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## Vulnerability profile of Vanuatu

Note by UNCTAD

### 1. **Institutional context**

#### 1.1 Date of independence

The New Hebrides gained independence from France and the United Kingdom on 30 July 1980.

#### 1.2 Date of admission in the LDC category: 1985

#### 1.3 History of qualification for graduation

Vanuatu met two graduation thresholds (GDP pc; human assets) in 1994 and 1997; met only one threshold in 2000 (GDP pc) and 2003 (GNI pc); met two thresholds again (GNI pc; human assets) in 2006, thereby pre-qualifying for graduation.

Same observation in 2009 as in 2006.

### 2. **Low income criterion**

#### 2.1 GNI per capita, in US \$ (3-year average used in 2009): \$1,737

#### 2.2 GNI per capita, in US \$ (latest year available, World Bank online database):

\$1,840 (2007)

NB: GNI is 8% smaller than GDP.

#### 2.3 Income distribution status (based on household income and expenditure surveys or poverty surveys)

40% of the total population (51% of people in rural areas) have an income below \$1 a day, and 16% of the population is under the basic needs poverty line. Per capita income measurement overshadows the dramatic income inequalities between rural and urban areas. Over 80% of the population depend on agriculture for their livelihood. Yet the rural sector contributes only 8% of GDP.

#### 2.4 Distance from the graduation threshold (per capita income score)

2000: 137.1% of the threshold

2003: 120.3% of the threshold

2006: 131.9% of the threshold

2009: 159.9% of the threshold

3. **Human assets weakness criterion**

3.1 Population (*Source: UNCTAD*): 226,000 (2007)

3.2 Population growth rate (per annum over the 2005-2010 period): 2.38%

3.3 Percentage of population undernourished (*component of the HAI*)

CDP estimate in 2006: 12% (2000-2002)

No confirmation could be obtained from national authorities. It is estimated that 10% of children are underweight. Changing pattern of food preferences involves increased reliance on imported food ("we sell our taro to buy rice"), which exposes people to price shocks as well as dietary imbalances. A third of all people are considered overweight.

Other nutrition indicator: According to a national survey in 2006, only 21.5% of the total population enjoys the comfort of piped water at home as their source of drinking water. This ratio is 13% within the 30% of the population with the lowest levels of income.

3.4 Child (under 5) mortality rate (*component of the HAI*)

CDP estimate in 2006: 42 per 1,000 (2000-2005)

This figure is informally confirmed by national authorities. People in rural areas have very little access to health services beyond primary facilities. The vast dispersion of islands and narrow government expenditure base make the provision of health services in rural areas very difficult.

Life expectancy at birth (*2005-2010; Source: UNCTAD*): 70 years

3.5 Secondary school enrolment rate (*component of the HAI*)

CDP estimate in 2006: 28% (2002-2003), subsequently revised to 41%.

Implementation, since 2006, of an education management information system (the *SIGEN*) has enabled government to find a gross secondary school enrolment rate of 37.4%. Yet, this figure reflects, for most students, only the early part of the school year, and overlooks the high drop-out rate. The latter causes the gross enrolment rate to be well under 20% if one takes into account students who would have attended at least a full semester (10% for students attending the full school year). Most parents in rural areas cannot afford the expense of a full year at secondary level (85 to 90% of Form 13 or 14 students drop out for these and other reasons).

### 3.6 Adult literacy rate (component of the HAI)

CDP estimate in 2006: 74% (2000-2004)

A 2007 AusAID-funded survey found an adult literacy rate of 33%, which corroborated two earlier surveys by the ADB (33.5% in 1997) and the South Pacific Commission (34% in 2001). This low performance is explained by the fact that, for a large majority of ni-Vanuatu, the ability to write as acquired at primary school level was subsequently lost as a result of the predominance of oral communication in private and work life.

### 3.7 Distance from the graduation threshold (HAI score)

2000: 94.5% of the threshold

2003: 94.1% of the threshold

2006: 103.1% of the threshold

2009: 109.5% of the threshold

## 4. **Economic vulnerability criterion**

### 4.1 Natural shocks (overview)

Extreme vulnerability to violent natural shocks.

World-record numbers of disasters:

- . over 100 tropical cyclones in 40 years, including about 60 hurricane force events (average of 2 cyclones per year)

- . at least 10 active volcanic sites (with exposed population) throughout the country

- . 22 major earthquakes in 27 years (July 1980 to August 2007), with an average magnitude of 6.6 on the Richter scale

- . Flooding and drought events associated with the Southern Oscillation Index (El Niño/La Niña)

### 4.2 Instability of agricultural production (component of the EVI)

CDP, in 2006, observed a level of instability 15% higher in Vanuatu than in other developing countries. There was great instability, over the years, in the production of copra, coconut oil, beef, cocoa and kava. Not all these movements were related to natural shocks, but the latter did explain some of the fluctuations in produced quantities.

### 4.3 Homeless population as a result of natural disasters (component of the EVI)

CDP, in 2006, observed a level of homelessness 3.6 times higher in Vanuatu than in other developing countries. Though a proportion of these homeless would have been in this situation continuously for poverty-related reasons, many became homeless because of severe natural events.

#### 4.4 Economic shocks (*overview*)

Beyond the economic impact of natural shocks, Vanuatu is highly exposed to the effects of demand and price factors, which affect its balance of payments. The instability of merchandise exports is relatively high (see below). For example, total exports of goods were estimated by the central bank to be 27% lower in 2007 than in 2006 (at current prices). One also anticipates that 2008 balance of payments data will reflect food and oil price shocks.

#### 4.5 Instability of exports of goods and services (*component of the EVI*)

CDP observed, in 2006, a level of export instability slightly lower than the average for all other developing countries. This reflects the increasing role of international services (with a share of total exports greater than 80% over the last decade). Trade in services, in the Pacific, enjoys lower exposure and a stronger resilience to international shocks.

#### 4.6 Economic specialization (*overview*)

Trade in services, over the last decade, developed further as the mainstay of Vanuatu's economy, with gross tourism receipts now accounting for 2.5 times the value of merchandise exports. Hotel development and unprecedented growth in foreign ownership of real estate have boosted the construction sector. Meanwhile, the specialization of the rural sector did not change significantly (with copra, beef, timber, cocoa and coconut oil accounting for 34% of total merchandise exports). Noteworthy is the rising importance, since 1998, of kava, now the leading export crop. Overall, the pattern of Vanuatu's specialization is that of a dual economy, with a modern urban sector on the one hand, and a large majority of the population, in rural areas, trapped into poverty on the other.

#### 4.7 Primary activities as a percentage of GDP (*component of the EVI*)

CDP's 2006 estimate of the share of agriculture, forestry and fisheries in GDP: 21.4% (2003 or 2004 data).

Government estimate for 2006: 16.9%

The decrease in the economic importance of these sectors is a consequence of the structural disadvantages of remoteness and smallness more than a reflection of lesser economic vulnerability.

#### 4.8 Merchandise export concentration (*component of the EVI*)

CDP, in 2006, observed a merchandise export concentration 9% lower in Vanuatu than in all other developing countries. Though relatively diversified, the merchandise export base is highly vulnerable to natural shocks and international price fluctuations: sometimes for the better (e.g., coconut oil, kava and vanilla in 2006), or for the worse (cocoa and root crops in 2006).

#### 4.9 Economic smallness (*component of the EVI*)

Economic smallness as a component of the EVI remains one of the factors explaining Vanuatu's economic vulnerability. With the overall rural economy undergoing little development, the notion of smallness is not ill-placed.

#### 4.10 Economic remoteness (*component of the EVI*)

Vanuatu's score in the remoteness index the CDP used in 2006 revealed that the country had been 20% more remote than all other developing countries. Remoteness is a major structural handicap for Vanuatu, a factor of the difficulties the country faces in re-specializing its rural economy, and ultimately a lasting factor of exposure to shocks, therefore of vulnerability. In addition to the country's remoteness from international markets, it is important to note the scarcity of transport services between the outer islands of the archipelago on the one hand, and the capital island of Efate (let alone the rest of the world) on the other.

#### 4.11 Environmental vulnerability (*overview*)

Vanuatu, like all Pacific SIDS, is affected by global environmental threats. The frequency of cyclones increases as a result of climate change, while the frequency of earthquakes remains unchanged. Meanwhile, climate change and sea level rise aggravate the impact of meteorological and hydrological disasters.

#### 4.12 Distance from the graduation threshold (*EVI score*)

2000: 74.9% of the threshold

2003: 74.3% of the threshold

2006: 59.3% of the threshold

2009: 61.2% of the threshold

### 5. **Anticipated consequences of graduation**<sup>1</sup>

#### 5.1 In the area of development financing

The question of graduation has so far not been considered an important parameter in the dialogue on development financing between national policy makers and the country's development partners. Moreover, the question of graduation from LDC status is irrelevant to the US-funded Millennium Challenge Account programme for Vanuatu.

The six main bilateral partners of Vanuatu (the European Union, New Zealand, Australia, France, China, Japan), which account for 69% of the donor-funded part of the Government Investment Programme, are more or less

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<sup>1</sup> Findings summarized in this section result from an UNCTAD mission to Vanuatu in July 2008.

silent on how a loss of LDC status might affect the continuation or extension of their aid to Vanuatu.

It is generally hoped that ODA inflows will not be affected in any significant manner in the short to medium term if donors do not lose sight of the dual nature of Vanuatu's development pattern.

The two most important regional partners of Vanuatu, namely, New Zealand and Australia, are likely to maintain a fairly stable pattern of aid to Vanuatu irrespective of the country's status, in keeping with their history of special attention to the problems of SIDS of the Pacific.

There is no indication that a hypothetical loss of LDC status would have any impact on Vanuatu's entitlement to the technical assistance several regional bodies such as the Forum Secretariat, the South Pacific Regional Environment Programme, and the South Pacific Commission extend to their members.

Three agencies and programmes of the UN system are among the development partners of Vanuatu (UNDP, UNICEF, UNFPA, together accounting for 27% of the GIP), where they provide important technical assistance; in the event of a loss of LDC status, these organizations would be bound to the most exemplary adherence to the UN General Assembly's call for a "smooth transition" for graduating countries.

## 5.2 In the area of trade

According to most recent export data made available by the Government of Vanuatu, 36% of the total value of Vanuatu's merchandise exports involved zero-tariff treatment on an MFN basis in 2006, therefore no preferential margin for Vanuatu, and accordingly, no loss of preference in the event of graduation.

Within the free-trade zone of the Melanesian Spearhead Group (Fiji, Papua New Guinea, Solomon Islands, Vanuatu), Vanuatu exports two products on a (preferential) duty-free basis that would not be affected by a loss of LDC status: bovine meat to all three partners, kava to Fiji and the Solomon Islands, and small quantities of vanilla to Fiji.

Moreover, a loss of LDC status would have no direct consequence on Vanuatu's exports to New Caledonia in terms of market access and competitiveness.

For a range of products of interest to Vanuatu, preferential (zero-tariff) treatment on LDC grounds, in the event of graduation, would be superseded by equally advantageous preferential treatment by virtue of another special regime such as EU treatment of imports from countries of the Africa-Caribbean-Pacific (ACP) group, or the Spartecca preferential treatment unilaterally granted by Australia and New Zealand to Pacific island States.

Overall, products benefiting from, or facing: (i) MSG free-trade arrangements; (ii) zero MFN rates; (iii) MFN (or non-MFN) duties and no relevant special treatment; or (iv) equally advantageous preferential arrangements (ACP, Spartecca, Japan's GSP) other than LDC treatment account for a very large proportion of Vanuatu's export structure. This proportion was estimated at 87% in 2007. This leaves at less than 10% the share of merchandise export receipts that is facing the risk of losing the benefit of LDC treatment without compensation (fresh and frozen bovine meat to Japan, wood to the United Arab Emirates).

The only credible concern, among these three cases of anticipated losses of preferential margin and possible loss of competitiveness, is the case for frozen meat exports to Japan, as this market accounted for a significant two-third (65.7%) of the total value of frozen bovine meat in 2006, and involved one of the largest preferential margins (38.5%) in the entire structure of Vanuatu's external trade. There is no indication of what Japan's graduation policy would be with regard to its imports of frozen meat from an ex-LDC.

In short, there is ample evidence of a very small anticipated impact of graduation on Vanuatu's export economy, based on the current structure of exports, which is unlikely to evolve significantly in the medium to long term.

In the multilateral arena and outside the sphere of technical assistance, the benefits derived by Vanuatu from LDC status in its long-lasting (still unfinished) process of accession to the WTO have been non-existent. In region-wide negotiations among Pacific States, toward free trade within the region or in the framework of "North-South" negotiations (Economic Partnership Agreement with the European Union; Pacific Agreement on Closer Economic Relations with Australia and New Zealand), LDC status seems to carry no weight as a criterion for special treatment, although a case for non-reciprocity in free-trade arrangements could in theory be made by the five LDCs of the region.

Implementation of the Enhanced Integrated Framework of trade-related technical assistance to LDCs would be in large part, or totally, completed before 2013 if Vanuatu's graduation was decided upon in 2009 (implying effective loss of LDC status in early 2013).

### 5.3 In the area of UN budgetary support by virtue of LDC status

The estimated total UN coverage, by virtue of LDC status, of UN-related travel costs for Vanuatu's delegations may amount to US \$150,000. Losing access to UN budgetary support in the event of graduation would result in either a substantial additional range of public expenditure or frequent absence from international events and ensuing marginalization from the multilateral scene.

## 6. **Has the country demonstrated structural progress?**

This section raises, and briefly answers, six important questions relevant to the country's structural progress (the irreversible and catalytic progress logically expected to be observed, at least to some extent, in any graduating country). These questions are not graduation criteria, but supplementary considerations the LDC criteria could not underpin. The aim is to enhance the understanding of graduation cases.

### 6.1 Human assets and productive capacities

(Question 1:) Has the health and education infrastructure already reached investment levels sufficient to generate human capabilities?

The dispersion and under-development of the outer islands of the archipelago is a lasting cause of the limited access to health services for a large majority of ni-Vanuatu. As for the education infrastructure, it will not generate structurally sufficient levels of human capital so long as secondary education is not free of charge for ni-Vanuatu families, a large majority of which cannot afford to maintain their youth through the secondary school cycle.

### 6.2 Infrastructure and productive capacities

(Question 2:) Has a minimum public infrastructure already been developed as a catalyst for enhanced productive capacities through all populated regions of the country?

Outside the sphere of rapid development in the two main urban areas of the country, the public infrastructure remains poor or greatly insufficient to fuel domestic entrepreneurship or attract foreign investors (except in the hotel industry). Vanuatu's dual economy is easily recognizable through this particular facet of inequalities and uneven development among the islands.

### 6.3 Institutional development and productive capacities

(Question 3:) Has government managed to create an enabling environment that already proved efficient in encouraging private investment through all populated regions of the country?

As noted by the World Bank, Vanuatu remains one of the most costly countries in the Pacific for business development, except perhaps in the two main urban centres. The structural characteristics of remoteness and smallness, in an environment often threatened by natural disasters, defeats the idea of an overall enabling environment for productive capacities.



#### 6.4 Productive capacities and economic specialization

(Question 4:) Has the specialization of the economy already evolved toward products less dependent on trade preferences and/or more resilient international service activities?

The specialization of the country has considerably evolved, over the last two decades, toward a service-dominated economy, notably as a result of tourism growth. This constitutes a precious step toward structural progress, though the hotel industry is not exempt from exposure to risks of natural disasters. However, the road toward a more integrated Vanuatu economy in which enhanced specialization would mean poverty reduction for large numbers remains long.

#### 6.5 Employment-based or jobless growth?

(Question 5:) Has the increase in per capita income been fuelled primarily by enhanced productive capacities and employment opportunities?

The steady increase in the country's per capita income illustrates the most important aspect of Vanuatu's economy, namely, its dual nature, with a modern sector that revealed productive capacities (tourism, real estate, construction and related services), and a rural economy (involving over two thirds of the population) where productive capacities and employment opportunities, if maintained, remain unable to lead to prosperity levels.

#### 6.6 Equitably distributed prosperity?

(Question 6:) Has poverty reduction, all things being equal, already taken place in an equitable manner?

Poverty reduction, for two thirds of the population, has hardly taken place at all. The goal of equitably distributed economic opportunities will remain difficult to fulfil because of the severe permanent constraints on the economy.

#### 6.7 Conclusion

Nearly non-existent progress in productive capacities in the rural country, as the apparent prosperity essentially remains limited to the two urban centres, with buoyant construction activities (hotels and private real estate) largely benefiting foreigners. In this symptomatic dual economy, nearly three quarters of the national population (notably in the peripheral islands and shantytowns) never felt the winds of economic progress and poverty reduction.