offered here by way of a focussed update on earlier.

In terms of export potential, we see relative comparative opportunities in:

Tourism: Vanuatu has comparative advantages in international tourism, having pristine tropical ecosystems, beautiful scenery and interesting and friendly cultures. The industry is sold internationally based on these images although, interestingly, most are found beyond Port Vila, where the tourism industry is currently centred. The deregulation of Vanuatu's airways in 2003 led to a reduction in airfares from the major destinations (Australia and NZ) and an immediate spike in tourist numbers as Pacific Blue and other regional carriers entered the market. The resort sector is also a major employer, accounting for 12% of total employment positions in 2002 (Table 1). An increase in the number of trained staff to support the expanding tourism industry is currently a priority. There is no doubt that the resort sub-sector has a significant positive impact on Vanuatu's economy. However, the benefits accruing from Vanuatu's Port Vila-based tourism industry are eroded by high "leakage" rates (reliance on imported goods and services and repatriation of profits) and very limited potential for broad-based participation.

The budget-priced resort market competes directly with Fiji for customers, but is more expensive and has fewer flight connections from the regions major centres. Not surprisingly, Vanuatu's tourist numbers have showed limited growth (1.8% annually) over the past 10 years, whereas Fiji's tourism sector has expanded significantly (3.8% annually), rising to 500,000 in 2004 (Table 1). Having said this, the Port Vila industry can provide a basis from which Vanuatu's tourism sector can diversify and therefore there is national interest in the sector's success. Further, there is some growth in the industry with a major resort

expansion being undertaken on Iririki Island in Port Vila harbour and a range of smaller investments.

The Vanuatu Tourism Office hosts annual promotional events and other initiatives to promote Vanuatu's traditional tourism products. There is considerable targeting of specific events, such as the Vila Races and the Pentecost land-dives. This is a justifiable approach, but needs to be balanced with promotion of initiatives conferring lower rates of leakage and more broad-based benefits. A cohort of recent entrants into the tourism sector, with considerable experience in development of niche markets, may be the catalyst needed to address past marketing inadequacies and forge more productive and creative private-public sector partnerships. The sector is also well linked with a recent European Union initiative to improve the supply of skilled workers to the sector.

Table 1: Tourism data for years 2002-2003

Year	2002	2003	2004	2005
No of Tourists	49,462	50,400	60,610	62,082
No of Cruise-ship tourists	48,866	51,995	37,870	63,554
Available hotel rooms	1007	901	926	903
Occupancy rate	44.2%	46.5%	51.9%	51.6%
Available hotel beds	2,652	2,383	2,329	2,375
Occupancy rate	32.8%	35.3%	40.8%	40.4%

(Source: National Statistics Office, Vanuatu Government)

The Vanuatu Investment Promotion Authority lists accommodation supply; recreational services; inter-island cruises; game fishing and scuba diving; ecotourism projects; and joint venture tourism projects as priorities for investment. Data for room and bed occupancy rates indicate that the resort market is adequately catered for with accommodation.

The increasing number of cruise ships visiting remote locations injects relatively large amounts of cash into provincial economics (estimates of US\$40,000/day/ship), albeit on an irregular basis. However, the severe distortions in local economies caused by the availability of "easy money", in combination with the unreliability/infrequency of visits and the preference for very specific locations favouring individual communities over others has resulted in social unrest and severe disruption of traditional lifestyles. This issue requires immediate attention.

There is increasing evidence that niche marketing to adventure, eco and back-packer tourists has significant potential to deliver broad-based benefits to Vanuatu. These tourists tend to stay longer and spend more money, particularly outside of the major centres. With appropriate support, provincial tourism can also directly benefit the agriculture, forestry and fisheries sectors through supply of inputs to tourism operations and direct sales to tourists. These are expanding

sub-sectors of tourism internationally, but are currently poorly serviced by Vanuatu's tourism promotion agencies.

The development of outer-island (outside Port Vila) tourism requires a combination of improved tourism services and products and a targeted marketing campaign. The provincial adventure tourism market is currently heavily focussed on the Yasur volcano on Tanna and scuba-diving on the President Coolidge on Santo, and a limited number of high profile events, such as the land dives on Pentecost. Most of these can be done in a single day, therefore limiting benefits to provincial communities. There have been attempts to develop other adventure tourism products, such as village life and culture, jungle treks, mountain climbs, alternative scuba-diving sites and sporting events such as the Segond Canal swim. However, the majority of these have not been supported by concurrent development of appropriate quality accommodation and other tourism services, or specific promotional campaigns. Ni-Vanuatu tourism initiatives generally: fail to meet the expectations of clients for accommodation and services; have unrealistic expectations of cash flow; have limited concept of expected visitor numbers; and miss opportunities due to poor communications with potential clients. Capacity development is required to overcome these constraints to development.

Targeted research will be a crucial in determining the most favourable niche markets, and collaboration, cooperation and vision among the various stakeholders involved in the tourism sector will be required to develop strategies and products to successfully target these markets. A concept for stimulation of outer-island tourism development is outlined in Attachment 4.

Beef cattle: Vanuatu's comparatively large areas of fertile interior land and the freedom from most bovine diseases of economic importance have been the foundation for a cost-efficient, pasture-based beef cattle industry. In addition, the long term commitment to beef cattle production by medium to large-scale owner/manager operations on Efate, and to a lesser extent Santo, has created a relatively stable and growing export industry.

Two export abattoirs support the industry, Vanuatu Abattoirs Limited on Efate, (85% government / 15% private-owned), and Santo Meat Packers on Santo, owned by the Japanese company Nitchiku. Both abattoirs suffer from insufficient throughput due to unavailability of slaughter cattle. This situation was exacerbated to some extent by the opening up of live cattle exports in response to low prices being paid by the abattoirs, particularly on Santo. This situation turned around in 2005 with development of higher prices beef markets. However, sustained low prices and lack of support services has resulted in a declining national herd until very recently. Current signs are that the industry is entering a period of expansion.

Table 2: Export data for beef, live cattle and hides, 2002 - 2005

Year	2002	2003	2004	2005
Value of agricultural exports (million Vatu)				
Beef	192	287	286	302
Live cattle	60	52	29	56
Cow hides	60	36	28	43
Total beef/cattle/hides (million Vt)	312	375	343	401
Export quantities (tonnes)				
Beef	685	976	927	947
Live cattle	2,123	2,048	1,312	1,581
Cow hides	235	289	225	299
Commodity prices (export price in Vatu/kg)				
Beef	283	294	352	458

(Source: National Statistics Office, Vanuatu Government)

Providing that off-take does not exceed sustainable limits the medium term future for the

industry is bright, with diversified markets into Noumea, Australia, the Solomon Islands PNG and Japan. Vanuatu's Efate-based beef industry has recently attained organic production certification, however little price differential is currently achieved

Box 1. Smallholder cattle production in northern Vanuatu

A series of development projects supported smallholder beef cattle production in the late 1980s and early 90s, so that by 1993 50% of the Santo abattoir's throughput of 7-9 containers/month was provided by smallholders. Currently, the abattoir processes 2-3 containers of beef per month, of which less than 5% is derived from smallholder producers. The decline was associated with the withdrawal of government services for transport (cost-recovery) marketing logistics and decreasing returns for cattle sold. Interestingly, private transport businesses were functioning concurrently with government transport, but were far less efficient and reliable once the range of government services was withdrawn.

from this initiative. The potential to access higher priced markets for organic beef requires investigation. The industry reports significant constraints as high processing and marketing costs, arising from high stevedoring and electricity changes, and inadequate numbers of cattle available for slaughter.

The Santo-based industry has much greater potential to expand production than that on Efate, but has suffered from a less stable commercial sector and poor road and transport infrastructure. Historically, Santo has achieved high levels of smallholder participation in the beef industry, although at present smallholder production is relatively low (see Box 1). Given the limited ability of the commercial industry on Santo to collaborate effectively, additional government facilitation will be required to develop the smallholder industry.

A concept note proposing interventions to stimulate the smallholder beef industry is outlined in Attachment 4.

Kava: Vanuatu is the centre of botanical diversity for kava (*Piper myhisticum*) and among the indigenous varieties are the world's best commercial varieties. This gives comparative advantage for supply to the kava-consuming countries of New Caledonia and Fiji. Previously, a considerable volume of kava was sold into the EU, but its sale has recently been banned due to poorly defined and possibly dubious health risks. Despite this, strong domestic demand, in combination with demand from Fiji and New Caledonia, has seen the industry expand to be second only to copra in terms of export sales. Furthermore, smallholder participation in the industry is huge. Back in 1999, 16,700 of Vanuatu's 30,000 rural households were involved in kava production. It is expected that participation has grown considerably since this time.

The deregulation of kava marketing in 1997 greatly increased both export volumes and income for Vanuatu's producers (see Box 2). However, there was also a serious negative side to deregulation. With the high demand for kava, inferior quality wild varieties were marketed, often by unknowing (and uncaring) traders. At best, these varieties have low concentrations of the active compound, "kavalactones", so that they have little medicinal or narcotic effect. At worst, these wild kavas contain additional toxic alkaloids that affect the liver and may have serious health consequences with prolonged use. Additionally, some traders began shipping kava that was not properly dried, resulting in spoilage at destination. Most recently (June 2006), a container sent to Fiji in was rejected for this reason.

The kava marketing situation raises the broader issue of export quality standards for Vanuatu's agricultural produce. As a price taker selling into fickle markets, Vanuatu must maintain high quality product standards. Kava, in particular, requires quality standards to

Box 2. 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 Vanuatu Commodity Marketing Board (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. The role of VCMB in assisting commodity marketing is widely considered to be in need of review.

be introduced to regain the previous high reputation afforded to the Vanuatu product. This may require the introduction of chemical analysis to determine kavalactone content and presence of toxic alkaloids. Trace-back systems may also be required, so that specific producers can be identified. Given improved quality standards, there is reasonable potential to increase production and

revenue from export sales of Vanuatu's kava, although recent high levels of production in Hawaii are a threat. The achievement of organic certification for Vanuatu's kava, in combination with the introduction of minimum quality standards for moisture content and kavalactone concentration, are required to safeguard current export markets and move towards future expansion.

Organic produce: Vanuatu has comparative advantages in crop production by having climate and soils conducive to growth and in being free from many pests and diseases that constrain agriculture elsewhere in the region. However, export markets are impeded by its small size preventing economies of scale, irregular supply due to inconsistent shipping services, irregular cyclones and seasonality of production, and relatively high costs of transport and labour. The ability to exploit Vanuatu's comparative advantages will therefore not be realised by selling high volumes at world commodity price, but by accessing high-value, "organic" niche markets. This is already occurring to some extent with cocoa and vanilla.

Cocoa and vanilla are supplied by smallholders via nucleus enterprise systems developed through the POPACA Project. In the case of vanilla, a key to the industry's success has been the willingness of Venui Vanilla, the largest producer (but still a small owner/manager company), to involve smallholders in accessing its high-value, organic export markets. Through the engagement of the Farm Support Association as an intermediary, a high quality product has been consistently produced by smallholder farmers which is able to attract a premium price. There are currently approximately 300 registered smallholder organic producers across 6 localities. The certification system involves surveying 20% of producers in each locality on a 2-year basis.

Kaoka is a company purchasing organic cocoa from smallholders on Malekula and selling into the chocolate market in France. The company has sold 150 to 200 t annually (approximately 18% of Vanuatu's total production) over the past 3 years and receives a premium of up to 40% for the organic status its product. There is some concern about the credibility of Kaoka's organic certification status (different to Venui Vanilla's system), a matter that requires investigation.

Similar opportunities to piggy-back on the initiatives of committed and successful producer-exporters need to be developed for other commodities.

Canarium nuts (Nangai) are another product with niche market potential. However, this will require a long term process to develop stable supply chains and markets.

Taro and cassava are root crops that have been exported as frozen produce into New Zealand and Australia in recent years. However, these products compete directly with root crops produced in Fiji, where volumes are higher and production and transportation costs are lower. The development of organic certification standards may offer potential to accessing economically viable niche

markets for Vanuatu's root crops. Value chain studies are required to assess the true potential of these nascent industries.

The development of niche organic markets requires a robust organic certification process, development of minimum quality or grading standards, reliability of supply, effective transport and marketing systems and a reasonable return on investment for all involved in the value chain. A series of targeted, commodity specific, value chain studies is required to identify priority products, niche market opportunities and sustainable supply chain systems.

Timber. Timber is one of the few agricultural commodities that is expected to steadily increase in price into the future. Vanuatu's natural timber reserves are small, as cyclones regularly damage or destroy maturing forests and re-growth is constrained by the strong smothering growth of the exotic vine, *Merremia peltata*. Whilst most timber species are cyclone susceptible, one species in particular, whitewood (*Endospermum medullosum*) is cyclone resistant and produces a high-value, low density timber.

The main islands having significant potential plantation areas identified are Espiritu Santo (estimated at 9,000 ha), Erromango (4,000 ha), Malekula (3,000 ha), Vanua Lava (2,000 ha), and Efate (2000 ha). Small areas have plantation whitewood have been successfully established on the northern island of Santo, but further planting is needed to establish a sustainable industry. It is estimated that 3000 – 5000 ha of plantation whitewood harvested on a 20 – 25 year rotation would sustainably produce around 50,000 m³ of timber annually with an export value of US\$35 million annually.

Unfortunately, international investors have been reluctant to become involved in plantation forestry in Vanuatu because of the small size of the industry and the insecurity of land tenure. However, there is considerable potential for smallholder farmers of north-east Santo to become involved in white wood production. Woodlots with as few as 50 stems will be valuable for both farmers and timber cutters in the coming years. Facilitation is required now if a sustainable industry, largely based on smallholder agroforestry systems, is to be established.

Further opportunities exist in production of sandalwood. Again, the centre of sandalwood production is Santo, from where the vast majority of the current harvest is accessed. Replacement planting will be required on Santo as harvesting is currently exceeded the sustainable yield.

Opportunities for development need to be identified in collaboration with private sector operators who have established a long-term commitment to the sector. This will necessarily require a shift in the adversarial relationships that have characterised Department of Forestry and logging/sandalwood industry interactions. Community forestry initiatives have been successfully developed in the Solomon Islands and could be used as a model.

Copra remains the most important agricultural export commodity, returning more revenue to Vanuatu in 2005 than beef and kava combined. However, it is an industry based on outdated, labour-intensive production systems and return to labour is extremely low. The recent closure of Santo's coconut oil factory and the reduction in merchant vessels purchasing copra are further major set-backs. Given this situation, production in 2006 is likely to be well down on 2005. Plantation owners report great difficulty is accessing labour to cut copra, due to the difficulty of the work and the low return to labour. Given that the industry is dominated by plantations with palms approaching 100 years of age, it is possible that the industry could be revived through replanting schemes. However, the largest plantation in Vanuatu, PRV on Malekula, is currently looking to fell its palms to produce coco-lumber and convert to open pastures for grazing. In short, plantation copra/coconut oil production in Vanuatu is no longer considered to be economically viable.

Given smallholder commitment, a modernised industry based on replanting of senile coconuts and use of mechanised systems to extract the kernel may be viable. A small mill continues to operate in Santo using a mechanised system to produce high-value virgin oil. The fortunes of this initiative will be closely followed by the sector. However, the smallholder sector may also maintain its current swing away from coconuts/copra to kava and other higher value commodities.

There is much talk regionally of the use of coconut oil as a (partial) replacement for diesel as a fuel. Indeed, the electricity utility, Unelco, is increasing the concentration coconut oil used as mix with diesel as a fuel for its generators and many of the public buses in Port Vila run on coconut oil. However, the development of a coconut oil fuel industry is far from established. Reliable sources of oil need to be identified. This may involve increased prices paid for copra cutting or use of new extraction technologies. A factory is also required to refine the oil (esterification process) and ensure its purity before its widespread use is assured.

Finally, an independent functional and expenditure review of the VCMB is required to determine its value for money to growers in terms of income foregone in levy payments and real benefits. The coconut oil/copra production sub-sector requires immediate assessment to determine the requirement for support.

Fisheries: Unlike countries to the north, Vanuatu has a limited tuna fisheries resource, apparently because of its cooler waters. Further, reef fisheries are relatively small due to Vanuatu's limited reef area, and are already over-exploited around centres of moderate population. The estimated sustainable catch for reef fish is only 300 t annually. There are no processing facilities and exports are

minor. In 2000, Vanuatu exported 5 t of fish (frozen snapper), compared with imports of 951 t of tinned fish.

Despite this, reef fisheries provide an important source of protein for Vanuatu's coastal communities and 60% of ni-Vanuatu fish regularly for their own consumption. Given their limited scale, it is appropriate that the reef fisheries resources are retained for sustainable exploitation by small-scale ni-Vanuatu entrepreneurs and coastal communities.

Other marine products of note are trochus shells, green snails and bêche-de-mer, all of which have reasonable export potential provided that the limited resources are not over-exploited. Both trochus and bêche-de-mer have been severely over-exploited in the past and there is limited potential to increase production due to the limited reef area. Small amounts of aquarium products are regularly exported, but again, concerns exist as to the sustainability of the industry should it grow significantly. Initiatives to promote sustainable

exploitation of these industries are required to protect the resource and avoid the boom-bust cycle that has predominated in recent times. Exploitation of coconut crab and triton shells has been banned for the foreseeable future due to their endangered status.

There is also an active game fishing industry

based on Efate that generates reasonable income for modest exploitation of the available resource. This activity is closely connected with the Tourism industry, from where clients are primarily sourced.

Given this situation Vanuatu should retain its reef fishing resource for local fishing communities, which will include some small commercial fishermen, and concentrate on 1) careful regulation of other marine products, such as trochus shells, green snails and bêche-de-mer, and 2) collection of licence and catch fees from commercial tuna and game fishing vessels.

Box 3. High returns for domestically marketed pepper

Pepper can be easily grown in northern Vanuatu and is produced in small quantities by a moderate number of smallholder farmers. Return on investment is excellent, with quality dried pepper attracting around Vt1000/kg in Port Vila. This pepper is sold into the domestic and immediate regional markets (New Caledonia), which require a total of approximately 2 t annually. Once Vanuatu exceeds this domestic market demand and must sell its pepper into the global market the price paid to producers could be expected to fall to below Vt200/kg. Other commodities face similar limitations, either due to domestic market limitations or limited high end, versus bulk markets. Vanuatu's future rural growth will be best served by carefully targeting high value niche markets.

A "Silver Bullet": Vanuatu has always looked to the next big thing, the Silver Bullet to elevate the country from its trade deficit and to deliver sustainable benefits to its rural communities. Kava is as close to a Silver Bullet as a country can hope to get. Kava is grown by most ni-Vanuatu households, is high value per weight unit and, once dried, is non-perishable. It is unlikely that any new

products will be discovered that will impact rapidly and significantly on GDP in the short to medium term. Further, great care need to be exercised in extrapolating from domestic and regional market outcomes. The case study of pepper best highlights the pitfalls (see Box 3).

Another recurring mistake has been to promote commodities that have a history of failure within the country due to either a lack of economic comparative advantage or unsuitable environmental conditions. Rice is a low value crop of marginal viability even in countries with low cost labour and a long history of production (e.g., Vietnam). Rice has been unsuccessfully promoted in Vanuatu on regular occasions over the past 100 years, including in the 1970s, 1980s and 1990s. There is another attempt at its promotion currently underway. Oil palm has experienced rapid development throughout the equatorial tropics over the past 10 years as it produces high yields of oil. However, it is well established that oil palm is of very low productivity outside of its climatic range and particularly in locations affected by high winds and cyclones. Guadalcanal in the Solomon Islands is well established as the lower latitude limit for oil palm production. However, a new initiative is considering establishment of oil palm on Santo.

Scarce development dollars would be best utilised in facilitation of better quality of production and marketing of the existing products for which the country has true competitive advantages, *viz.* specific tourism products, beef cattle, kava, specific forestry products and specific organic food products.

Attachment 2:

Brief Review of the Priorities and Actions Agenda (PAA), 2006-2015

The PAA articulates GoV's high level development priorities and strategies to achieve the goal of creating "an educated, healthy and wealthy Vanuatu". The PAA integrates and prioritises policies and initiatives outlined in the CRP, Business Forum outcomes and the Rural Economic Development Initiatives (REDI) Plans for the period 2006 - 2015. The document was approved by the Council of Ministers in June 2006.

The PAA lists its main agendas for action to be: "growing the productive sector, especially agriculture and tourism; maintaining macroeconomic balance; raising public service performance; cutting costs associated with transport and utilities; and improving access to basic services such as health and education".

The PAA provides considerable background information and statements of strategic intent under the headings of:

- National Vision and Development Overview;
- Medium Term Strategic Framework;
- Private Sector Development and Employment Creation;
- Macroeconomic Stability and Equitable Growth;
- Good Governance and Public Sector Reform;
- Primary Sector Development and the Environment;
- Provision of Basic Services and Strengthening Social Development;
- Education and Human Resource Development; and
- Support Services: Infrastructure and Utilities.

The PAA does not provide an immediately implementable list of prioritised actions. Rather, Ministries must prepare their own, more detailed, strategies and plans based on the PAA. In this sense, the PAA is misnamed, and is rather a "statement of strategic intent", not a "priorities and action agenda". In its current form, the PAA does not sufficiently specifically inform Ministries and donors as to where development efforts should be targeted.

The PAA regularly refers to the need for a medium term expenditure framework (MTEF) to link policy and planning with financing and resources. However, an expenditure framework is also required for this to occur. The development of an MTEF is currently being undertaken and will be completed by October 2006.

The PAA is to be accompanied by the Medium Term Strategic Framework (MTSF), which will "guide priorities and the development of policy as well as implementation of policies and the monitoring of development outcomes". There has been considerable confusion among GoV, aid donors and the public as to the

differentiation between the PAA and the MTSF. The MTSF is expected to be a shorter, more tightly focussed document, and will prioritise a small number (2-3) of program areas within each sector.

The PAA proposes a monitoring system based on annual reports from Ministries, utilities and aid donors, and data from the NSO. Where possible MDG indicators are used as PAA indicators. Ministries are expected their own detailed indicators, as none are specified for the productive sectors.

The ADB MTSF Inception Report (April 2005) reported that the previous PAA (2003-2005) had a number of significant weaknesses. These were:

1. The PAA mixed macro-level strategies, and macro and micro-level interventions;
2. The PAA lacked focus, overall strategic direction and clear definition, and prioritisation of issues and strategic actions, and
3. Monitorable performance targets were not included.

The current PAA has gone some way a macro-level approach, and has included a range of general performance targets. However, there remains a lack of prioritised strategic actions. The result is that the current document will require considerable effort on behalf of the Ministries to determine specific actions. Further, the lack of prioritisation leaves the Ministries free to include almost any initiative as being consistent with the PAA.

These issues will be addressed in the near future through the production of a second part to the PAA, which will include 2-3 major programme priorities for each sector. This should indicate where GoV wants donors to assist in the short to medium term. This should go some way to addressing point 2 above.

The lack of a national agriculture policy and key strategic planning instruments within the Ministry of Agriculture, Forestry, Fisheries and Quarantine is a significant impediment to the development of a detailed, indigenously driven PAA.

For a country with high high-risk social behaviour²⁹, HIV/AIDS rates only a single paragraph in the PAA and is not listed under "Priorities and Strategies" or as a performance indicator. (The Vanuatu National Council of

Box 4: HIV/AIDS in Vanuatu

A recent Pacific survey of sexually transmitted diseases showed both high risk behaviour and high prevalence of STIs in Vanuatu, although the incidence of HIV/AIDS is currently very low. The study reported:

- High rates of multiple and casual partners
- Low use of condoms by youth: 37% at last sex with a non-regular partner
- 13% of pregnant women tested positive for Chlamydia
- Only 26% of youth correctly understood how HIV is transmitted.

²⁹ WHO/SPC (2005) Second Generation Surveillance Surveys of HIV, STIs and Risk Behaviours in Six Pacific Island Countries

Women's Strategic Plan (2006- 2010) also makes no reference to HIV/AIDS).

Attachment 3: GoV Development Policy & Planning Mechanisms

The Comprehensive Reform Program (CRP) was initiated by the GoV in 1997 to address ailing government systems and introduce improved development planning and economic management. Through the CRP, a wide range of structural reforms were undertaken, including the corporatising or privatising of SOEs, establishing a Director General (DG) level of executive governance within each Ministry, reducing the number of ministries, reducing the size of the public service and other initiatives. A core objective of the CRP was improved economic growth through stimulation of private sector investment. To extent to which the CRP has achieved its objectives will be assessed in an up-coming review (July/August/September 2006).

DESD and DESP: The primary planning institution established under the CRP was the Department of Economic and Social Development (DESD). Initially, DESD comprised economic and sector planners, a Strategic Management Unit, and the Aid Coordination Unit. Assisted by long term technical support, DESD was able to drive policy development across ministries. Located in the Ministry of Finance and Economic Management, DESD was tasked with:

- Providing policy advice to the Minister of Finance and the Ministerial Budget Committee;
- Liaising with line ministries and the Budget Division of the DoF to evaluate development of expenditure proposals in the context of the annual budget and recurrent commitments;
- Preparing benefit/cost analyses on development proposals for the Minister of Finance and the Ministerial Budget Committee;
- Assisting relevant ministries to identify funding sources for approved development projects;
- Providing a monitoring and evaluation function for review of development initiatives and report to relevant Ministries/Ministers; and
- Providing evidence-based policy advice to GoV on development opportunities, constraints and options for the various sectors.

In 2003, DESD was fragmented through a government restructuring initiative. The strategic management unit was moved to the Prime Minister's Office as the Department of Strategic Management (DSM), and the Aid Management Unit was moved to the Department of Foreign Affairs as the Development Cooperation Division (DSD). The effectiveness of all three organisations has been severely diminished as a result. DESD became the Department of Sector and Economic Planning (DESP), but has since been constrained by poor continuity of Directors,

Acting-Directors, short-term appointments to other key positions and various long term vacancies. Current vacant positions include the Director, 2 Economic Analysts and a Database Manager. Given the difficulty in retaining staff, it is most important that the Public Service Commission responds rapidly to fill vacancies, thereby allowing the in-built succession mechanisms to function. (Economic Analysts are junior planning staff with potential to replace departing Sector Analysts). In addition, DESP has received *ad hoc* and/or uncoordinated assistance from donors.

The Priorities and Actions Agenda (PAA) is reviewed in Attachment 2. The PAA is designed to identify and sequence the key actions needed to realise the GoV's development intentions as defined in the CRP Matrix, the Business Forum Matrix and the REDI Plans. The PAA is prepared by DESP.

DSM is located in the Office of the Prime Minister and was established to provide strategic management to the PM in development of policy and to provide a secretariat role for the Central Agency Committee. DSM nominally has 4 staff, (Director and 3 Policy Coordinators) although 2 positions are currently vacant. There is currently a plan for DSM to amalgamate with the PM's Corporate Services Department.

The key development policy mechanism for the CRP is the CRP matrix. The CRP Matrix is prepared by DSM and details initiatives, projects and other proposed interventions. The precise relationship between the CRP Matrix, the PAA and the GIP is unclear at present. The CRP Matrix has a three year outlook, but is revised annually through CRP summits convened by DSM.

The Prime Minister's Advisory Group (PMAG), comprised of private sector, NGOs and specific DGs was established to provide independent advice to the PM. DSM provided a secretariat role to PMAG until it was disbanded some years ago due to poor attendance of members. PMAG should have functioned much like the proposed "think tank", but was not facilitated and was poorly resourced.

DCD is a small division within DFA, having two local staff, the Head and an information systems/database manager, and three expatriate advisors, provided by JICA, France and EU, to manage their respective development assistance programs. The last donor coordination meeting was held in 2002, (convened by the Aid Management Unit of DESP). DCD maintains its own version of the GIP database, which is not reconciled with the DESP GIP database.

Rural Economic Development Initiative (REDI): The REDI initiative was first implemented in TAFEA province in 1999 as a networked partnership system private, public and community stakeholders for the coordination of planning and development. The central principle was the promotion of economic growth in rural areas by providing community stakeholders with the capacity to identify and articulate their needs and the required support to achieve these needs through economic development. The Provinces are assisted in developing their annual programs by national, provincial and area Technical Advisory Groups

(TAGs), of greatly varying capacity. The National TAG is comprised of key ministry DGs.

Whilst it is accepted that REDI initiatives are very small and limited in scope and economic impact, the REDI initiative plays a potentially important role in linking national planning organisations with area level, community-based planning.

VCCI Annual Business Forums: The Vanuatu Chamber of Commerce and Industry (VCCI) holds annual business forums to develop its Business Forum Matrix to support the private sector. These seem to be very much targeted at smallholder farmers at present. A refocus on facilitating micro-entrepreneurship through policy advice would be appropriate, starting with assessment of business licence fees that deter business start-up.

A further obvious role for VCCI is in facilitating producer-merchant relationships. The Nucleus Enterprise approach successfully adopted by Venui Vanilla and the FSA may be successfully replicated for other smallholder crops such as kava and root crops. The POPACA Project has established similar systems that are currently functioning for cocoa and coffee.

Council of Chiefs (CoC): The strength of the Vanuatu chief system and its apex organisation, the Malvatumauri, is potentially a powerful force in future economic development and in maintenance of social stability. The CoC play an important role in dispute settlement and would be expected to be a powerful force in the event of future social unrest. The potential involvement of the CoC in high level policy development is currently under-utilised and requires further consideration.

Attachment 4: Concept Notes for Short- to Medium-term Development Initiatives

The following concept notes have been prepared based on a rapid analysis of the current status of the productive sectors, examination of key planning mechanisms, and a limited number of discussions with key stakeholders. It is expected that the Governance for Growth program will ultimately facilitate more indigenously driven and holistic development planning recommendations, however it will be many months before this process is functional.

The concepts focus on support for broad-based growth of Vanuatu's productive sectors, and therefore necessarily encourage ni-Vanuatu and provincial participation in economic development. They are provided as a starting point from which comprehensive designs can be developed. Importantly, the consultants generating the concepts are not experts across all of the fields of interest, hence the necessity for engagement of appropriate national and international expert technical specialists to undertake further consultation with stakeholders, comprehensively assess feasibility, and formally develop concepts into contractible designs.

Concept Note 1: DESP Institutional Support

Purpose:

Improve capacity of the Department of Economic and Sector Planning to redefine and effectively conduct its core functions.

Problems to be addressed:

The primary planning institution established under the CRP was the Department of Economic and Social Development (DESD). Initially, DESD comprised economic and sector planners, the Strategic Management Unit, and the Aid Coordination Unit. Assisted by long term technical support, DESD was able to drive policy development across ministries. Located in the Ministry of Finance and Economic Management, DESD was tasked with:

- Providing policy advice to the Minister of Finance and the Ministerial Budget Committee;
- Liaising with line ministries and the Budget Division of the Department of Finance to evaluate development of expenditure proposals in the context of the annual budget and recurrent commitments (the Government Investment Program);
- Preparing benefit/cost analyses on development proposals for the Minister of Finance and the Ministerial Budget Committee;
- Assisting relevant ministries to identify funding sources for approved development projects;
- Providing a monitoring and evaluation function for review of development initiatives and report to relevant Ministries/Ministers; and
- Providing evidence-based policy advice to GoV on development opportunities, constraints and options for the various sectors.

In 2003, DESD was fragmented through a government restructuring initiative. The Strategic Management Unit was moved to the Prime Minister's Office as the Department of Strategic Management (DSM), and the Aid Management Unit was moved to the Department of Foreign Affairs as the Development Cooperation Division (DSD). The effectiveness of all three organisations has been severely diminished as a result. DESD became the Department of Sector and Economic Planning (DESP), but has since been constrained by poor continuity of Directors, long-term appointment of Acting-Directors, short-term appointments to other key positions and various long-term vacancies. Further, no revision of function for the newly created DESP was undertaken and a functional analysis is long overdue.

Current vacant positions include the Director, 2 Economic Analysts and a Database Manager. Given the difficulty in retaining staff, it is most important that the Public Service Commission responds rapidly to fill vacancies, thereby allowing the in-built succession mechanisms to function. (Economic Analysts are junior planning staff with potential to replace departing Sector Analysts). It is an urgent priority to fill all vacant positions with permanent staff.

A further complication to the effective functioning of DESP is that it has received *ad hoc* and/or uncoordinated assistance from donors. This situation has not necessarily emanated from donors, but it is donors that are ultimately able to provide coordination of assistance. The very recent request for termination of the ADB-Vinstar technical assistance may bring the issue to a head. Clearly, the Acting Director and DESP staff acknowledge that assistance is required, but communication among MFEM, DESP and donors is required to provide the right kind of assistance.

It is anticipated that a new Director will be appointed to DESP in the very near future. As no internal applicants are expected for the position, it is unlikely that the appointed Director will have a thorough understanding of DESP processes and deliverables. Given this situation, it will be essential that the appointed Director has high quality technical assistance over the first 6 months of his/her appointment. ToRs have been drafted for TA to support the Director (DESP) and are currently with AusAID for funding consideration.

The Economic Planning Unit is currently represented by the Acting Director and one junior planner. This section needs to have all vacancies filled immediately. ToRs have been drafted for a macroeconomist to assist the Economic Analysts and are currently with AusAID for funding consideration. Further discussion is required to determine whether a macroeconomist is required or whether a micro-economist would be preferable.

There is currently almost no monitoring and evaluation by DESP of development initiatives. Technical assistance should focus on development of effective and efficient systems to monitor progress and adjust implementation approaches as required. DESP's budget should be sufficient for key sector planners to meet with provincial SGs regularly to conduct monitoring and evaluation of current development initiatives and assist with planning of future initiatives. Planners currently have limited ability to assess development initiatives spatially. More effective use of VANRIS by line ministries is required for this purpose. Donors should consider providing direct support for this activity should DESP's budget be unable to meet this need.

As the Governance for Growth initiative begins implementation it is expected that it will subsume this immediate support.

Activities:

- Undertake a Functional Analysis of DESP and make recommendations for appropriate functions and job descriptions;
- Assist MFEM as required to fully staff DESP and plan for provision of supporting technical assistance. Effective collaboration and consultation with DESP/MFEM and among donors is essential to avoid past/current mistakes. Investigate potential to engage DESP Director on a 3 year contract at negotiated salary and specific performance objectives;
- Provide technical assistance to DESP to support the Director and the Economic Planning section. This will include development of economic analysis and monitoring and evaluation skills.
- Improvement of skills in routine monitoring, evaluation, reporting and adjustment of development initiatives (including the publication of an annual Development Report). This will include improved linkages with NSO and line ministries and use of planning tools such as VANRIS.

Expected Outcomes:

- DESP functions and deliverable redefined according to current needs and organisational structures;
- DESP facilitating the regular provision of policy advice to guide development planning;
- DESP monitoring and evaluating development initiatives and providing assistance to implementing agencies in improving development outcomes;
- DESP providing briefings on imminent problems to minimise negative impacts.

Institutional Arrangements:

Conducted within DESP, with consultation with MFEM and DSM.

Geographical Scope:

MFEM.

Timeframe and Duration:

To be determined in consultation with DESP Director. Consider continuation of support over a 5-year period depending on needs (being subsumed by the Governance for Growth project once it begins implementation).

Indicative Budget:

Unknown.

Immediate action required:

Donors, particularly ADB, AusAID and NZAID, to agree on processes to provide fully coordinated support for DESP.

Donors to meet with DG of MFEM and Acting Director of DESP to confirm requirements and terms of reference for provision of assistance to DESP.

Persons to be consulted:

Fred Hosea, Acting Director, DESP

Thomas Bangalini, Natural Resources Sector Analyst, DESP

Simeon Athy, Director General, Department of Finance and Planning

Mark Bebe, Public Service Commission

Gregoire Nimbtik, Department of Strategic Management (previously DESP)

John Colwick, NZAID (previously DESP)

Leith Veremaito, AusAID

Willie Toa, NZAID (previously DESP)

Other private and public sector stakeholders

Concept Note 2: Outer Islands Tourism Development

Purpose:

To increase tourism outside of Port Vila through development and promotion of adventure, cultural and eco-tourism products and markets.

Problems to be addressed:

Vanuatu has comparative advantages in international tourism, having pristine tropical ecosystems, beautiful scenery and interesting and friendly cultures. The industry is sold internationally based on these images although, interestingly, most are found beyond Port Vila, where the tourism industry is currently centred. The deregulation of Vanuatu's airways in 2003 led to a reduction in airfares from the major destinations (Australia and NZ) and an immediate spike in tourist numbers as Pacific Blue and other regional carriers entered the market. The resort sector is also a major employer, accounting for 12% of total employment positions in 2002. An increase in the number of trained staff to support the expanding tourism industry is currently a priority. There is no doubt that the resort sub-sector has a significant positive impact on Vanuatu's economy. However, the benefits accruing from Vanuatu's Port Vila-based tourism industry are eroded by high "leakage" rates (reliance on imported goods and services and repatriation of profits) and very limited potential for broad-based participation.

There is increasing evidence that niche marketing to adventure, eco and back-packer tourists has significant potential to deliver broad-based benefits to Vanuatu. These tourists tend to stay longer and spend more money, particularly outside of the major centres. With appropriate support, provincial tourism can also directly benefit the agriculture, forestry and fisheries sectors through supply of inputs to tourism operations and direct sales to tourists. These are expanding sub-sectors of tourism internationally, but are currently poorly serviced by Vanuatu's tourism promotion agencies. A growing body of "pro-poor tourism" experience can now be drawn on to maximise broad-based benefits.

The development of outer-island (outside Port Vila) tourism requires a combination of improved tourism services and products and a targeted marketing campaign. The provincial adventure tourism market is currently heavily focussed on the Yasur volcano on Tanna and scuba-diving on the President Coolidge on Santo, and a limited number of high profile events, such as the land dives on Pentecost. Most of these can be done in a single day, therefore limiting benefits to provincial communities. There have been attempts to develop other adventure tourism products, such as village life and culture, jungle treks, mountain climbs, alternative scuba-diving sites and sporting events such as the Segond Canal swim. However, the majority of these have not been supported by concurrent development of appropriate quality accommodation and other tourism services, or specific promotional campaigns. Ni-Vanuatu tourism

initiatives generally: fail to meet the expectations of clients for accommodation and services; have unrealistic expectations of cash flow; have limited concept of expected visitor numbers; and miss opportunities due to poor communications with potential clients. Capacity development is required to overcome these constraints to development.

The development of outer-island (outside Port Vila) tourism requires a combination of improved tourism services and products and a targeted marketing campaign. There is limited understanding, particularly among ni-Vanuatu bungalow owners, regarding the appropriate standard of services required by clients, including accommodation standards, food requirements and hygiene standards. For example, a well-designed wash room build from local materials is likely to be preferable to a poorly constructed Western facility. Capacity development should also cover interactions with local communities to maximise the benefits of the tourism presence and the potential negative impacts of aid, including HIV/AIDS. Concurrent development of targeted promotional campaigns would result in significant increases in outer-island tourism.

The Vanuatu Island Bungalows Association was established to develop the ni-Vanuatu provincial tourism sector. VIBA's network includes the Vanuatu Tourism Office (VTO), the National Tourism Development Office (NTDO), the Department of Co-operatives, the Vanuatu Chamber of Commerce and Industry (VCCI), the provincial councils and, recently the EU-funded tourism and hospitality training initiative, VATET. VIBA's aims and objectives are to:

- Represent members (30) in any statutory or business matters
- Develop business opportunities for all members
- Improve quality, service and skills of VIBA members staff
- Improve marketing of small rural bungalows

VIBA promoted its clients through a shop-front called Island Safaris (IS). For various reasons, IS was not a financial success, and these issues that require further detailed investigation. There are now private sector operators able to perform the booking functions provided by IS. However, further capacity development is required to improve the performance of the sub-sector, as suggested in the following activities and expected outcomes.

Previous donor support for the sub-sector has been minor, poorly designed and piece-meal in delivery. To the knowledge of the author, approximately Vt27,000,000 has been provided across 7 small projects since 1997, with funds being used for computers, promotional materials and marketing, life jackets, business management and book-keeping training, VIBA standards and accreditation systems, travel and workshops. More emphasis on feasibility and design is required to improve the impact of future investments. This will

necessarily involve gradual transfer of responsibilities to the private sector, the ultimate drivers of tourism.

Activities:

- Assist tourism entrepreneurs to assess the viability of outer islands tourism business investment opportunities and to develop business plans and financial management systems.
- Assist outer islands tourism enterprises to design appropriate accommodation and other tourism services and products for the target clients.
- Provide opportunities for capacity development of local labour through tourism training at hotels and VIT in Port Vila.
- Conduct research to identify target clients and develop appropriate promotional materials and marketing campaigns.
- Assist outer islands tourism enterprises to directly and collaboratively market their products to potential clients, including linkages to and co-marketing with Vila-based tourism enterprises.
- Conduct training for outer islands tourism enterprises and their neighbouring communities to: reduce negative impacts of tourism on traditional cultures and livelihoods (including HIV/AIDS); and maximise benefits to the local communities by sourcing inputs and services locally.

Expected Outcomes:

- Appropriately designed and constructed tourism services in the outer islands.
- Viable tourism businesses functioning in the outer islands resulting in increased money flows and improved livelihoods.
- More harmonious integration of tourism initiatives with indigenous cultures.
- Higher direct and indirect participation of ni-Vanuatu in the outer islands' tourism sub-sector.
- Measurable and continuing increases in visitor numbers to the outer-islands over implementation of the project.

Institutional Arrangements:

Given the financial problems associated with VIBA and its shop-front, Island Safaris, considerable thought needs to go into institutional arrangements for supporting initiatives. The potential of involving committed private sector stakeholders should be encouraged as this will improve long-term sustainability.

Geographical Scope:

Concentrate initially on locations with better developed adventure, cultural and eco-tourism products, but expand to all provinces over time.

Timeframe and Duration:

Unknown. (Tentatively 5 years with increasing hand-over to ni-Vanuatu counterparts commencing from end year 2)

Indicative Budget:

Unknown (Tentatively NZ\$2.5 million, front-loaded to cover higher international consultant inputs in years 1 and 2)

Immediate action required:

Feasibility study to be undertaken by pro-poor/adventure/cultural/eco-tourism specialist and local tourism sector expert, concentrating particularly on reasons for limited success of past initiatives and potential to overcome these. Proceed to design if feasible.

Persons to be consulted:

Olivier Fidelio, Vanuatu Island Bungalows Association (President)
John and Silvana Nichols – Vanuatu Hotels Ltd (Owner/Manager)
Harmon Chellen, VATET (Team Leader)
Linda Kalpoi, Vanuatu Tourism Office (General Manager)
Robyn Redknap, Vanuatu Hotel and Resort Association (Chairperson)
Kalmer Vocor, Lonoc Beach Bungalows (Owner/Manager)
Mariane Numake, Evergreen Bungalows, Tanna (Owner/Manager)
Gilles Bourdet, Air Vanuatu Domestic
Taso, Paradise Sunset Bungalows, Epi (Owner/Manager)
Robert Avio, National Tourism Development Office
David Miles, Airports Vanuatu Ltd
Other private and public sector stakeholders

Concept Note 3: Restructuring and strengthening of the Department of Agriculture and Rural Development

It is acknowledged that the restructuring of Vanuatu's Department of Agriculture and Rural Development is not a matter to be taken lightly. The current consultancy has undertaken a short visit to Vanuatu, examining a wide range of productive sector issues. During this time, the effectiveness of DARD was regularly raised as an important issue, but not investigated in detail. The following is therefore a basis from which more serious and detailed investigations should proceed.

Tentative purpose:

To restructure and strengthen DARD so that it can effectively and efficiently support agriculture and rural development through policy development and strategic planning, sector monitoring, coordination and research, extension and training services, and provision of information services.

Problems to be addressed:

DARD is currently suffering from lack of resources, capacity, and an understanding of its role in supporting agriculture and rural development in Vanuatu. DARD was diminished in capacity by the public servants' strike of 1993 and again by the CRP restructuring initiatives of the late 1990s. No comprehensive restructuring plan was implemented to guide DARD to function effectively in its depleted form. As a result, extension officers suffer from low morale and productivity and the public image of DARD is negative. The Acting-Director is fully aware of the issues facing the Department and has a vision for a revitalised DARD facilitating the growth of agriculture using modern development approaches. DARD should be supported to appropriately assist agriculture and rural development in Vanuatu.

Currently, salaries comprise almost 70% of the DARD budget, leaving little money for field activities. The Vanuatu Agriculture Research and Training Centre (VARTC) soaks up a major component of available resources. The Vanuatu Agricultural College currently has an independent budget, but this may change in the future. The most appropriate use of the VAC facility also requires investigation. There is considerable evidence from elsewhere in Melanesia that community based training using local trainers is far more effective and less socially disruptive than long-term live-in training systems. The impact of VAC on DARD's resources needs to be carefully monitored.

Resource intensive methods of service delivery, as were promoted in the recent past, where Field Assistants (FAs) with superior knowledge and resources undertook one-on-one visits to farmers, are no longer possible. However, no alternative methods of operation have been developed. Not surprisingly, many

FAs have not been able to adapt to function effectively in the new resource poor environment.

A process of dialogue is required to determine the future functions and supporting organisational structure of DARD. There is evidence that agriculture departments in small developing countries need to provide more services than would be sensible in larger countries due to the lack of private sector service provision. The extent to which this is true in Vanuatu needs to be determined.

The POPACA Project has an objective of strengthening DARD and VARTC but little has happened to date. POPACA envisages DARD working to facilitate, supervise development and extension, and undertake monitoring and evaluation, rather than providing hands on implementation. This vision is in line with current thinking on the role of national agriculture departments. Based on regional best practice, DARD may eventually provide services such as:

- Provision of policy and strategy advice to national and provincial governments regarding subsistence, semi-commercial and commercial food security, farming and commodity systems. This requires effective collaboration/interaction with ministries of trade, lands and finance;
- Provision of leadership in agriculture and rural development planning in collaboration with forestry, fisheries and tourism sectors. This would include effective use of GIS systems;
- Conduct of applied research and evaluation of new varieties and systems derived from regional research organisations;
- Coordination of provincial extension, marketing, training and information services, concentrating on better cooperation with FSA, VIT, NCW and other public and private service providers; and
- Coordination of monitoring and evaluation and information delivery systems for agriculture and rural livelihoods.

Activities:

- Working with the Acting Director of DARD, senior DARD staff and key industry stakeholders, assess the current operations and effectiveness of DARD in supporting agriculture and rural development in Vanuatu;
- Consult widely to gain understanding of services needed to be provided by DARD, recognising that the level of government support is likely to be greater than that expected of larger economies with more active private sector service provision. This will also require assessment of service delivery from the private sector and other GoV departments;
- Draft a specific range of services to be provided by DARD to support agriculture and rural development and develop appropriate organisational and cost structures for DARD;

- Assess the potential and cost effectiveness of collaborating with regional agricultural research and marketing information institutions; and
- Develop a restructuring plan, including redundancy provision if necessary, to support new functions and organisational structure.

Expected Outcomes:

DARD will be strengthened to improve its ability to:

- Provide policy and strategy advice to national and provincial governments regarding subsistence, semi-commercial and commercial food security, farming and commodity systems;
- Coordinate monitoring and evaluation and information delivery systems for agriculture and rural livelihoods;
- Provide leadership in agriculture and rural development HRD planning in collaboration with forestry, fisheries and tourism sectors;
- Improve facilitation and coordination of provincial extension, training and information services, concentrating on better cooperation with FSA, VIT, NCW and other service providers; and
- Collaborate with DoF and Department of Lands, particularly at provincial level in encouraging application of land use planning and under-utilized information resources into the REDI process.

Institutional Arrangements:

Conducted within MAFFQ, but including consultation with industry stakeholders, DESP, and ministries associated with land, labour, trade and tariffs etc.

Geographical Scope:

All provinces.

Timeframe and Duration:

Unknown (Tentatively 1 year)

Indicative Budget:

Unknown. (Tentatively NZ\$500,000. Consider additional direct budgetary support over a 3 year period to establish new organisation structure)

Immediate action required:

Consult with DG of MAFFQ, Acting Director of DARD and GoV and industry stakeholders to assess requirement and acceptability of a restructuring and strengthening program for DARD. Determine next steps to move towards feasibility and design study.

Persons to be consulted:

James Selwyn Wasi, Acting Director, DARD
Jeffrey Wilfred, Director General, MAFFQ
Thomas Bangalini, Natural Resources Sector Analyst, DESP
Francois Japiot, Team Leader, POPACA Project
Frazer Bule, Principal Research Officer, DARD
James Mackie, Principal Extension Officer, DARD
Principal Extension Officers in provincial centres
Charles Rogers, Director, Farm Support Association
Peter Kau, Farm Support Association
President/representatives, Syndicat Agricole
John Aruhuri, General Manager, Vanuatu Chamber of Commerce and Industry
Benuel Tarilongi, Director, VQLD
George Pakoasongi, Director, Provincial Affairs
Other private and public sector stakeholders

Concept Note 4: Improved Export Certification and Marketing Standards

Purpose:

To protect current, and facilitate broad-based expansion of, agricultural export markets through provision of creditable, cost-efficient certification and marketing standards

Problems to be addressed:

As a price taker selling into fickle markets, Vanuatu must maintain high quality product standards. To date, the development of quality standards has been relatively uncoordinated, with VCMB providing minimum standards for copra and cocoa (and to some extent for kava) and private exporters providing often highly variable standards for other commodities. For example, there has been some concentration of effort in ensuring quality standards for vanilla through the marketing system operated by Venui Vanilla and the FSA. Ideally, similar industry-imposed quality standards are required for other products. However, Vanuatu's commodity traders tend to be immature and opportunistic in their approach. During the vanilla boom in 2002, a number of novice traders entered the market and purchased and on-sold vanilla with little regard for quality. Vanuatu's vanilla industry is based on the sale of a high quality product into high-priced markets. Not surprisingly, the disregard for quality by some traders during the boom period had negative impacts on the market. Where the private sector is currently unable to sensibly regulate itself, some form of government regulation of quality standards, backed by government or private inspection services, may be required to safeguard Vanuatu's export industries.

The current kava marketing situation is a further example of the broader issue of export quality standards for Vanuatu's agricultural produce. The deregulation of kava marketing in 1997 greatly increased both export volumes and income for Vanuatu's producers (see Box 2). However, there was also a serious negative side to deregulation. With the high demand for kava, inferior quality wild varieties were marketed, often by unknowing (and uncaring) traders. At best, these varieties have low concentrations of the active compound, "kava-lactones", so that they have little medicinal or narcotic effect. At worst, these wild kavas contain additional toxic alkaloids that may have serious health consequences with prolonged use. Additionally, some traders began shipping kava that was not properly dried, resulting in spoilage at destination. Most recently (June 2006), a container sent to Fiji in was rejected for this reason.

Kava, in particular, requires quality standards to be effectively regulated to regain the previous high reputation afforded to the Vanuatu product. This may require the introduction of chemical analysis to determine kava--lactone content

and presence of toxic alkaloids. Trace-back systems may also be required, so that specific producers can be identified. Given improved quality standards, there is reasonable potential to increase production and revenue from export sales of Vanuatu's kava, although recent high levels of production in Hawaii are a threat. The achievement of organic certification for Vanuatu's kava, in combination with the introduction of minimum quality standards for moisture content and kavalactone concentration, are required to safeguard current export markets and move towards future expansion.

Other products also require development of quality standards. A regional FAO project recently worked with traders and DARD in Vanuatu to develop quality standards for nangae (*Canarium*) nut. POPACA has established quality standards for cocoa and coffee. FSA/Venui Vanilla has established quality standards for vanilla and some spices. Other standards no doubt exist. The groundwork started with these initiatives should be built on to develop a more comprehensive range of standards, preferably with self-regulation by industry backed by private inspection services, with spot compliance checks by government. Furthermore, the FAO project offers potential to develop regional standards for some products.

Trace-back systems are now widely established among exporting countries. Simply, this is the ability to trace a product back to its point of origin. It enables issues of product quality and pests and diseases to be rapidly addressed and builds in additional purchaser confidence in product quality. There is no doubt that trace-back mechanisms will be a challenge in Vanuatu due to the prevalence of numerous, low volume producers spread across diverse locations.

Associated with this is the need for effective sanitary and phytosanitary systems. The NZAID-funded VQIS strengthening project has been completed. However, VQLD has been unable to maintain the necessary level of support required to effectively maintain quality biosecurity, quarantine and export certification standards. This typifies the fate of short-term project initiatives in the agricultural sector. With no current capacity to reuse fees earned from inspection, incineration and fumigation service provision (CRP recommendation that departments are centrally funded), there has been a decline in quarantine effectiveness. Maintaining favourable animal disease and plant disease status (particularly freedom from major fruit flies and diseases of livestock) is critical.

A further important issue to address is the future of the VCMB. Numerous studies have reported the need to review the utility of VCMB in provision of cost-effective marketing services, with most arguing for its cessation. The recent "Baseline Study of the Trade Situation and Business Environment in Vanuatu" has reviewed this issue in some detail and should be referred to for additional information. It is expected that private-public linkage systems, including compliance checking mechanisms, will be far more effective and cost-efficient in providing regulation of standards and marketing.

Activities:

- Assess the potential to link with the FAO regional quality standards project to continue development of standards, including regional standards.
- Examine the requirement for establishment of trace-back systems for specific commodities and how these might be developed and establish trace-back systems where possible. (The system used for vanilla could be used as a model).
- Examine the potential for development of industry-driven regulation and government or independent inspection services, including compliance checking mechanisms and develop these as appropriate. (Suggest using kava as a model commodity).
- Examine options for improving effectiveness and sustainability of quarantine services.
- Establish requirement for standards to be legislated and systems for enforcement. This must include an assessment of the role of VCMB in provision of cost effective regulation of commodity export and marketing standards.

Expected Outcomes:

- Minimum export and domestic quality standards developed for agricultural commodities.
- Industry-driven adoption of minimum standards and (possibly) self-regulation, with effective compliance assurance systems.
- Trace-back systems developed where possible.
- More effective and sustainable quarantine services.
- Appropriate legal requirements adopted, including the future role, if any, for VCMB.

Institutional Arrangements:

Not straight-forward. Possibly within VQLD. Needs to be determined in consultation with stakeholders (MAFFQ, DESP, MoT, VQLD, DARD/POPACA, producer organisations, private sector, etc).

Geographical Scope:

All provinces.

Timeframe and Duration:

Unknown (Tentatively 3 years)

Indicative Budget:

Unknown (Tentatively NZ\$2.0 million)

Immediate action required:

Consult extensively with government and industry stakeholders to determine feasibility. Proceed on the basis of feasibility study.

Persons to be consulted:

Benuel Tarilongi, Director, VQLD

James Selwyn Wasi, Acting Director, DARD

Jeffrey Wilfred, Director General, MAFFQ

Thomas Bangalini, Natural Resources Sector Analyst, DESP

Francois Japiot, Team Leader, POPACA Project

Pierro Bianchessi, Venuei Vanilla

Frazer Bule, Principal Research Officer, DARD

James Mackie, Principal Extension Officer, DARD

Charles Rogers, Director, Farm Support Association

Peter Kau, Farm Support Association

President/representatives, Syndicat Agricole

John Aruhuri, General Manager, Vanuatu Chamber of Commerce and Industry

Commodity exporters including VCMB, kava, cocoa, coffee, livestock, rootcrops exporters

Other private and public sector stakeholders

Concept Note 5: Smallholder Cattle Production and Marketing

Purpose: To increase the sustainable production and income of smallholder beef cattle farmers through improved market linkages and access to information and inputs.

Problems to be addressed:

Vanuatu enjoys a fortunate animal health status, with very few significant animal diseases, and a benign climate well suited to extensive low input livestock farming systems. Beef cattle production has been widely conducted by ni-Vanuatu and expatriate farmers for over a century now and production systems are generally well understood. As a result, beef-cattle farming is an important part of Vanuatu's economy, supporting formal and informal domestic and export markets.

Vanuatu's beef industry has recently entered a period of expansion, with various markets being opened at greatly improved prices compared with previous years. Despite this, there remain many capacity issues hindering growth and particularly, participation of the smallholder sector. Cattle production is limited by unreliable and expensive transport, a lack of credit for rural farmers, and limited government and private sector support services.

The Vanuatu Quarantine and Livestock Department (VQLD) has produced a comprehensive report on the state of livestock industries and made wide-ranging recommendations for development of the livestock sector. These include:

- Numerous initiatives to meet export market requirements including meat residue testing, improved ability to survey for animal diseases, organic certification, and brand development;
- Addressing abattoir/processing issues of processing and health standards, the high costs of electricity, transport and stevedoring costs, meat processing and improving standards; ensuring permanency of meat inspection services;
- Developing regulations to control live cattle exports to provide transparency and ensure that off-take does not exceed sustainable supply;
- Facilitate marketing of smallholder cattle through private sector marketing linkages and road and sea transportation and development of local butcheries;
- Support for improved smallholder production of poultry and pig production; and

- Improved production of smallholder and large commercial ranches through improvement of pastures, animal genetics and production systems.

The large commercial beef sector has been functioning relatively effectively (at least on Efate), and as a consequence has been able to negotiate assistance for abattoir improvements, support for animal health initiatives, development of organic certification and access to high value markets. These initiatives should continue to be supported by GoV, donors and the private sector.

In addition, there is potential for pig and poultry initiatives to link with the ACIAR projects currently being implemented in PNG and the Solomon Islands to address village poultry production. The FSA have also made significant advances in developing effective feeds based on low cost, locally available by-products. These initiatives are also worthy of support.

Initiatives that directly encourage smallholder engagement in the beef cattle are required to maximise broad-based participation, but currently are attracting only minimal support from donors. Inadequate GoV funding has greatly limited the ability of the VQLD to assist the smallholder sector and it is here that greatest donor impact can be achieved in supporting broad-based sector growth. A series of development projects supported smallholder beef cattle production in the late 1980s and early 90s, so that by 1993 50% of the Santo abattoir's throughput of 7-9 containers/month was provided by smallholders. Currently, the abattoir processes 2-3 containers of beef per month, of which less than 5% is derived from smallholder producers. The decline was associated with the withdrawal of government services for transport (cost-recovery) marketing logistics and decreasing returns for cattle sold. Interestingly, private transport businesses were functioning concurrently with government transport, but were far less efficient and reliable once the range of government services was withdrawn.

An important component of previous support was the use of revolving funds to provide fee-for-service transportation and improved genetics. The ability to reintroduce revolving fund systems needs to be assessed. The appropriate use of slaughter levies and export licence fees also requires assessment.

Currently, the EU is providing a small amount of support (Vt2.0 million) through the POPACA project. The potential to expand this initiative is currently being discussed. NZAID is supporting the development, printing and delivery of existing and new extension materials for animal production (Vt7.0 million). A range of additional activities should be considered to reinvigorate the smallholder beef industry.

Activities:

- Expand current POPACA-funded initiatives linking commercial producers with smallholders for marketing and transportation of smallholder cattle.

- VQLD to facilitate smallholder groups to improve transportation and marketing of cattle.
- VQLD to facilitate extension services to provide accurate advice regarding improved pastures, management, herd dynamics, improved genetics and market access.
- Production of extension and training materials through access to regional and previously developed materials, and development of new or upgraded materials where necessary.
- VQLD to facilitate commercial sector linkages with smallholder producers for distribution of improved breeding stock.

Expected Outcomes:

- Improved capacity of VQLD to facilitate production and marketing of smallholder cattle, including improved pastures, herd dynamics, improved genetics, market access and sale prices.
- Increased number of smallholder producers accessing formal and informal markets.
- Increased production and income from smallholder beef cattle, including more smallholder cattle being sold as store cattle for fattening and, where appropriate, meeting top grade fat cattle specifications.
- Improved commercial sector linkages with smallholder producers for transportation and marketing of cattle.
- Improved commercial sector linkages with smallholder producers for distribution of improved breeding stock (bulls).

Implementing organisation:

Vanuatu Quarantine and Livestock Department

Geographical Scope:

Initially Santo, Malekula and Epi, increasing over time to all islands with significant cattle numbers.

Timeframe and Duration:

Unknown. (Tentatively 5 years).

Indicative Budget:

Unknown. (Tentatively NZ\$5.0 million. Combination of TA and, possibly, direct support)

Immediate action required:

Consult with DG of MAFFQ, Director of VQLD and GoV and industry stakeholders to assess feasibility and refine concept. Proceed on the basis of feasibility study.

Persons to be consulted:

Benuel Tarilongi, Director, VQLD
Dale Hamilton, Chief Veterinary Officer, VQLD
Livestock Officers, VQLD
Thomas Bangalini, Natural Resources Sector Analyst, DESP
Francois Japiot, Team Leader, POPACA Project
James Selwyn Wasi, Acting Director, DARD
Jeffrey Wilfred, Director General, MAFFQ
Charles Rogers, Director, Farm Support Association
Peter Kau, Farm Support Association
President/representatives, Syndicat Agricole
John Aruhuri, General Manager, Vanuatu Chamber of Commerce and Industry
Vanuatu Abattoirs
Ni-Vanuatu cattle producers: Toara Suele, Kuvu Noel,
Cattle road and sea transport providers
Purchasers of smallholder cattle: Santo and Vila abattoirs, Caroline Ernst, Peter Colmar, etc
Other private and public sector stakeholders

Additional Note: Improved Commodity Marketing Systems

Purpose:

To develop improved understanding of whole of value chain opportunities and constraints for key productive sector commodities and to facilitate productive partnerships among value chain stakeholders.

Problems to be addressed:

Commodity production systems in Vanuatu are constrained by the lack of effective market linkages to facilitate marketing. With the exception of kava and peanuts, the private sector is relatively inactive in commodity marketing. VCMB has constrained the development of traders in some sectors. However, the establishment of marketing businesses is constrained by:

- Low volumes of production,
- Disparate production locations,
- Lack of organisation among producers,
- Limited marketing infrastructure and
- The complexity of transport work.

There is little doubt that the agriculture sector requires the development of more effective marketing systems that include smallholder producers. The success of vanilla production and marketing systems proves that this is possible. However, it requires the support of committed large producers to assist the smallholder sector for mutual benefit.

The POPACA project has commenced an integrated approach to production and marketing to some extent in the cocoa, coffee, vanilla and beef sectors in certain localities. The current POPACA project will be completed in late 2007. France and the EU are working on a 3 to 5 years project to follow on from POPACA, but not necessarily with a similar emphasis/approach.

Consideration should be given to include holistic value-chain approaches to development of commodity systems. POPACA has assessed value-chain logistics in cocoa and coffee and has instituted marketing arrangements to address constraints. The very limited numbers and capacity of functional and effective supporting organisations and individuals means that progress will necessarily be slow. Initiatives need to be well supported over extended periods so that sustainability can be improved.

Commodity value chain stakeholder relationships are characterised by suspicion and internecine interactions that severely constrain sector development.

Collaborative analyses of stakeholder relationships are required to minimise these constraints. Modern concepts of value chain analysis includes assessment of stakeholder relationships in addition to the conventional logistical assessments of value chains.

There may be potential for AusAID and NZAID to contribute to the future initiatives being undertaken by France and the EU.

Attachment 5: Draft / Outline TOR for Follow-up Mission

Next Steps in Promoting Economic Growth from the Productive Sectors Draft / Outline Terms of Reference for Further Development of Concepts and Approaches (V.1 – July 2006)

Background

The Government of Vanuatu (GoV) has identified broad-based economic growth from the productive sectors as a development priority and has requested assistance from donors to meet this objective. NZAID and AusAID mounted a fact-finding consultancy in May/June 2006 to scope out the principal issues and initiate dialogue with government and other stakeholders over the possible substance and process of any future support in this area³⁰.

That mission concluded that while Vanuatu benefits from some comparative advantages in the productive sectors, it also has inherent disadvantages that are largely immovable. The net result is that to compete and to contribute meaningfully to economic growth, Vanuatu must operate its productive sectors with great *economic efficiency*. The mission identified policy inefficiencies, inefficiencies in the supply of public goods, private sector inefficiencies, infrastructural inefficiencies and donor inefficiencies that serve to constrain the potential contribution of Vanuatu's productive sectors to economic growth.

The principal recommendation from that mission was that there needs to be a strengthened capacity for the analysis of productive sector performance and its policy, institutional and organisational constraints, and stronger, more indigenous and more consultative generation of robust, evidence-based and appropriately sequenced policy and public expenditure options.

The mission also tabled, in outline only, a number of related Concept Notes to assist donors' in shorter-term programming. These will be appraised separately.

The next step – and the purpose of this next mission – is to explore ways of, and processes in, achieving improved sector analysis and more robust policy, and define any specific requirements for donor support to that.

³⁰ Reported in 'Vanuatu Economic Opportunities Fact-Finding Mission', Peter Bazeley & Ben Mullen, July 2006, AusAID and NZAID.

The Concept

The concept to be developed is that support and resources would be provided to a high-level process – perhaps a ‘think-tank’ – that would, over a period of perhaps 18 months or so:

- Bring together ni-Vanuatu ‘big-thinkers’ to consider the policy, institutional and organisational constraints to rapid and broad-based economic growth;
- Resource that group such that they could commission working groups, analyses, studies and consultancies as required;
- Facilitate a robust process of public and stakeholder consultation; and
- Assist the group’s deliberations with any external long- or short-term expertise and facilitation deemed appropriate.

In addition, support might be given to strengthening the role and function of GoV planning units such as DESP and DSM.

However, such a process would only have merit if it genuinely reflected the wishes and priorities of the highest levels of government.

This Consultancy

This consultancy will, in dialogue with senior GoV officials and other stakeholders:

Part 1:

- i. Explain and validate the findings and conclusions of the May/June 2006 fact-finding mission with a broad range of stakeholders, probably through some form of multi-stakeholder workshop;
- ii. Discuss with senior government officials and politicians the way forward, and the concept of a ‘think-tank’ (as above) in particular.

Part 2:

- iii. Elaborate the design, scope, mandate and ways of working of such a think-tank;
- iv. Define its relationship to government and other relevant government programmes, the private sector, civil society and the donor community³¹;
- v. Define its funding and resourcing requirements (including any TA, and the supporting role of any government units such as DESP);

³¹ Including consideration of improved donor coordination more broadly in support of productive sector growth.

- vi. Draft Terms of Reference for the think-tank and any identified executive or advisory positions;
- vii. Draft any project documentation required to provide for donor support to such an initiative³².

Inputs and Timing

A total of approximately 3 weeks' input by a consultant familiar with Vanuatu and with such policy processes elsewhere. Most writing-up should be conducted in-country. Depending on the initial response to the Bazeley & Mullen report, it may be appropriate to split Part 1 and Part 2 (above) into two separate missions.

Timing should be as soon as possible, preferably before the review of the Comprehensive Development Programme, and the ADB's support to the drafting of a Medium Term Strategic Framework, is completed.

³² It is expected, but necessarily concluded, that such an initiative might form a component of the AusAID-funded Governance for Growth programme, although the involvement of other donors as well would be advantageous.

Attachment 6: Economic Data for Vanuatu's Productive Sectors

Table 1: Balance of trade data for Vanuatu 2002 to 2005

Balance of trade data (million Vt)				
Year	2002	2003	2004	2005
Total exports	2590	3252	4167	4126
Total imports	12433	12702	14306	16315
Trade deficit	-9843	-9450	-10139	-12189
Balance ratio	0.21	0.26	0.29	0.25

(Source: National Statistics Office, Vanuatu Government)

Table 2: Value of principal agricultural export commodities

Value of agricultural exports (million Vatu)				
Year	2002	2003	2004	2005
Copra	174	282	446	126
Coconut oil	471	382	1026	733
Coconut meal	75	93	117	85
Total copra/oil/meal	720	757	1589	944
Beef	192	287	286	302
Live cattle	60	52	29	56
Cow hides	60	36	28	43
Total beef/cattle/hides	312	375	343	401
Kava	253	228	440	477
Timber	197	249	247	203
Cocoa	141	295	160	181
Shells	50	45	30	57
Root crops	50	38	47	39
Vanilla	50	34	33	15
Coffee	40	0	0	0
Other	417	579	630	615
Total agricultural exports	1702	2599	3331	2908
Agriculture as % exports	66%	80%	80%	70%

(Source: National Statistics Office, Vanuatu Government)

Table 3: Quantity of agricultural exports 2002 - 2005

Export quantities (tonnes)				
Year	2002	2003	2004	2005
Copra	7,339	10,620	15,194	4,319
Coconut oil	9,856	7,723	17,111	10,452
Coconut meal	2,253	3,948	6,535	5,137
Beef	685	976	927	947
Live cattle	2,123	2,048	1,312	1,581
Cow hides	235	289	225	299
Cocoa	756	1,506	1,011	1,246
Shells	19	24	25	62
Kava	601	491	828	686
Coffee	81	-	-	-
Vanilla	2	16	14	2
Root crops	118	267	393	324

(Source: National Statistics Office, Vanuatu Government)

Table 4: Prices for principal export commodities

Commodity prices (export price in Vatu/kg)				
Year	2002	2003	2004	2005
Copra	24	27	29	18
Coconut oil	48	49	64	57
Coconut meal	72	42	49	52
Beef	283	294	352	458
Cow hides	120	123	126	143
Cocoa	189	196	165	157
Shells	2,684	1,940	2,030	2,477
Kava	383	464	514	660
Coffee	9	-	87	176
Vanilla	10,245	3,874	5,316	4,165
Root crops	113	163	136	131

(Source: National Statistics Office, Vanuatu Government)

Table 5: Value of Vanuatu's 10 major import items

Value of 10 major imports (as million Vatu)				
Year	2002	2003	2004	2005
Fuel	875	900	988	985
Pharmaceuticals	935	738	762	1,761
Rice	500	613	772	654
Household goods	205	212	435	392
Motor oil	168	241	232	240
Cement	126	177	225	252
Chicken wings	91	130		134
Gas	102	82	108	107
Tinned fish	101	114	85	109
Wheat flour	110	152	192	156
Total value of 10 imports	3,213	3,359	3,926	4,789
Percentage total imports	26.30%	26.30%	27.80%	29.70%

(Source: National Statistics Office, Vanuatu Government)

Attachment 7: List of Persons Met

Adrien Mourgues, European Union, Port Vila
Ahman Leong, Vanuatu Root Crop Exports, Santo
Alopi Latukefu, AusAID, Canberra
Alwyn Chilver, AusAID, Canberra
Andre Pileki, VARTC, Santo
Benjamin Shing, Director, Department of Finance MFEM
Benuel Tarilogi, Director, Vanuatu Quarantine and Livestock Department
Caroline Ernst, Property Manager, Efate
Charles Rogers, President Syndicat Agricole and Director, FSA
Colin Tavi, Economic Analyst, DESP
Dale Hamilton, Principal Veterinary Officer, VQLD
David Hutton, ADB Medium Term Strategic Framework TA, MFEM
David Miles, Airports Vanuatu
Derrin Davis, ADB Medium Term Strategic Framework TA, MFEM
Dick Tomker, Principal Forestry Officer, Santo
Didier Slachmuylders, EU Advisor, Department of Foreign Affairs
Edwin Garae, Vanuatu Chamber of Commerce and Industry
Elrico Munoz, Managing Director, VANWODS Microfinance
Fita Siosi Veterinary Officer Northern, VQLD, Santo
Francois Japiot, Team Leader, POPACA Project
Fraser Bule, Principal Research Officer, DARD
Fredrick Hosea, Acting Director, DESP
Geoff Fox, AusAID, Canberra
George Pakoasongi, Director, Department of Provincial Affairs,
Graham Nimoho, Principal Fisheries Officer, Efate
Hilton Tarileo, General Manager Cooperatives Council
Ioan Viji, Principal Forestry Officer, Efate
James Mackie, Principal Extension Officer, Efate
James Selwyn Wasi, Acting Director, Department of Agriculture and Rural
Development
James Toa, NZAID, Port Vila
James Wilson, Food Technology Business Consultant, Tagabe
Jenny Ligo, CEO, Vanuatu National Council of Women
Joe Ernst, Manager EICress
Joel Path, Secretary General, SANMA Provincial Council
John and Silvana Nichols, Vanuatu Hotels Ltd
John Aruhuri, General Manager, Vanuatu Chamber of Commerce and Industry
John Colwick, NZAID, Port Vila
John Oke, REDI Unit, Department of Provincial Affairs, Port Vila

Leith Veremaito, AusAID, Port Vila
Lennox Vuti, Millennium Challenge Account, MFEM
Margaret Bohn, Team Leader, AusAID TVET Project
Mark Bebe, Director, Strategic Management
Mary Oliver, NZ High Commission/NZAID, Port Vila
Michael Karo, Livestock Officer, Efate
Michael Hoffman, Peace Corps, Mabuna Rural Training Centre, Epi
Moses Amos, Director of Fisheries, MAFFQ
Nambo Moses, Animal Health Officer, VQLD
Nancy Wells, Director, National Statistics Office
Nicolas Martinez, Head of Office, European Union, Port Vila
Neil Croucher, Owner/Manager, Melcoffe Sawmill, Santo
Nigel Ewels, NZAID, Wellington
Nikunj Soji, Ministry of Finance and Economic Management (MFEM)
Peter Kau, Farm Support Association, Efate
Peter Napwatt, Vanuatu Chamber of Commerce and Industry
Peter Robinson, Livestock Officer, Santo Meat Packers, Santo
Petro Jack Louhman, Principal Agricultural Extension Officer
Philip Pangpang, Principal Extension Officer, Santo
Philippe Metois, natural scientist and photographer
Pierro Bianchessi, Manager, Venui Vanilla
Robert Jimmy, Acting Director, Department of Fisheries
Robert Tranter, AusAID, Port Vila
Robyn Redknap, Manager Iririki Resort and President VHRA
Rodney Ari, Melcoffe Sawmill, Santo
Selwyn Garu, Secretary, Council of Chiefs
Shadrack Welegtabit, Research Economist, Reserve Bank of Vanuatu
Stevenson Boe, Livestock Officer, Northern Region
Thomas Bangalini, Natural Resources Sector Analyst, DESP
Toara (Nichiku), Santo Meat Packers, Santo
Vincent Lebot, VARTC Rootcrop Research Scientist, Tagabe
Watson Lui, Director, Department of Forestry
Wendy Tendys, Secretary, Vanuatu Hotel and Resort Association
William Narete, Fisheries Inspector, Efate

Attachment 8: Terms of Reference for the Mission

TERMS OF REFERENCE FOR VANUATU'S ECONOMIC OPPORTUNITY FACT FINDING MISSION

1. Background

The Government of Vanuatu (GoV) has identified broad-based economic growth as a development priority to address these constraints, and has requested assistance from donors to meet its objectives. Research into hardship experienced by both rural and urban communities in Vanuatu has identified the lack of employment opportunities and poor access to services as major constraints to human and social development and sustainable livelihoods. Interventions to enhance broad-based economic growth have been articulated by the GoV in fundamental terms as:

- The need for enhanced economic opportunity in both rural and urban areas;
- The need to enable private and public investment to utilize potential in the '*productive sectors*' such as agriculture, forestry, fisheries and tourism; and
- The need to address the difficulty that the government has in providing services from the existing narrow revenue base.

At the October 2004 Comprehensive Reform Programme National Summit in Luganville, the Vanuatu Prime Minister called for increased resources and effort to go into support of the economic sectors that generate revenue and thereby facilitate economic and social development. "Today we must change the direction of reform"....(and)....."put sustainable economic development and rural development as the number one priority." Vanuatu identified donors as having an important role to play through their respective development assistance programs.

Following High Level Consultations with the GoV, it was agreed that NZAID would undertake a scoping study, to be based on Vanuatu's priorities, and that the study would take a broad approach (non-sector specific) and assess assistance in the area of "agricultural development and sustainable livelihoods" for ni-Vanuatu. A two-staged study was proposed to develop an Economic Development Strategy (EDS) to identify economic opportunities supporting broad-based growth of Vanuatu's "productive sectors" and the potential for donors to provide harmonised strategic assistance to help realise these opportunities.

A literature review, in conjunction with a brief in-country mission was conducted as Stage 1 of the study in March/April 2005. The second stage, for which Terms of Reference follow, is to develop consensus between the Vanuatu Government and donors on a long-term programme for assistance to productive sector development.

2. Methodology

In order to guide development partners of their respective programmes in response to the economic growth and productive sector priorities of Vanuatu, AusAID and NZAID are

mobilising two adviser inputs that will assist Vanuatu Government and other stakeholders develop a realistic and manageable programme of action for the two donors and other interested donors in response to the priorities and guidance provided by the MTSF.

The input will involve scoping, designing activities and undertaking analytical work on economic opportunities agreed to by GoV for AusAID and NZAID program of assistance. This process will involve ongoing engagement with Vanuatu around promoting economic growth in the productive sectors. By undertaking this, it is expected that GoV will coordinate donors and encourage discussion on key economic issues between Vanuatu stakeholders and donors.

3. Task

The main tasks of the TA in the short term will be to:

- understand the aims and objectives of the MTSF and other key economic documents as they apply to generating sustainable and broad-based economic growth, through their identification of key constraints, opportunities and priorities
- consult widely with government agencies, donors, private sector, NGOs, volunteer agencies such as Peace Corps, VSO, FSA
- work with VG and other Vanuatu stakeholders (parliamentarians, chiefs, private sector, etc) to identify, scope and if possible design immediate programming responses for AusAID and NZAID, in consultation with EU and France, to help promote economic growth based on the priorities laid out in the MTSF. This could include follow-up analytical work as required. Consultations should include all relevant government agencies, donors, private sector, NGOs, volunteer agencies including Peace Corps, VSO, FSA
- assist VG in coordinating broader donor responses to economic growth priorities identified in the MTSF. This could include assisting the government to re-institute regular donor meetings around economic growth (building on the December 2005 donors' meeting on economic growth)
- assist VG to develop a longer-term plan for continued TA, to assist the government with programming and coordination on economic growth in the productive sectors and;
- participate in the launch of the MTSF with donors and other stakeholders.

4. Reporting

The following are required from the Contractor:

- An aide-memoir that will be presented to GoV, donors and stakeholders at a forum that will be jointly organised by GoV and the Contractor. This briefing of the aid-memoir will be undertaken prior to departure from Vanuatu
- Final report on the mission recommending programming options for AusAID and NZAID in response to the strategic priorities for economic growth and the productive sectors identified by Vanuatu in the MTSF and other strategic guidance. This could include initial scoping and design of activities and

Attachment 8

recommendations for further follow-up technical assistance to assist with programming and planning. A draft should be presented to AusAID and NZAID before 7 July 2006.

Attachment 8: Key References

- Abbott, D., Hutton, D. and Knapman, B. (2005). *Inception Report for the Development of a Medium Term Strategic Framework*. TA No. 4362-VAN, Asian Development Bank
- Anon. (2005). *Second Generation Surveillance Surveys of HIV, STIs and Risk Behaviours in Six Pacific Island Countries*. World Health Organisation / Secretariat for Pacific Communities
- Asian Development Bank. (2002). *Vanuatu: Economic Performance and Challenges Ahead*. Asian Development Bank, Pacific Studies Series
- Castalia Advisory Group. (2004). *Pacific Infrastructure Review*. East Asia Pacific Infrastructure Flagship Study, Asian Development Bank-JBIC-World Bank
- Department of Economic and Sector Planning. (2006). *Priorities and Action Agenda 2006-2015*. Ministry of Finance and Economic Management, Government of Vanuatu
- Gay, D. (2005). *Baseline Study of the Trade Situation and Business Environment in Vanuatu*. Department of Trade, Industry and Investment (GoV) and Transtec for the European Commission
- Holden, P., Bale, M. and Holden, S. (2003). *Vanuatu: A Private Sector Study*. The Enterprise Research Institute for the Asian Development Bank
- Howes, S., Bell, E., Fox, G., Gilling, J. and Pieper, L. (2006). *Pacific 2020: Challenges and Opportunities for Growth*. AusAID
- Macfarlane, D. and Mullen, B. (2005). *Vanuatu Economic Development Study, Stage 1*. NZAID
- Taylor, D. and Greer, R. (2002). *Vanuatu: Policy Issues in the Agriculture, Fisheries and Forestry Sectors*. Asian Development Bank, Pacific Studies Series
- Zuniga, L. (2003). *Priorities of the People: Hardship in Vanuatu*. Asian Development Bank