



Macroeconomic planning in Vanuatu: paramount or time-killing activity?

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In this paper it is argued that in a small open economy such as Vanuatu, micro analysis is more relevant to achieving improved growth performance than macroeconomic planning.¹

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Smallness as something unique

Are there peculiar features that need to be addressed before embarking on a particular economic policy in a small country? If so, is there a need to understand these features before their economic performance can be judged?

It seems the question is more one of ideology than size. International organisations reject the idea that smallness is a dimension that warrants special attention. Other observers, less concerned with the faith of market forces, believe that sustainability or economic success in small economies originates from their ability to attract aid and their reliance on remittances from overseas citizens.

The World Bank defines a small country as one with a population of less than one million inhabitants. In discussing smallness, observers refer to the degree of vulnerability (for example, few economic sectors), decision-making and administrative capacity, and aid dependence.

Concentration on few sectors and vulnerability

Srinivasan (1986) argues that there has been no significant correlation found between economic growth and the size of the market or country. Heavy concentration on the export of one or few commodities exists in many countries, small and large alike, and some countries, such as Singapore and Hong Kong, stand out as counter-examples to small countries being doomed to mono-culture production.

The World Bank (1991b) notes that adverse external factors during the 1980s do not tell the full story of meagre economic success in the Pacific. Instability of export earnings and import prices were not significantly higher in the Pacific than in big developing economies (Brazil, Thailand). Mauritius and the Maldives are examples of small, successful developing economies.

The World Bank recommends that growth in Pacific countries needs to be geared to a few specialised areas. Gayle

suggests that 'for small developing states, economic growth becomes much more closely correlated with effective involvement in international trade' (cited in Baker 1992:6). Streeten (1993) claims that in city states like Hong Kong, the absence of an agricultural sector has helped the country to prosper.

Decision-making

Some observers have argued that decision-making in small Pacific Island states is based on consensus. Srinivasan suggests that 'smallness brings social advantages, such as greater cohesion, and fewer vested interests' (1992:211).

Not necessarily conflicting is the view that government in small countries is more pervasive and when conflicts materialise, they are 'more personal, more intense, more emotionally charged' (Schahczenski 1992:44).

Administrative capacity

Arguments in favour of treating smallness as something singular fail to hold up when subjected to closer examination, but aid and local government capacity raise interesting questions. Because of the shortage of skilled local people in the administration, 'there is a natural tendency for aid missions to assume the role of identifying projects and deciding whether they are acceptable for funding' (Baker 1992:19). This occurs in all developing economies, but more so in small developing states.

Because of the size of fixed overhead costs in aid projects, donors automatically favour larger projects. In the case of Vanuatu, the Japanese government made it clear to the local authorities that they would only contemplate one large project each year. With no permanent diplomatic staff in-country, the Japanese attitude is probably understandable, although it makes things difficult for the Vanuatu

government—in a small country, large projects are hard to come by.

This applies to most sectors with the possible exception of infrastructure projects. The main problem is that with large infrastructure projects, there are large ongoing maintenance costs and these must come from the government's recurrent budget. Few projects are rejected because they are too costly for the recipient country. Problems with high maintenance costs exist in all developing economies, small or large.

Aid dependence

In terms of aid inflows as a percentage of GNP, the list is headed by other than small countries. In 1990, ODA as a percentage of GNP was 38 per cent in Tanzania, 42 per cent in Somalia and no less than 77 per cent in Mozambique. Aid accounted for 25 per cent of GDP in Vanuatu. But measured in terms of aid per capita, Vanuatu and Tuvalu belong to the group of most aid-reliant countries in the world. In Vanuatu, the figure is more than US\$250 per capita, compared with an average of US\$30 for all least developed economies (Folke 1992:45).

The observation that aid per capita is high in small countries could be related to the fixed cost limit of most aid projects.

Paths to development in small economies

Because of limited resources, small domestic markets and high transport costs (at least in states grouping several islands) and often high electricity costs, small countries are unlikely to reap profits from import substitution ventures. Nevertheless, almost every Pacific island country strives to become an industrialised country.

An alternative path could be to switch directly from a largely agrarian society to a service-sector based economy. Compared to other developing economies, most Pacific island countries have a clean environment, benign climate and a stable political

situation. These ingredients could be exploited to attract regional and international organisations, and research and educational institutions. There is no argument per se that every country has to become industrialised to achieve economic development.

There seems to be no conclusive evidence in the discussion that small states face problems that are exclusive to them. But it is argued here that micro analysis is more important in small states than macro planning. Vanuatu is examined as a case study.

Vanuatu's growth experience

During 1983–90, real economic growth was slow and unstable, averaging approximately 2 per cent per annum in real terms but fluctuating between 6.5 per cent in 1984 and –2 per cent in 1986. Growth slowed to around 2 per cent in 1991 and –2 per cent in 1992, and increased to 4.2 per cent in 1993. Fluctuations are attributed mainly to the openness of the economy and its vulnerability to external factors.

Vanuatu is an open economy, with no controls on capital flows or exchange rates and no direct taxation. Contrary to many other developing economies, Vanuatu has not experienced any major problems with internal (government budget) or external (balance of payments) macroeconomic imbalances. Aid transfers have covered the two deficits: external borrowings are related to projects funded by soft loans.

A current account deficit emerged in 1991 as repatriation of profits jumped from 500 million vatu in 1990 to a record of 4.1 billion vatu in 1991, presumably as a result of uncertainty about political stability.

Macroeconomic planning in Vanuatu

Ensuring that national financial stability is achieved and maintained is a vital factor in fostering investor confidence. It is one of the lessons from the macroeconomic

failures of the 1980s, when debt frustrated economic growth prospects in many developing economies. In contrast, Vanuatu has a good record in this respect. It has avoided high inflation and achieved considerable exchange rate stability without resorting to widespread controls or restrictions on capital movements. The government normally achieves a balanced budget for recurrent components. There are no price controls and no major government involvement in productive sector businesses. A Finance Centre (tax haven) has developed as a result of the absence of direct taxes.

If aid were to decline significantly, budgetary and exchange rate pressures would emerge. The exchange rate would have to adjust through a depreciation. A depreciation, however, could create new opportunities for, most importantly, the rural population and tourism.

Shortcomings in macroeconomic policy and planning should not be held responsible for Vanuatu not achieving growth rates similar to those of the Maldives or the Caribbean. Indeed, praise might be given for the determination with which the Vanuatu government has adhered to market-oriented philosophy. For the first time in the history of the Republic, a macroeconomic subcommittee was set up in 1990. Looking at the economic record of the two following years, it is tempting to see a connection between the improvement in macroeconomic planning and the relatively satisfactory result in 1990 and 1991 in terms of economic growth. This is erroneous.

The macroeconomic subcommittee to the budget committee (government budget) did not serve its original purpose, to form a group of government representatives to advise the Minister of Finance on macroeconomic issues. In two years, it produced only one paper on which all members agreed and this dealt with an assessment of economic growth patterns during the second national development

period (1987–91). Most disturbing is the fact that the various Ministers of Finance hardly knew of the existence of this committee.

The interesting point is that the economy continued to grow, however slowly, not because of, but despite, the absence of any macroeconomic planning. Most of the macroeconomic setting was inherited from the colonial times, for example, the tax haven. Fiscal policy has largely aimed at achieving an approximate balance of the recurrent budget. This is sometimes incorrectly interpreted as structural adjustment in Vanuatu. If anything, fiscal policy is at best regarded as stabilisation policy, but more properly, fiscal policy is the result of conservative accounting principles. An across-the-board 10-15 per cent reduction in recurrent allocations to the ministries was introduced in 1989, without prior debate on priorities between sectors or discussion of the likely impact on major donor projects.

The origin of trimming the budget deficit lay in the Department of Finance that correctly predicted a slower increase in revenue earnings than previously budgeted. With a self-defined policy of no lending for almost any purpose, the department could hardly approve a decrease in earnings resulting in a recourse to borrowing, and then only to cover recurrent expenditures. The Minister of Finance endorsed this approach.

With no exchange or capital control and an underdeveloped local monetised economy, the deposits of the offshore finance centre dominate the money supply. If the government wishes to maintain a relatively stable exchange rate policy, there is virtually no scope for active monetary policy. Furthermore, there are no effective administrative controls on bank lending and informal guidelines for commercial bank interest rates, issued in 1985, were later abolished. One international donor organisation has indirectly suggested that at least some sort of supervision of

commercial bank activities by the monetary authorities might be appropriate.

Is better macroeconomic planning the answer to Vanuatu's slow economic growth?

Theoretically, there are two possible scenarios under which macroeconomic measures become imperative. Either, macroeconomic planning is a prerequisite to achieving high growth rates in the 1990s, or if aid inflows look like they will suddenly be cut dramatically. Nevertheless, it is difficult to design a policy that maintains the openness of the economy (if deemed an absolute condition for high economic growth) and simultaneously introduces macroeconomic planning. Is Vanuatu therefore the ultimate response to the international call for liberalism, namely to make macroeconomic planning redundant?

A contraction in aid inflows may very well come into play at some point. A revamp of the entire taxation system is long overdue, partly because of the distortions created by the heavy reliance on import duties. The Third National Development Plan (National Planning and Statistics Office 1993) states that in terms of disbursed project aid, Vanuatu faced a 21 per cent decline during the second plan period (1987-91). Nevertheless, important projects are signed and the funds committed, so the actual decline may even out in the years to come. It is unlikely that the Vanuatu government will proceed with any major taxation reform without being forced.

The challenge for Vanuatu is to get better value for money from its huge aid portfolio. Skilled labour is a scarce resource in Vanuatu. Greater consideration should be given to using this resource more efficiently, especially by ni-Vanuatu economists and expatriates on TA programs.

In the past, the planning office, perhaps because of lack of legislative backing of its functions (Siwatibau 1991), has devoted most of its time to preparing five-year plans and administering aid programs. Considerable time is used dealing with administrative tasks *ad hoc*, because of a lack of capacity in the line ministries and because aid donors, even in small matters, find it easier to deal with the planning office. There has been too much focus on project administration and a neglect of economic analysis of projects and programs.

Despite the absence of a clear government statement spelling out the development priorities and the fact that politically-driven aid projects will appear occasionally, whatever the level of in-house economic sophistication, few ni-Vanuatu civil servants presently utilise even simple cost-benefit analysis. This could be one of the reasons why so many obscure projects are approved for external funding by the government, whether it is the First Secretaries or the Council of Ministries that has the final vote.

Politicians and civil servants in Vanuatu should not lose sight of the shortcomings of being aid dependent. Aid donors have inflexible policies that tend to pick certain sectors and preclude others. Often projects are capital-intensive or are overloaded with technical assistance services. Projects are very output biased and seldom truly long term. Laying the foundation conducive for establishment of a middle class of entrepreneurs in Vanuatu is a good example of such a project, with a typical three year duration, for which the donor organisation bears part of the responsibility for failure. Only when basic educational standards improve and the government's policy on industrialisation becomes transparent will a project of this nature be ripe for implementation.

A clear policy statement to establish priorities and preferred strategies is needed. Even with a huge aid portfolio,

resources are not unlimited. The Vanuatu government should do away with the ill-advised import substitution policy and switch to a less distorted taxation policy. While it is easy to criticise the present taxation system, it is less obvious how to replace it with a non-conflicting alternative. In a recent economic report, financed by one of the donor organisations, it was suggested to introduce a payroll tax while phasing out the import duties. The idea appears persuading, but one problem is, of course, the many foreign-owned businesses that could easily adjust their affairs so they pay themselves profits and no wages (*Pacific Islands Monthly*, May 1993).

Such discussion of future industrial policy and its repercussions on taxation policy or vice versa could be seen as macroeconomic policy. The boundary between macro and sectoral policies is not clearcut. But once this issue is dealt with, macroeconomic planning is made obsolete in Vanuatu. In Vanuatu, the key elements are program and project planning and improving administrative capacity in the line ministries. Instead of insisting on macroeconomic planning and policy, more effort needs to be devoted to establishing the capacity to review programs and projects within the government sector.

These conclusions are pertinent to Vanuatu and might not be applicable in all other small countries. At the same time, international organisations should be cautious with their advice to other small countries with limited labour resources. Is macroeconomic planning really required in small countries and if so, what are the data requirements to render the planning process useful? Small countries do, in fact, display some unique features.

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