



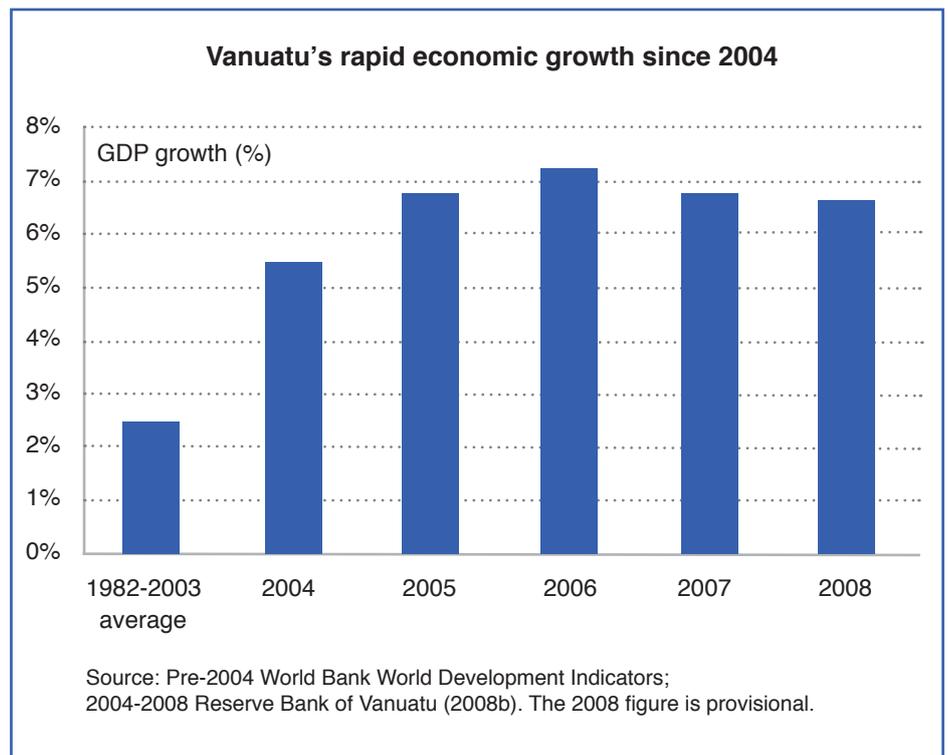
Fast growth in the Pacific is possible - look at Vanuatu

Stephen Howes and Nikunj Soni¹

Key messages:

- » Analysts have been slow to notice Vanuatu's economic turn around.
- » Vanuatu's growth acceleration is important for the Pacific.
- » Tourism and construction have been major drivers of growth in Vanuatu.
- » Macroeconomic stability has been important for growth, but is far from the only factor.
- » Vanuatu's recent growth has been led by the private sector, not by aid.
- » Vanuatu's upsurge in tourism and construction would not have been possible without an active land market.
- » Vanuatu has also benefited from deregulation.
- » Social stability underlies Vanuatu's recent success.
- » Recently-gained access to foreign labour markets boosts Vanuatu's growth prospects.
- » Due to the global recession, short-term growth prospects are uncertain. But so far in 2009, tourism growth has accelerated not declined.
- » Vanuatu's future is not assured. Small island economies are volatile and easily destabilised. But Vanuatu has gone much further than achieving macroeconomic stability, and has good prospects for long-term growth.

Analysts have been slow to notice Vanuatu's economic turn around. Most economists writing on Vanuatu credit it for having achieved macroeconomic stability, but note its poor long-term growth performance, which is little different from its annual population growth of about 2.5%.² It has been little noticed that growth in Vanuatu has accelerated in recent years. The economy grew at an annual average rate of 6.6% between 2003 and 2008.

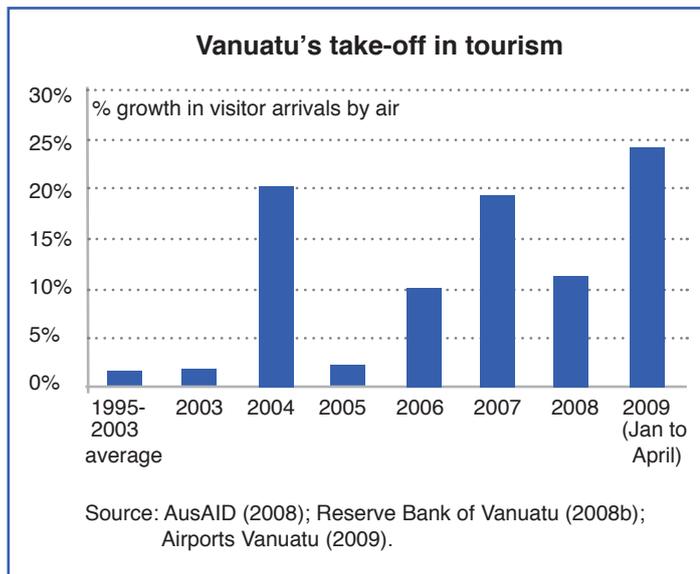


Vanuatu's growth acceleration is important for the Pacific.

It dispels the myth that the Pacific island economies cannot grow, and it confirms the range of factors which are important for growth in the Pacific – tourism, active land markets, deregulation, and macroeconomic and social stability.

Tourism and construction have been major drivers of growth in Vanuatu.

Tourism is fundamental to the Vanuatu economy. Even before the current boom, in 2002, tourism was estimated to be 17% of Vanuatu's GDP and 12% of employment.³ The average annual growth in visitor arrivals by air into Vanuatu was 12.5% between 2003 to 2008, compared to only 1.8% between 1995 and 2003.⁴ Visitor arrivals reached 90,657 for 2008. This is about the level of Cook



Islands and Palau, both of which were well ahead of Vanuatu five years earlier.⁵

Cruise-ship visitors to Vanuatu doubled since 2003, reaching 106,000 in 2008.⁶ The private sector is reported to be investing heavily in expanding hotel capacity.⁷

Construction growth accelerated from about 7% in 2004 to 25% in 2008.⁸ Construction is being driven by tourism growth, by expatriates and locals building houses, and now by the Millennium Challenge Corporation's large road-building project.

Macroeconomic stability has been important, but is far from the only factor underpinning growth.

Like many other Pacific island nations, Vanuatu has enjoyed macroeconomic stability, with relatively low inflation and a slight fiscal surplus in recent years. This has no doubt helped laid the foundations for growth. A number of other factors have also been important, however.

Vanuatu's recent growth has been led by the private sector, not by aid.

In current US dollars, average annual aid in the 1990s was USD 40 million, and from 2000-06 USD 38 million on average.⁹ Meanwhile, domestic lending to the private sector has grown strongly. A fourth commercial bank (the French bank, BRED) entered the Vanuatu market in March 2008. The stock of domestic credit to the private sector increased from 13.4 billion Vatu at the end of 2002 to 31.3 billion Vatu at the end of third quarter of 2008, an average annual growth in excess of 15%.¹⁰ Commercial lending has increased across most sectors. Loans for housing

and land purchases and for other personal loans have increased from 39% (end-2003) to 52% (Q3 2008) of the stock of commercial bank credit to the private sector.¹¹ This bears testimony to Vanuatu's growing middle class, as well as the country's active land market.

Vanuatu's upsurge in tourism and construction would not have been possible without an active land market.

As AusAID's 2008 *Making Land Work* report notes, "Customary land in Vanuatu can be leased for periods of up to 75 years and there is an active market in customary land leases." (p. 48) This has been effective in making land available for tourism and other uses. Most of Vanuatu's main island, Efate, has been marketed under 75-year leases, and the land markets in the outer islands are now becoming active as well. The problem Vanuatu faces is not that it lacks a land market, but that that market is not well regulated, so that, for example, disputes over ownership are common. There is also discontent that landowners are not benefiting from subsequent sub-divisions and development. These issues need to be addressed since they raise important questions of equity, and may lead to a social backlash, but they are very different issues to those which arise in countries which lack a land market.

Vanuatu has also benefited from deregulation.

Vanuatu's opening up of the telecom sector in 2008 led to an increase in mobile subscribers from 23,000 to 100,000 in the space of just 6 months. Air travel between Australia and Vanuatu grew by 19% the year after Pacific Blue started flying to Vanuatu in 2004 from Brisbane, thereby breaking Air Vanuatu's monopoly.¹² A further boost to tourism came in October 2008 when Pacific Blue started to provide competition on the Sydney-Port Vila route. Prior to October 2008, arrivals from Sydney were about 20% less than arrivals from Brisbane; by January 2009, they were 20% higher.¹³ Flights from Sydney to Port Vila are now available for not much more than flights from Sydney to Cairns. Vanuatu is now also served by Air New Zealand, Air Pacific, and Solomon Airlines.

Finally, social stability underlies Vanuatu's recent success.

Vanuatu suffered from a fiscal crisis in the late 1990s, two years of negative economic growth in 2001 and 2002, and intense political instability mixed with diplomatic tensions in 2004. Throughout this difficult period, violence was limited. Vanuatu has

a tradition of political instability – with nine prime ministers between 1995 and 2004. Perhaps the relative political stability enjoyed since then – with a single prime minister from end-2004 to end-2008 – has helped promote growth.

More fundamentally, underlying social stability in Vanuatu, and its ability to make transitions of power peacefully – national elections in 2008 resulted in another change of government – have helped lay the foundations for growth, including by enhancing the country's reputation among potential tourists and by promoting its prospects for inclusion in seasonal workers programs.

Social stability is also a key factor behind Vanuatu's ability to attract and retain expatriates, who bring investment and specialist skills to the economy. Its lack of an income tax is also an attraction for expatriates, though its role as an offshore financial centre seems to have played little role in its recent growth.

Vanuatu's recently-gained access to foreign labour markets boosts its growth prospects.

Vanuatu, like other Melanesian countries, has traditionally lacked access to foreign labour markets. However, Vanuatu was included in, and in fact is the biggest beneficiary of the Recognized Seasonal Employer program which provides temporary farm employment in New Zealand.¹⁴ Over 1,700 ni-Vanuatu participated in the scheme in its first year, 2008, and the total cap on participants from the region has recently been increased from 5,000 to 8,000.¹⁵ Vanuatu has also been included in Australia's Pacific Seasonal Worker Pilot Scheme, commencing in 2009. This will initially involve smaller numbers, but has the potential for large growth.

Due to the global recession, short-term growth prospects are uncertain. But so far, tourism growth has accelerated not declined.

Of course, with the global recession there is enormous uncertainty about Vanuatu's short-term prospects, as there is for most countries. The Government predicts growth of 4.4% for 2009. A downturn in tourism numbers is the major risk, but has not happened yet.

One would think that the global recession would have induced a slow down in tourism, but so far arrivals have been accelerating. Growth in January, February, March and April 2009 were, respectively, 29%, 24%, 12% and 31% above the corresponding

month in 2008. P&O announced in February that its cruise ship stops in Vanuatu will increase from 100 in 2008 to 180 in 2009.¹⁶

Aid has increased in the last two years. The large US-financed Millennium Challenge Corporation road construction (USD 66 million over 5 years) project which is just now taking off will also help counteract the effects of the global recession.

Vanuatu's future is not assured. All small island economies are volatile and easily destabilised.

Vanuatu has a long way to go, and faces a wide range of reform challenges. These include: improving health and education indicators, promoting further structural reform, reducing corruption, maintaining social stability, ensuring law and order, and promoting equity.

But it is time to recognise that Vanuatu has gone much further than achieving macroeconomic stability, and that it has good prospects for long-term growth.

For five years, Vanuatu has enjoyed broad-based, private-sector-led and relatively rapid growth. Tourism, construction and remittances will continue to offer opportunities for new employment, not only for Port Vila but the Outer Islands.

Traditionally, analysts have distinguished between the relatively good performance of the Polynesian countries (Samoa, Tonga, Cook Islands) and the relatively poor performance of the Melanesian countries (Vanuatu, Solomon Islands, Fiji and PNG). That Vanuatu's recent performance is making the contrast between these two regions less stark is a welcome development.

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End notes

1 This is a revised version of the article "Vanuatu's good recent growth performance and prospects" which appeared in the 2009 Pacific Economic Bulletin (Vol. 29, No.1). Stephen Howes is Professor, Crawford School of Economics and Government, Australian National University (stephen.howes@anu.edu.au); and Nikunj Soni is the Executive Director, Pacific Institute of Public Policy. Thanks to Chris Bleakley, Satish Chand, Rod Duncan, Timo Henckel, Helen Hughes, Odo Tevi, Leith Veremaito and Charles Yala for comments and inputs.

2 Duncan (2008), Hughes and Sodhi (2006, 2008) and Henckel (2006).

3 AusAID (2006)

4 Reserve Bank of Vanuatu (2008b), AusAID (2006).

5 AusAID (2008), Figure 2.5.

6 Reserve Bank of Vanuatu (2008b).

7 For example, the Australian Department of Foreign Affairs September 2008 brief (DFAT, 2008) notes that: "Increasing investment in new boutique-style hotels, refurbishment of larger resorts, stronger interest in locally-owned bungalows and industry interest in the backpacker market also point to further growth in this industry." See also EU (2008).

8 Reserve Bank of Vanuatu (2008a), Figure 11.

9 Data from the World Bank World Development Indicators, accessed on-line on 17 February 2009.

10 Reserve Bank of Vanuatu (2008a)

11 Reserve Bank of Vanuatu (2008a)

12 AusAID (2008)

13 Airports Vanuatu (2009)

14 McKenzie et al (2008)

15 "NZ RSE Scheme Cap Raised to 8000 Workers for the New Season," 20 November 2008, <http://www.nzembassy.com/news.cfm?CFID=23278009&CFTOKEN=56391964&c=29&i=75&i=5483>

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