The emperor's tailor: an assessment of Vanuatu's Comprehensive Reform Program

Daniel Gay

This article assesses the Asian Development Bank-sponsored CRP from two angles, situating it beside World Bank and IMF structural adjustment programs and also evaluating the impact on the economy. The adjustment of economic structure in Vanuatu was necessary. Public spending was under control but financial management problems were emerging by 1998. Governance left a lot to be desired, the political system was unstable and corruption was growing. The government had little option other than to seek outside support. But it is argued here that it was a mistake to enact a governance-heavy package of reforms rather than attack the macroeconomic problems. GDP per capita declined, exports and incoming investment slumped and the trade balance remained in deficit. The worst failing of the CRP is perhaps not that it worsened economic performance, rather it was the missed opportunities. Vanuatu has taken on the garb of economic restructuring but little of the substance.

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Vanuatu is sometimes advertised to tourists as 'the land that time forgot'. It could also be called the land the global financial institutions forgot. Three-quarters of sub-Saharan African countries had tangled with the World Bank and International Monetary Fund (IMF) by the end of the 1980s, while 12 Central American economies signed emergency agreements with the IMF between 1980 and 1988. Neighbouring Papua New Guinea underwent adjustment in the early and mid 1990s. Vanuatu's turn came only in 1997, with the Asian Development Bank (ADB) sponsored Comprehensive Reform Program (CRP), which was aimed at arresting a perceived policy crisis and a downturn in economic performance. This article assesses the CRP from two angles, situating it beside World Bank and IMF structural adjustment programs and also evaluating the impact on the economy.

First, there is a review of the background to structural adjustment and some terms of reference. The term 'structure' is defined; and the query is raised as to whether Vanuatu's reform program involved the adjustment of structure. Second, it examines briefly Vanuatu's economic performance prior to the CRP. There was a persistent trade deficit and GDP growth was unsatisfactory, while political instability plagued policy.

An outline of the changes initiated by the CRP comes next. It is important to look not just at desired outcomes but at the appropriateness of policies. From an early stage the program did not meet its objectives. GDP per capita began to shrink, foreign investment declined and exports plummeted. These trends alone are not enough to condemn the CRP since their causes were partly exogenous; it is possible that the economy would have fared worse without the program. The study is therefore plagued by the ubiquitous problem of the counter-factual.

However, a detachment from local economic reality—there was not a serious attempt to correct the chronic balance of payments problem—suggests that the CRP could have been more focused and better implemented. Some current macroeconomic problems, such as the escalating foreign-currency loan stock, demonstrably result from the program. In a tiny, volatile economy it would also seem sensible to have enacted measures aimed at dealing with exogenous shocks.

Some alternative reforms are offered that recognise the importance of the balance of payments, sequencing and local ownership.

In vogue: the background to structural adjustment

As pointed out by Zack-Williams, Brown and Mohan (2000), structural adjustment programs must be seen against the backdrop of the post-colonial experience. A statist approach lasting several decades had 'hemmed in' many developing-world policymakers, leaving them with little alternative but to seek assistance from outside sources (Callaghy and Ravenhill, 1993:2). The GNP of sub-Saharan Africa declined by 22 per cent in the 1980s. The volume of major exports also fell. In many African countries the failure of import-substitution policies, overvalued currencies, and corruption in commodity marketing boards precipitated a balance of payments crisis.

Latin America also suffered from the underperformance of import-substituting industrialisation policies. Dependence on developed economies increased owing to the resulting necessity to import capital goods, while government profligacy encouraged rampant inflation. Industrial and trade policy in newly-industrialising Asian economies, whilst far more successful, also encountered the need for change by the 1980s. As in other regions, public debt was growing, although high economic growth meant that it was less of a problem.

Some of these experiences resonate in post-colonial Vanuatu, in particular, corruption, the failure of import-substitution policies, and balance of payments problems. The economy, however, was reasonably well managed, with inflation under control, public spending low, and overseas borrowing relatively restrained.

Since its post-Bretton Woods meta-morphosis, the IMF has seen the core of its mission in simple terms: as making the balance of payments viable.

> The concept of a viable balance of payments typically means, especially for many developing countries, a

> current account deficit that can be financed, on a sustainable basis, by net capital inflows that are compatible with the development and growth prospects of the country (Guitian 1981:24).

Killick (1995) points out that the IMF essentially sees the creation of excess domestic credit as the key explanation of balance of payments problems. This result is derived from the following set of equations, known as the financial programming or Polak model (Killick 1995:129), where *R* is the local-currency value of the net foreign assets of the banking system, *M* is the stock of money and *D* is domestic credit.

Money stock varies according to changes in the international and domestic money supply.

$$\Delta M = \Delta R + \Delta D \qquad (1)$$

Equilibrium in the money market means that changes in the demand for money equal changes in the supply of money.

(2)

Money demand depends on changes in real income and prices. Real income is not affected by monetary variables.

(3)

Combining Equations 1, 2 and 3 shows that balance of payments deficits, in other words losses of reserves, are caused by increases in domestic credit over and above increases in demand for money.

(4)

Even when fully elaborated, the model can be criticised for having weak assumptions—it is not clear, for example, that real income is unaffected by monetary variables. There are also criticisms common to all monetarist models. For instance, the British government abandoned its monetarist experiment in the early 1980s after it proved impossible to find an accurate measure of the money supply.[1]

Commentators of various theoretical persuasions have criticised the IMF and World Bank for having a monocular perspective (see, for example, Stiglitz 2002, Walters 1994, and Wade 1990 and 2001). There is certainly no consensus that the adjustment of economic structure should proceed according to the particular visions of the World Bank or the IMF. It is also unclear whether most programs helped (see Lensink 1996, Killick 1995). Such discussion, however, is not the purpose of this paper.

Whether structural change should be allowed to take place naturally or be wrought by policymakers, and in which direction the change should go, are contentious issues. What is less controversial is that economic structures exist and that they change over time.

What is an economic structure? Killick (1993) suggests that the three main ways of calculating national accounts provide a starting point: production, the factoral composition of value-added, and the composition of demand. He points out that the institutional base constitutes a fourth, more nebulous angle of economic structure.

> Included in this is the political system; the legal framework and the agencies for its enforcement; established patterns of social organisation and control, including the existence and freedoms of special interest organisations like trade unions; the agencies of public administration; and the physical infra-structure that provides transport and communications (Killick 1993:6).

Structural change therefore involves altering the basic, long-lasting fabric of an economy into which policies are woven. In turn, there are political and social implications. The emphasis placed on the fourth criterion above depends on how much it is believed that economies hold in common. Economists from

Thorstein Veblen to Geoffrey Hodgson have argued that certain institutional features peculiar to individual economies are of decisive explanatory importance (see Veblen 1899 and Hodgson 1999). The neoclassical tradition, on the other hand, broadly claims that markets work in similar ways across all economies. Most structural adjustment programs involve an attempt to alter the composition of an economy based on all of the four definitions above, with emphasis on each depending on the methodological leanings of the implementing body.

Vanuatu's CRP paid so little attention to the balance of payments that it is questionable whether it can usefully be analysed alongside the 1980s programs of sub-Saharan Africa or Latin America. The CRP revolved largely around specific elements within the fourth category above, with little obvious attention to the composition of production according to tradables and non-tradables, the way in which factors are combined, or to the use of resources. It could arguably be characterised as a civil-service reform package sponsored by an outside agency.

There is little question, however, that it was seen as a structural adjustment program and therefore must be treated as one. The Asian Development Bank acts as a kind of IMF or World Bank for the Asian and Pacific regions. Conventional methods are employed: loans are conditional upon specific targets. As shown below, the original six objectives of the CRP are all structural (Vanuatu 1997:4–6). There is repeated mention of raising GDP growth and per capita GDP. According to the 2002 Asian Development Bank report,

> [i]n June 1997 the government approved an overarching program of comprehensive reforms to address several structural problems within the economy (Asian Development Bank 2002:3).

Table 1 **Vanuatu trade trends, 1983–97**

	Exports (million vatu)	Imports (million vatu)	Trade deficit as a percentage of GDP
1983	2,583	4,338	16
1984	3,939	4,826	7
1985	2,753	5,257	19
1986	1,806	4,849	24
1987	1,937	6,157	29
1988	1,559	5,883	28
1989	1,609	6,727	31
1990	1,783	8,854	38
1991	1,600	7,128	26
1992	2,027	7,131	23
1993	2,140	7,406	23
1994	2,402	8,203	23
1995	2,552	8,507	23
1996	2,708	8,647	22
1997	3,565	8,613	17

Note: Imports cleared for home consumption; merchandise exports.
Source: Vanuatu, Department of Statistics; author's calculations.

A bad fit: the economy and policy by 1997

One of the prominent features of the Vanuatu economy following independence in 1980 was the chronic visible trade deficit. The deficit ranged from 7 per cent to 38 per cent of GDP between 1983 and 1990 (Table 1).[2] Almost all processed products were imported. Exports were generally very low due to the limited market size, a small, fragmented production base, and dependence on a narrow range of volatile commodities such as copra. Exports in 1997 were 13 per cent of GDP and, as a proportion of output, have generally been lower than in other Melanesian economies.

Within the current account, the visible trade deficit was compensated partly by a surplus in services, with tourism accounting for around one-half of earnings from services. Overseas remittances have always been minimal.

In the capital account, in 1997 as now, aid flows dominated capital transfers, with roughly one-half of aid payments distributed to government and one-half going to other sectors. The main donors were Australia, New Zealand, the European Union, France, Japan and China. Net private investment flows were strongly negative.

Following independence the dominant Vanua'aku party declared it would achieve economic self-reliance by 1990. Import-substitution industrialisation policies were aimed at cutting the trade deficit, with an average import duty of 25.1 per cent by 1990 and 26.1 per cent in 1995. Tariffs on consumer goods were 47 per cent in 1990 and 36.5 per cent in 1995 (Vanuatu, Department of Statistics, cited in Grynberg and Joy 2000:161). Despite a fall in the ratio of imports to GDP from 48 per cent in 1988 to 37 per cent in 1997, the evidence in Table 1 suggests that the policy did not meet its objectives.

The vatu was, as it is now, managed against a basket of major trade and financial partners. It is thus a kind of 'dirty float'. Up to 1997 the currency had not been used as an explicit macroeconomic policy tool, while monetary and fiscal policy were not seen as routes to better economic performance. Thus, alternative policy options were available to tackle the balance of payments problem.

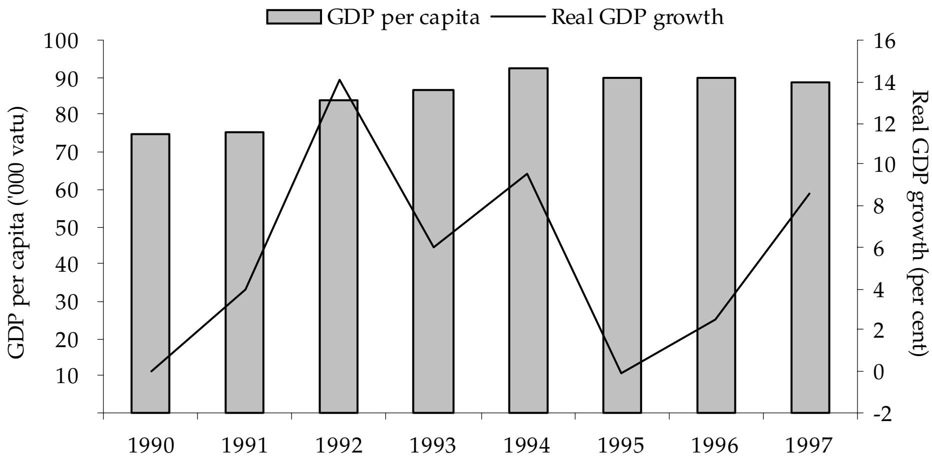
There is little question that Vanuatu had a balance of payments problem. Whilst aid plugged the gap caused by the trade deficit, dependence on foreign donors was clearly undesirable over the long term, not least because it has contributed to the existence of a dual economy. Port Vila, the capital, where most aid ends up, accounts for the vast majority of the cash economy while most people in the outer islands live a subsistence lifestyle. The Vanuatu government has long declared economic self-reliance its principal policy objective. To paraphrase the IMF, Vanuatu did not have non-aid net capital inflows compatible with its development and growth prospects that were sufficiently sustainable to finance the current-account deficit.

By mid 1997 several extra-budgetary provisions threatened a cash-flow problem. But unlike other countries undertaking structural adjustment programs, public spending had never been excessive, averaging 27 per cent of GDP between 1989 and 1997. The Asian Development Bank pointed out that Vanuatu had one of the lowest ratios of government employees per capita among Pacific island economies, at three per 100 inhabitants—as compared to Fiji (6), Tuvalu (8), and the Cook Islands (18.2) (Asian Development Bank 1996:103).

As a net importer, Vanuatu depends on overseas prices. Consumer-price inflation was moderate in the 1980s and averaged 3.4 per cent from 1990 to 1997. There is, therefore, no comparison with the spendthrift and inflation-prone Latin American economies of the 1980s.

GDP performance was erratic (see Figure 1), while a high rate of population

Figure 1 **Vanuatu real GDP growth and per capita GDP, 1990–97** ('000 vatu and per cent)



Note: US$1=110 vatu
Source: Asian Development Bank, 2002. *Vanuatu: economic performance and challenges ahead*, Pacific Studies Series, Asian Development Bank, Manila.

growth meant that GDP per capita grew sluggishly and appeared to be stagnating by the mid 1990s at around US$1,100. The instability of exports and Vanuatu's susceptibility to earthquakes and tropical cyclones contributes to the volatility of output.

Political instability has added to the uncertainty. Instability has been a product of the considerable constitutional power vested in the executive and the possibility of forming a new government without holding elections. The result has been an administration in constant flux, since backbenchers have nothing to lose by trying to form a new coalition. Ministers have no incentive to implement long-term policies because they know that they may only be in office for a matter of months.

Many arms of government simply performed badly. At the first training seminar for parliamentarians on 2 June 1997, then Prime Minister Rialuth Serge Vohor said

> [t]he continuous poor performance of institutions of government has had a destabilising effect on the economy and the community. It is a major impediment to reform and growth (quoted in Vanuatu 1997:15).

Corruption was also growing, culminating in protests during 1998 over the misappropriation of assets from the Vanuatu National Provident Fund. Later in the same year there was a botched attempt to devalue the vatu.

Laying down a design: the unveiling of the CRP

Unlike some other structural adjustment programs that aimed in a short period of time to spur economic change, the CRP 'big bang' was followed by a program lasting many years. Phase one, entailing a rash of public-sector reforms, began in July 1997 and ended in December 1998. Phase two, dealing more with economic policy, lasted until the end of 2000. Phase three is still in progress in 2004.

Annual Summits take stock of the CRP's progress and aim to prioritise issues for the coming year.

To aid restructuring and 'fiscal stabilisation', the Asian Development Bank lent US$20 million in two tranches during phases one and two—equivalent to one-half of annual government expenditure during those years and 8.3 per cent of 1997 GDP (Table 2). Other bilateral donors were also involved, led by Australia. Part of the ADB loan was used to employ 42 international consultants who were to carry out the first stages of the program.

The conditions for the release of the funds were overwhelmingly governmental in nature and involved few macroeconomic measures (see Appendix Table 1). The original CRP document details five main objectives.

1. Renewing the institutions of governance
2. Redefining the role of the public sector
3. Improving public sector efficiency
4. Encouraging the private sector to lead growth
5. Improving social equity.

These objectives were split into a further 25 specific aims, complete with concrete actions to be carried out by particular ministries and departments.

Objectives 1 to 3 have resulted in discernible improvements. Government and civil service decision-making is more transparent. For example, before the CRP the Minister for Immigration could issue a 'green letter' to expel foreign residents without reason or redress. Now such decisions can only be made through the court.

Pre-CRP the Minister of Finance vetted investment proposals. This created opportunities for kickbacks and could be time-consuming and arbitrary. The new Vanuatu Investment Promotion Authority has a mandate to approve and process investment applications quickly and consistently (Vanuatu 1998).

Financial management has become more consistent and professional, with a long-term AusAID project in place to build capacity. The emphasis on good governance in the original CRP matrix has borne some fruit, and the public sector has become more modern and accountable. A new public service code has reduced nepotism and enhanced professionalism. The support of a free press has also helped sustain an important watchdog on government.

Table 2 **Asian Development Bank loans to Vanuatu** (US$ million)

Purpose	First tranche		Second tranche	Total
	Release one	Release two		
Public sector cuts and restructuring	4	1	2	7
Financial restructuring	3	3	2	8
Fiscal stabilisation	3	1	1	5
Total	10	5	5	20

Source: UNESCAP, 2002. *Project Completion Report in Respect of the Comprehensive Reform Programme,* Pacific Operations Centre, UNESCAP, Port Vila.

Stitching the cloak: the CRP in action

However, Objective 4 (encouraging the private sector to lead growth) has proven less successful. There is no mention of exchange rate policy in the aims and objectives, which is strange for an economy with a persistent trade deficit. The original CRP document lists as one of its 25 objectives 'a more open economy'. The two strategies aimed at achieving this were making the offshore financial centre more competitive and attracting more foreign direct investment. The actions undertaken between June and October 1997 were to update the Offshore Finance Centre Act and enact the Foreign Investment Bill and amend related legislation.

Even had they worked, the latter actions fall far short of achieving a 'more open economy'. The foreign investment 'one-stop-shop' still did not exist six years after the start of the CRP. As in many countries, the departments involved (including Immigration, Environment, Customs and Labour) have proven reluctant to relinquish the financial benefits from contact with overseas investors. Winning major new investment takes supply-side reform as well as administrative change.

The only other component dealing with the current account was the advocacy of regional trade blocs and WTO entry, which was wrongly thought to require lower import tariffs (all negotiated bound duty rates have in fact been higher than applied rates) (Vanuatu 1997:35). Rather than trade liberalisation being carefully planned and on Vanuatu's terms, civil servants were subjected to the negotiating muscle of the United States. As it turned out, WTO entry was unsuccessful, with a finalised working party report put on hold by the government in 2001 (Gay 2003, Grynberg and Joy 2000).

A number of misleading comparisons with East Asian economies, aimed at selling the CRP to local policymakers, were made. According to the 1997 CRP plan,

> [t]he country has experienced such low economic growth that, on average, people are little better off now than they were ten years ago. This is in sharp contrast to most other countries, especially the dynamic economies on the Pacific rim (Vanuatu 1997:8).

The CRP document further claimed that studies of fast-growing economies, particularly in East Asia, indicate that economic growth is best promoted by a 'high degree of openness to the global economy' (Vanuatu 1997:11).

Statements such as this and the idea that the one-stop shop would turn around foreign investment betray fanciful thinking. It is unrealistic to compare industrial powerhouses like South Korea or Singapore with least-developed Vanuatu—a young, fragmented, tiny country four hours' flight from the nearest major market.

As a number of commentators have suggested, the rest of the world was open to the East Asian 'tigers', but the 'tigers' were not necessarily open to the rest of the world. Many were selective about foreign investment, employed fixed exchange rates and capital controls, and used significant protective barriers to nurture their infant export industries (among the major theoretical papers are Brander and Spencer 1985 and Krugman 1984). Liberalisation should arguably be even more cautious in a small, vulnerable least-developed country with a persistent trade deficit.

Like many other structural adjustment programs, the CRP advocated the sale of public assets. This reform aimed to make companies more efficient and encourage the government to concentrate on providing an improved environment for enterprise. At a stretch it could also be argued that it was an indirect way of reducing absorption, in that the private sector was more likely to export.

The results, however, were far from ideal. Most corporatised entities simply moved out of government jurisdiction and became private monopolies. Limited technical capacity and scant government resources, particularly at a time of budget cuts, meant that effective regulation was always unlikely. Although the lack of competition and high costs were noted in the CRP, institutional improvements were not given the central importance that they should have received.

During the subsequent five years no attempts were made to improve competition, while some political appointees retained major corporate influence. For example, with 20 members Air Vanuatu has the biggest board of any Pacific airline—many members are politically affiliated and yet the government has little control over the airline's operations. The lack of antitrust legislation or meaningful competition has meant that prices for many crucial services, such as water and electricity, transport and telecommunications remain extremely high.

Another key downside to the rapidity of the corporatisation program was the impact on government revenues. According to a UNESCAP assessment report on the CRP, the

> …wrong sequencing of privatisation and corporatisation has deprived the Vanuatu government [of] over 3.5 billion vatu [about US$35 million] in gross revenue (UNESCAP 2002:18).

At a time of falling revenues, government expenditure did not, in fact, fall relative to GDP. In 1997 government expenditure was 20 per cent of GDP. By 2000 the figure was 30 per cent and by 2003, 22 per cent. Job cuts under the CRP were often indiscriminate rather than conducted on merit, while salaries rose to 60 per cent of recurrent government expenditure by 2003 from 50 per cent in 1997. Departments find it increasingly difficult to function properly without sufficient funds for overheads.

It is difficult to understand why so much effort was devoted to curbing public spending when government extravagance was not a problem. Domestic credit creation was not rising quickly and there were no major inflationary pressures. As a small economy dependent on foreign prices and interest rates there was little likelihood of inflation running out of control.

The cost of financial sector reforms was much higher than simply the cost of the loans. During 1998 and 1999 the Vanuatu government was required to match the ADB loans with 1.4 billion vatu (about US$14 million) for financial restructuring, and a further 613 million vatu between 2000 and 2001 (Vanuatu, Department of Finance and Economic Management 2004). Most CRP projects included pre-programmed government contributions. The involvement of government therefore worsened an already problematic debt situation.

For all the CRP concern about the need to finance the recurrent government deficit with aid—'the Government's financial balance has been in deficit every year since 1989' (Vanuatu 1997:8)—there appears to have been little attempt to examine the wider problem: the visible trade deficit. Vanuatu's problem was, and remains, an inability to attract sufficient funds to pay for its imports. Trying to solve the problem by shrinking government spending is a bit like trying to deal with a leaky bottle by cutting it in half.

Vanuatu's balance of payments problem, as suggested earlier, stems from difficulties such as the weak and fragmented production base, a narrow range of exports, and commodity price volatility. In turn, these problems are partly due to a lack of competition and the resulting high prices for key services, as well as high internal and export transport costs. Improving the government's financial balance would mean enhancing the productive capacity of the economy and thus the tax base.

Ironically, rather than repairing holes in the budget or attracting more capital the CRP had the opposite effect of lumbering the government with a worse external borrowing position. A significant proportion of the initial lending was used to pay for short-term foreign consultants. When they departed, there were few lasting results and yet the government was still paying off the loans used to pay for their salaries. The remaining loan funds were mostly used for near-term consumption-oriented programs, artificially giving the economy a short-term boost. The impact on GDP can be seen in Figure 4 below. Exacerbating this problem, forecasts of revenue and expenditure were based on optimistic GDP figures.

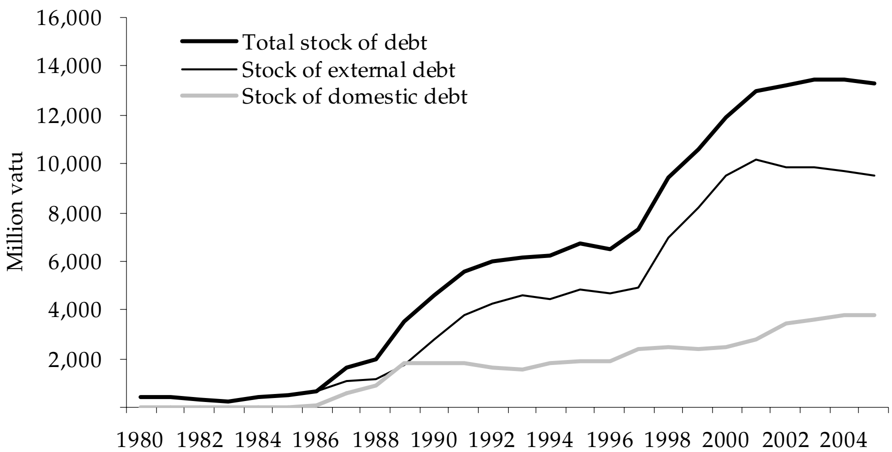
Figure 2 shows that the external debt stock, mostly ADB foreign-currency loans, ballooned in 1997. It reached 40 per cent of GDP by 2003, compared with 15.6 per cent of GDP in 1990.

What is more worrying from a financial management point of view is that debt servicing is expected to rise sharply from 2007 onwards as the principal on loans comes due, as shown in Figure 3. The Department of Finance and Economic Management predicts that total interest payments will have risen to 8 per cent of domestic revenue by 2007, from 7 per cent in 2003.

GDP growth has not performed as predicted, leaving Vanuatu with a substantial debt obligation but difficulty in generating new revenues for repayment. The failure to take into account the maturing of debts between 2000 and 2003 meant that the government had to tighten spending substantially during this period in order to meet its loan obligations.

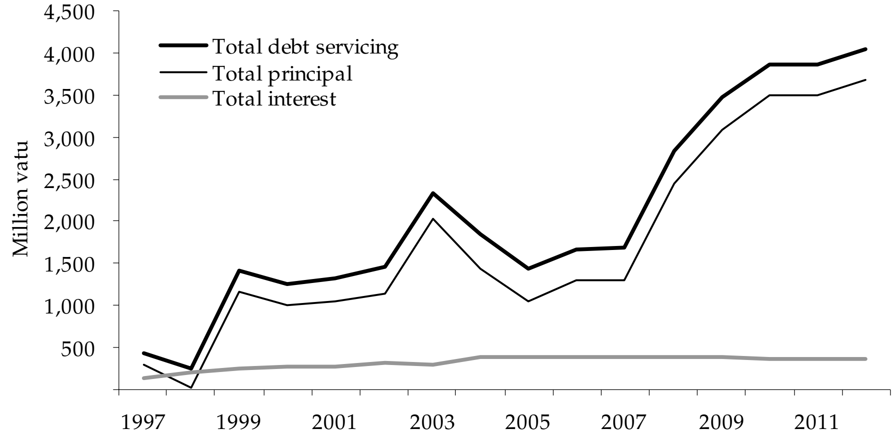
When considered in financial terms—as any loan should be—the CRP performed poorly. Some argue that the loan funds had a negative financial rate of return. The government has since made it a policy not to take any more foreign loans. Not only does the debt consume a growing amount of domestic resources but also it raises the cost

Figure 2 **Vanuatu's public debt, 1980–2004** (million vatu)



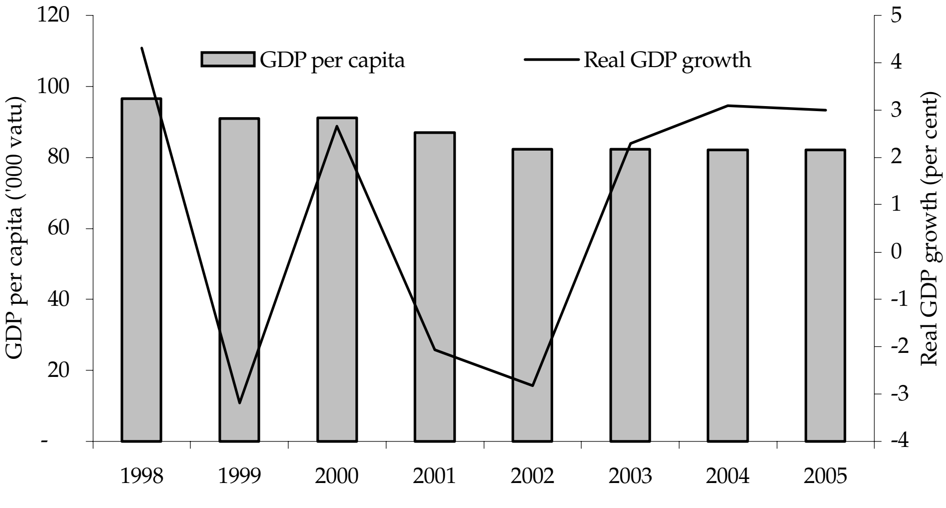
Source: Vanuatu, 2004. *Fiscal Strategy Report*, Budget 2004, Volume 1, Department of Finance and Economic Management, Government of the Republic of Vanuatu, Port Vila.

Figure 3 **Vanuatu's debt servicing, 1997–2012**[P] (million vatu)



[P] Projected
Source: Vanuatu, 2004. *Fiscal Strategy Report*, Budget 2004, Volume 1, Department of Finance and Economic Management, Government of the Republic of Vanuatu, Port Vila.

Figure 4 **Vanuatu real GDP growth and per capita GDP, 1997–2005**[P]



[P] Projected
Source: Vanuatu, 2004. *Half-Yearly Economic and Fiscal Update*, Department of Finance and Economic Management, Government of the Republic of Vanuatu, Port Vila.

of policy choices such as currency devaluation.

According to the Asian Development Bank (1996)

> [i]n the second period [of the reform program] between 2000 and 2005 the fruits of reform really begin to 'kick in' and GDP growth accelerates to an average rate of 5.8 per cent (Asian Development Bank 1996:xv).

GDP has stagnated for four years since the CRP began, performing worse than at any time since independence (Figure 4). The higher rates of growth in 1997, 1998 and 2000 were a result of CRP loan spending. Population growth has continued apace, meaning that per capita GDP has fallen from 1998 levels but is now stabilising as GDP picks up slightly, mainly as a result of increased agricultural output. GDP is predicted to grow 3.1 per cent in 2004 and 3.0 per cent in 2005.

The decline in GDP growth immediately after 1998 cannot be blamed entirely on the CRP. It was partly the result of a fall in investment and exports and poor performance in the agricultural and industrial sectors. Exports fell 40 per cent between 1997 and 2002, while incoming investment plunged 65 per cent from 1999 to 2003, worse than worldwide foreign direct investment trends. Exports fell partly because of outside factors such as the 2001 ban on kava and declines in the international price of copra and other key export products such as beef and cocoa.

The CRP made no inroads into the trade deficit. While exports declined, imports continued to increase (Table 3). The trade deficit rose to 30 per cent of GDP by 2001, higher than the average for the 1990s. This leaves Vanuatu in exactly the same predicament as it was before the CRP—dependent on foreign aid to plug the hole in the balance of payments created by the trade deficit.

What could have been done differently?

If the CRP were really an effort to alter the economic structure for the better, it should have attempted to deal with economic volatility. Vanuatu is always going to

Table 3 **Vanuatu trade trends, 1998–2003** (million vatu)

	Exports (million vatu)	Imports (million vatu)	Trade deficit as a percentage of GDP
1998	4,323	11,257	21
1999	3,327	12,451	28
2000	3,622	12,315	26
2001	2,895	13,118	30
2002	2,590	12,433	30
2003	3,252	12,703	28

Note: Imports cleared for home consumption; merchandise exports; author's calculations.
Source: Vanuatu, 2004. *Monthly News Release, Overseas Trade*, September, Department of Statistics, Government of the Republic of Vanuatu, Port Vila.

experience natural disasters. Yet it need not depend in the long-term on a restricted array of agricultural commodities to which little value is added and whose international prices fluctuate widely. Dealing with such problems would have addressed a fundamental economic problem—supply-side constraints that keep the trade balance in deficit and forced reliance on aid inflows.

There was no grant or loan funding to the productive sectors or assistance with moving the economy away from dependence on copra. The CRP could have begun long-term—meaning ten years or more—programs aimed at boosting export-orientated output in these sectors. Currently, the fragmented nature of the economy and the absence of knowledge among farmers about production for sale overseas means that few export. One such agricultural program has been implemented recently, although not under the auspices of the CRP.

It has been claimed that the Rural Economic Development Initiative was part of the CRP. In fact, the Initiative originated in Tafea province with the assistance of a volunteer based on Tanna island. The program was later adapted, with donor funding, for the other five provinces.

Local ni-Vanuatu entrepreneurs do not have access to credit, partly because many do not have a history of borrowing. The CRP could have looked at schemes to allow people to use personal possessions and possibly land as collateral for small loans.

Tourism is bigger and has more potential than agriculture. Yet this area was also neglected. Among the main reasons for under investment in tourism are high transport costs, high consumer prices, and over-priced utilities and telecommunications. Most of these industries are monopolies. As suggested below, the CRP should have considered enacting a competition law and paying for an anti-trust commission.

The CRP did result in lower import tariffs, and this was aimed partly at preparing for entry to the WTO and regional free-trade areas. However, the tariff cuts were not the result of an economic study and appear not to have been integrated with any international trade strategy.[3] Trade liberalisation makes sense only by taking into account effective protection rates, rather than according to the blanket approach effected by the CRP.

One of the aims of reducing tariffs and other trade barriers is to increase competition from overseas, which carries a number of benefits including the more efficient allocation of scarce resources. Simultaneous with current-account liberalisation must be some impetus toward competition. This places paramount importance on sequencing reforms correctly, which means first instituting measures such as cutting start-up costs, introducing anti-trust legislation, and forming consumer advocacy groups. Only then can full external trade liberalisation take place. It is at this stage—when competitiveness has increased—that currency devaluation could be considered. In sum, there is a counter intuitive result: a delay in trade liberalisation can actually help lead to conditions under which competition increases and prices fall.

Among the reasons why reforms were not sequenced in such a manner was that there was insufficient ownership by local policy-makers. As an ADB report acknowledges,

> [t]he most significant success factor of Bank assistance for reforms in the Pacific is also the most obvious: political commitment to and ownership of the reform program is essential. Externally imposed reform measures (conditionalities) that have little government ownership are doomed to certain failure (Knapman and Saldanha 1999:169).

Moreover, in politically unstable countries (Vanuatu has had nine governments between

1995 and 2004), reform measures must achieve acceptance beyond parliament. After the early stages of the CRP, most of the foreign consultants left the country. In 1999 and 2001 successful motions of no-confidence resulted in changes of government, meaning that few of the original architects of the CRP were in office or in-country. Civil servants felt that the CRP burdened them with a new set of problems—the economy was performing worse and the foreign loan stock had increased, while a host of new legislation was on the books.

There is now widespread scepticism among the public sector. For example, the Director of Trade, Industry and Investment says that 'the CRP was a complete waste of time. It paid for the salaries of a few consultants and did nothing for the country' (personal communication, 2004). The current head of the Department of Comprehensive Reform, charged with implementing what is left of the CRP, believes that the Asian Development Bank pushed reforms without asking local partners what they expected from the changes (personal communication, 2004).

The 2002 UNESCAP assessment of the CRP makes a related point.

> Most of the consultants came from developed countries. They ploughed through the change process at speeds which local counterpart staff could not keep pace with. The cultural shock left the local counterpart staff somewhat baffled (UNESCAP 2002:14).

A local commentator who was present at the June 1997 national summit when the CRP was adopted also believes that reform was too fast.

> By June 1997 the blueprint for economic and public sector reforms had been drawn up. A year later, the legislative requirements for the ADB loan to implement the CRP were being debated in parliament at a speed uncharacteristic of the usual prolonged ni-Vanuatu processes. This accelerated process leads one to question whether the CRP is a home grown product (Salong 1998:17).

Knapman and Saldanha (1999:160) agree: '[t]he speed of formal rule-making has made it difficult to adequately explain to the population the key aspects of the reform'.

Although outside consultants may feel that they conducted sufficient consultation, many commentators feel they did not take account of local culture. A succession of newly-arrived consultants have been wrong-footed by their assumption that silence means acquiescence. Because ni-Vanuatu decision-making traditionally takes a long time and is usually non-confrontational, a public workshop is a poor environment for discussion.

By emphasising public-sector reform and basing the reforms on governance, the CRP appeared to shift blame onto Vanuatu legislators rather than the macroeconomic factors that are the root of a structural problem; which further undermined ownership of the reforms. It is also clear that many short-term consultants from overseas knew less than local civil servants about the productive sectors. As Knapman and Saldanha sum up, 'the results [of using consultants and external advisers] are far from encouraging' (1999:174).

Conclusions

The adjustment of economic structure in Vanuatu was necessary. GDP performance was erratic, while exports had annually exceeded imports since independence. Public spending was under control but financial management problems were emerging by 1998. Governance left a lot to be desired, the political system was unstable and corruption was growing. The government was somewhat boxed in, with little option other than to seek outside support.

These problems would probably have grown worse without the CRP. Decision-making is now more transparent, financial controls have improved and there are more checks and balances on the power of the executive. In sum, the machinery of governance is more modern as a result of the CRP.

But it has been argued here that it was a mistake to enact a governance-heavy package of reforms rather than attack the macroeconomic problems.

The lack of attention to the balance of payments is in obvious contrast to the typical structural adjustment model. While a traditional IMF-style response which focused on restricting domestic credit-creation would have been inappropriate, the CRP could have learnt from other adjustment experiences in an effort to prevent the economy from worsening so dramatically after 1997. As it was, GDP per capita declined, exports and incoming investment slumped and the trade balance remained in deficit.

However, the CRP did follow the IMF approach in its emphasis on tightening public expenditure. Why this was so is difficult to understand. There was not a serious borrowing problem and public spending was low in comparison with neighbouring economies. Despite recommending a balanced budget, CRP expenditure caused a consumption-driven growth spurt in 1997, 1998 and 2000, followed by two years of economic shrinkage, forcing government to engage in a pro-cyclical spending pattern and creating difficulties with debt settlement. Attempts to rein in spending have been unsuccessful while the US$20 million in total CRP loans and associated recurrent budget expenditure—over one-tenth of 1997 GDP—have saddled the government with growing external debt repayments.

The CRP was thus a faint echo of the global structural adjustments of the 1980s and with few of the positive results. If it had bigger teeth, it would have had to recognise the importance of the national possession of policies, ensuring that reforms were passed in the correct sequence and the adoption of reforms aimed at correcting the chronic balance of payments problem. Dealing with the balance of payments problem would have meant improving the performance of the export sector. In turn, this would mean passing a competition law, improving local access to credit, and investing in the rural areas and the tourism sector. Only subsequently should the trade account have been liberalised and devaluation considered.

It is easy to see these things in hindsight, but it is difficult to understand why some of the above-mentioned reforms were not recommended, so apparent were the problems. The lack of tailoring to local circumstances further emphasises the apparent lack of consultation with national policymakers, despite attempts to portray the program as home grown. It takes much more than letters from senior politicians and periodic workshops to win the support necessary for fundamental reform. Even if the program had been technically successful there is a moral angle too: a critical mass of the people must *own* any reform package rather than having it foisted upon them.

The worst failing of the CRP is perhaps not that it worsened economic performance, rather it was the missed opportunities. Many useful reforms could have been enacted instead. Few Vanuatu policymakers or politicians will now advocate a wide-ranging or ambitious change in policy. Meanwhile, the economy remains in a potentially parlous state. Vanuatu has taken on the garb of economic restructuring but little of the substance.

Notes

[1] This is not to suggest that the financial programming model is always employed in a simple monetarist way. The use of fiscal policy has been a feature of numerous stabilisation and adjustment packages.

[2] In general, international data are more reliable than domestic data. Trade statistics come from the ASYCUDA customs database, but anecdotal evidence suggests some importers regularly misclassify products. In 2004 US$1 was worth approximately 110 vatu.

[3] There appears to have been misunderstanding about regional trading arrangements. For instance, the Asian Development Bank (2002:33) report refers to PACER as the 'Pacific Area Commercial and Economic Relations Arrangement'. The correct name is the Pacific Agreement on Closer Economic Relations.

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Appendix

Appendix Table 1

First tranche loan disbursement conditions

1. Pass new government act to define boundaries between political leadership and public service.
2. Enact leadership code for politicians, senior civil servants and other leaders.
3. Pass public finance and economic management act.
4. Pass expenditure review and audit act.
5. Pass public service act.
6. Establish department of strategic management to coordinate the CRP.
7. Pass foreign investment act.
8. Restructure National Bank of Vanuatu.

Conditions for second release under first tranche

1. Introduce value-added tax.
2. Cut public sector employment by 10–15 per cent.
3. Establish Development Committee of Officials.
4. Establish Asset Management Unit.
5. Externally recruit new executive staff.
6. Appoint new board of directors to the Vanuatu National Provident Fund.

Conditions for release of second tranche

1. Establish expenditure review committee.
2. Implementation of management improvement plan to improve key management systems.
3. Establish government remuneration tribunal.
4. Establish master plan for national infrastructure development.
5. Transfer good loans from former Development Bank of Vanuatu to the National Bank.

Source: UNESCAP, 2002. *Project Completion Report in Respect of the Comprehensive Reform Programme,* Pacific Operations Centre, UNESCAP, Port Vila.