LDC GRADUATION AND ITS IMPACT ON DOMESTIC REVENUE IN VANUATU

Summary findings

October 21, 2019

Port Vila

LOOSING LDC STATUS HAS NO DIRECT IMPACT ON DOMESTIC REVENUE

This is because unlike recent bilateral trade or multilateral fiscal negotiations LDC graduation is not an agreement. Vanuatu will graduate simply because mathematically it meets certain criteria. Therefore, unlike WTO, PACER PLUS, MSG or OECD FITF there are no fiscal policy requirements that result directly from LDC graduation.

THE CASE OF SAMOA HAS SCARED PEOPLE

It is known that Samoa sought to reverse its graduation due in part to similar concerns about the impact of LDC graduation. The general concern is that LDC graduation will hurt the domestic economy due to loss of access to concessional financing and loss of access to some international markets. The theory is that these losses will in turn affect domestic government revenue leading the Government to look at new taxes which in turn will cause more fiscal uncertainty.

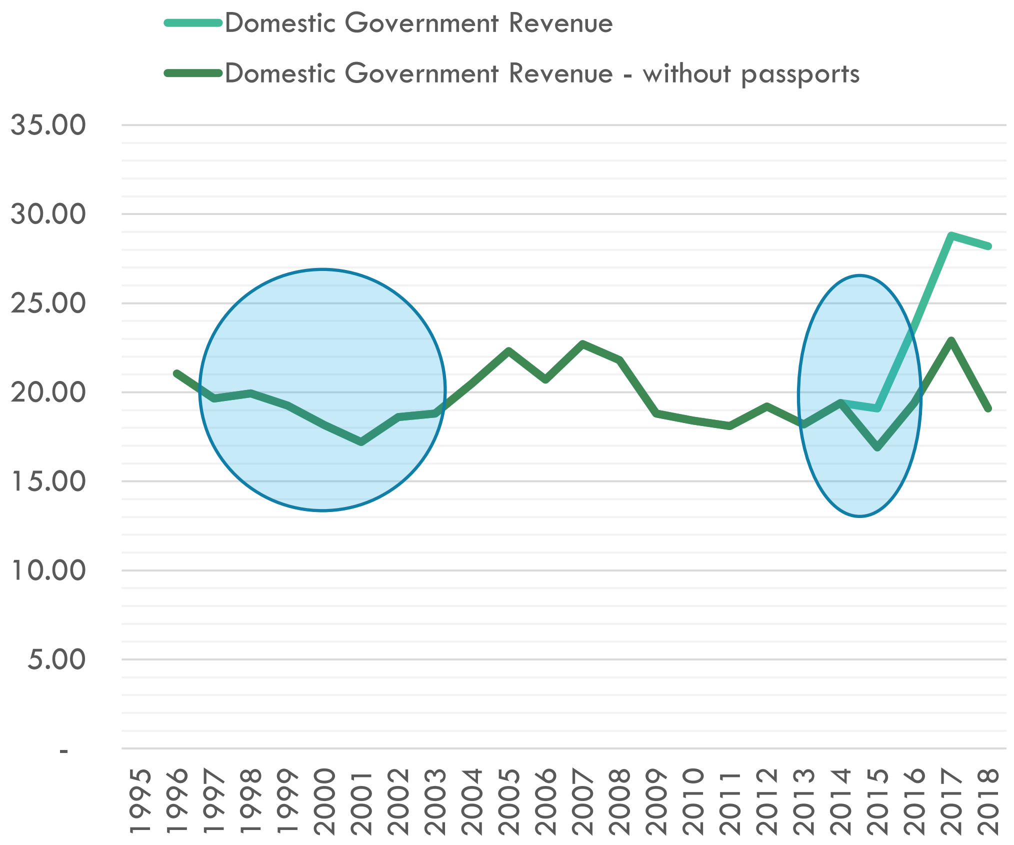
LOOSING LDC STATUS HAS NO INDIRECT BEARING ON DOMESTIC REVENUE IN THE SHORT TERM

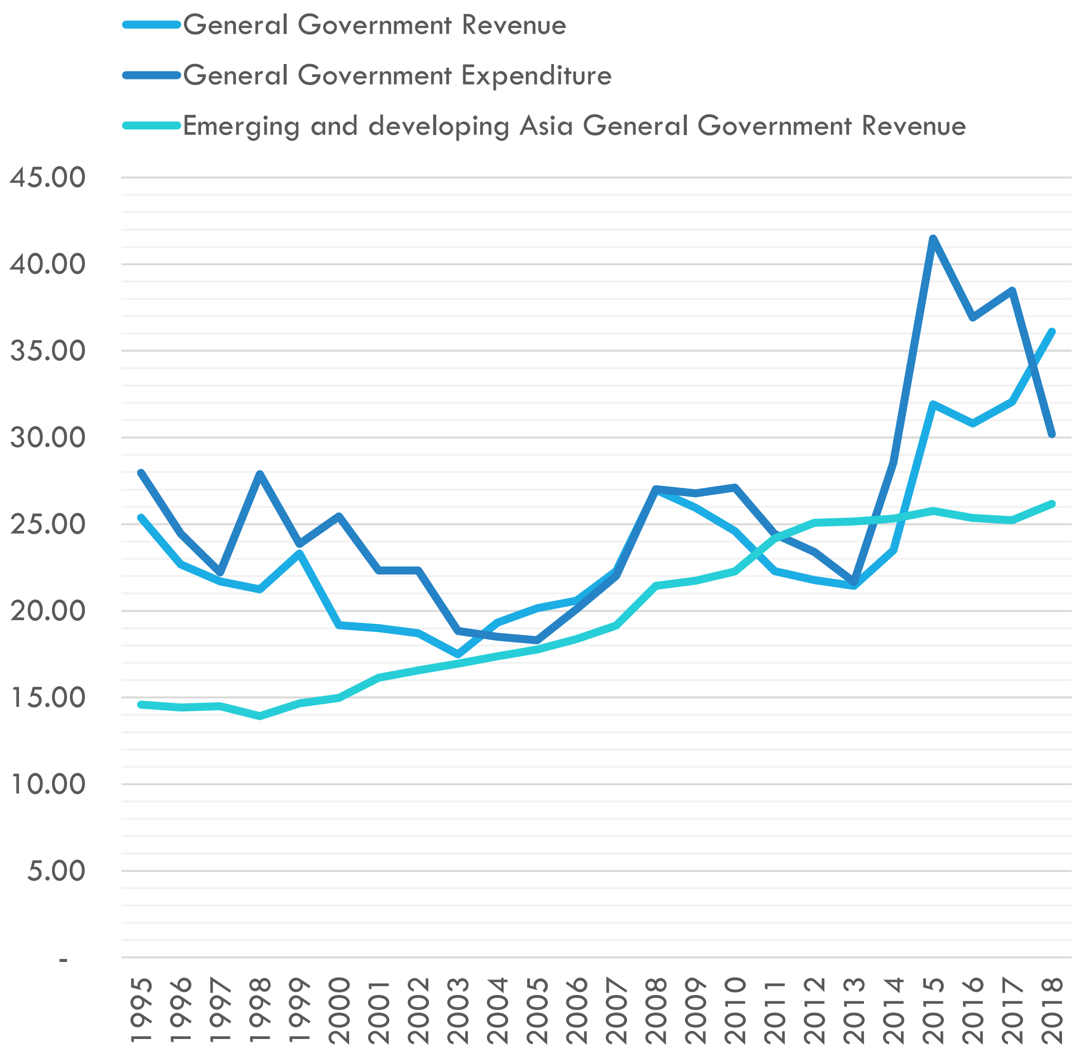
Vanuatu exports to markets that might be affected in the medium term by the loss of LDC status do not contribute anything significant to domestic revenue. This is because there are limited export taxes in Vanuatu, no income taxes and the exporting firms tend to directly employ few local people, usually on minimum wage. Secondly, as Samoa has shown, it is also possible to undertake direct agreements with bilateral partners to negotiate temporary access to some of these markets should there be a political and economic desire to do so.

International donor financing, grants and loans are increasing with more options meaning that there is no prospect of loans for economic projects not being financed. The increase in bilateral loans (which are almost always concessional) due to geopolitics also mean that there is no real prospect of Vanuatu seeing an increase in the cost of major economic projects and as such LDC graduation is unlikely to have a negative impact on future Government investment requirements.

Government Revenue Over The Past 28 Years

As % of Nominal GDP





THE MAJOR RISKS TO DOMESTIC REVENUES IN THE SHORT TO MEDIUM TERM

Climate Related

The impact of climate change as witnessed through a greater frequency and intensity of climactic events such as cyclones will affect the economy of Vanuatu.

Fiscal

Vanuatu is also vulnerable to some fiscal risks from potential events such as the sudden loss of passport revenue and historically poor implementation of fiscal changes as Vanuatu gradually opens up its economy in line with global trading norms.

THERE ARE REASONABLE SOLUTIONS TO THE CLIMATE AND FISCAL CHALLENGES

For example, the Ministry of Finance and Economic Management (MFEM) has done an excellent job of sterilising and protecting the revenue from passport sales. Moving forward this could be formalised by creating a Natural Disaster Fund to be used in the case of national emergencies such as cyclone Pam.

In the short to medium term the Government could also look to strengthen revenue collecting agencies in order to prepare them for the medium to long term changes in the fiscal base that will probably occur as part of the process of integration into various global markets.

IN THE LONGER-TERM RELIANCE ON IMPORT DUTIES WILL PROBABLY REDUCE

The impact of LDC status on trade will add to the growing argument that eventually almost all import duties for Vanuatu will be removed or greatly reduced. This is unlikely to happen in the next decade and will certainly not happen in the next five years in a way that would significantly affect domestic revenue, but it is important for Vanuatu to continue to think about and develop its tax structure to reflect its growing and changing economy.

The forthcoming Trade and Investment Framework Agreement's (TIFA) and Free Trade Agreements (FTA) such as PACER PLUS will require consideration of fiscal changes such as the greater use of excise taxes or the introduction of taxes on income, but this process is under the control of the Government and not dependant on LDC status.

If the Government can negotiate a relatively long time frame for these adjustments (similar to what is being proposed under PACER PLUS) and continue to focus on TIFAs with its Asian trading partners then there will be no need to rush now to make changes to the fiscal regime but if planned and designed carefully these taxes (on excise, income and consumption) could offset revenue losses from the gradual process of trade liberalisation.