Summary Report

Identifying Optimal Tax Structure for Vanuatu

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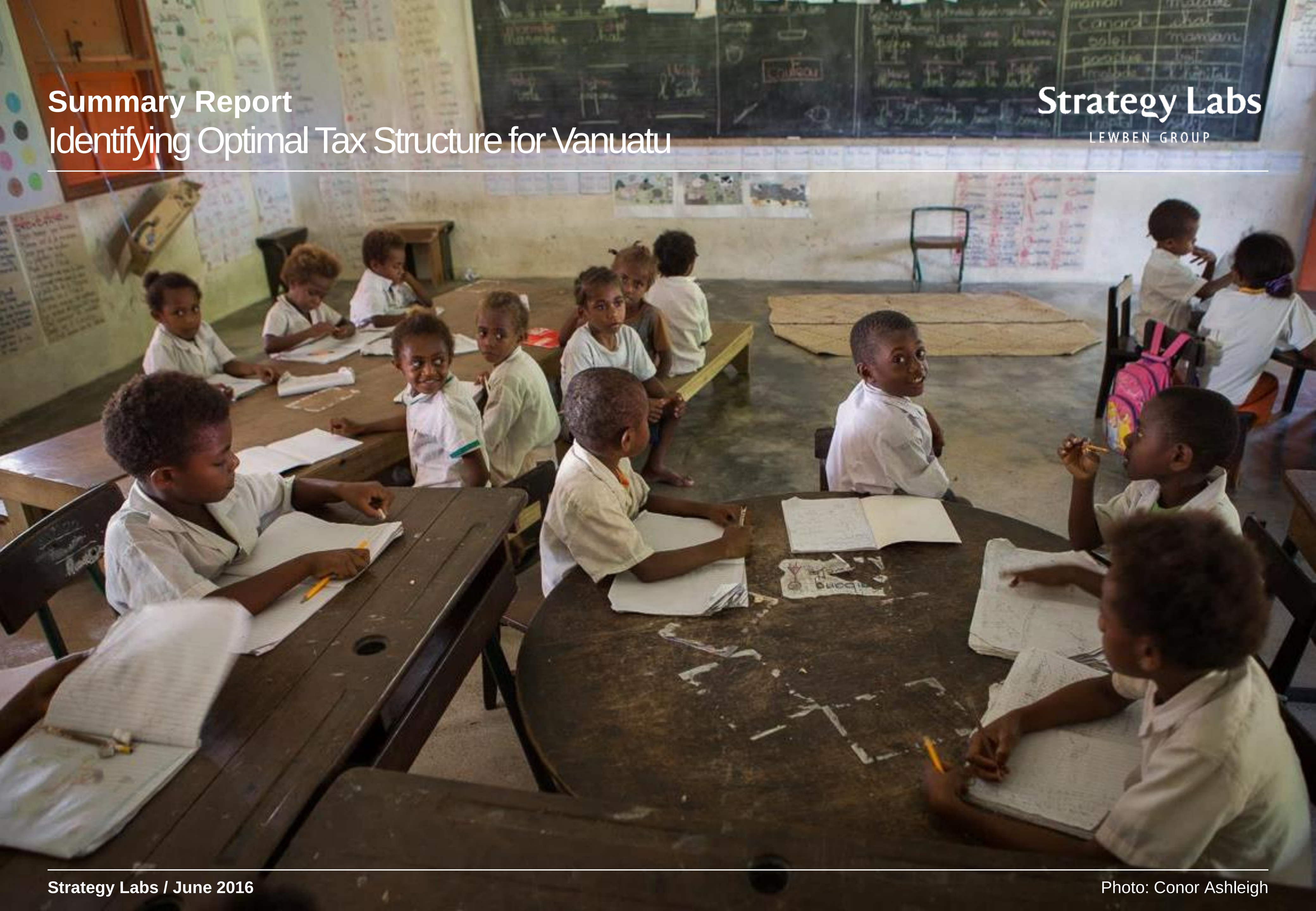

Photo: Conor Ashleigh

Executive Summary

Long-term prosperity through strategy aimed at growth and education

The government of Vanuatu is facing a difficult challenge of adjusting its tax structure in a way which would help increase revenues while at the same time ensure high standards of living for its population in the long run. Human capital, i.e. education and skilled workforce are what separates the rich countries from the poor, and enhancing the level of local schools should be one of the top long-term strategic goals. To increase government revenues for funding social and infrastructure projects, the medium-term development strategy should be aimed at capturing foreign investments, creating new jobs and attracting skilled labor force from abroad.

FDI as a key instrument to sustaining long-term growth

Foreign investment brings financial resources and new businesses to Vanuatu and in such way helps create new jobs as well as generate more fees and VAT revenue for the government. This revenue can then be used to finance medium and long-term development strategy projects which in turn will generate further flows of investments and create a virtuous circle fueling economic growth.

Creating enough jobs for a rapidly growing nation

Vanuatu population numbers are growing significantly. The job market must follow, signaling the need to prioritize job creation in the medium-term. This could potentially be achieved through structuring tax incentives for industries and individual businesses which promote more employment opportunities for the local population. Developing tourism sector could prove to be the most reliable strategy as it would give a considerable boost to a wide range of local industries.

Attracting skilled labor to meet the daily needs of the population

Due to its small population size and shortage of skilled labor locally, Vanuatu relies heavily on importing talent from abroad to fill critical roles in schooling, medicine, finance, government administration and many other sectors. In the medium term, the country should actively try to maintain its competitiveness in the PICs region to attracting foreign professionals with favorable tax structure as a primary instrument for doing so.

Introduction of income taxes would be counter-productive

Major changes to current tax structure, e.g. introduction of personal income and corporate taxes are not recommended as they would significantly hinder the country's potential to achieve identified medium-term strategic priorities of bringing in FDI, promoting local business activity and job creation, and attracting foreign talent. It is very doubtful that the newly acquired tax revenue would outweigh the costs of collection which include huge investments in systems, training of tax inspectors and resources for increasingly complex tax administration. Wasting valuable human resources on such trivial tasks as tax collection is also questionable in a country where availability of competent labor is so limited.

Increasing public revenue through compliance and tax rate adjustments

Targeting higher tax compliance and adjusting rates of current taxes could be a much more effective and quicker way of raising revenue for the government, at the same time contributing to implementing medium-term strategic objectives. VAT is currently the largest source of public income. Naturally, the largest potential lies within increasing VAT collections and adjusting VAT rate to 15%. Higher excise rates, particularly for tobacco products, as well as higher land and license fees is another potential source to raise revenues. Finally, considerable government financing opportunities could be unlocked by gradual sell-off of its land and buildings assets which would also help boost local entrepreneurship and reduce administrative strain. All these measures combined could provide government funding necessary to finance long-term strategy aimed at ensuring sustainable economic growth and prosperity.

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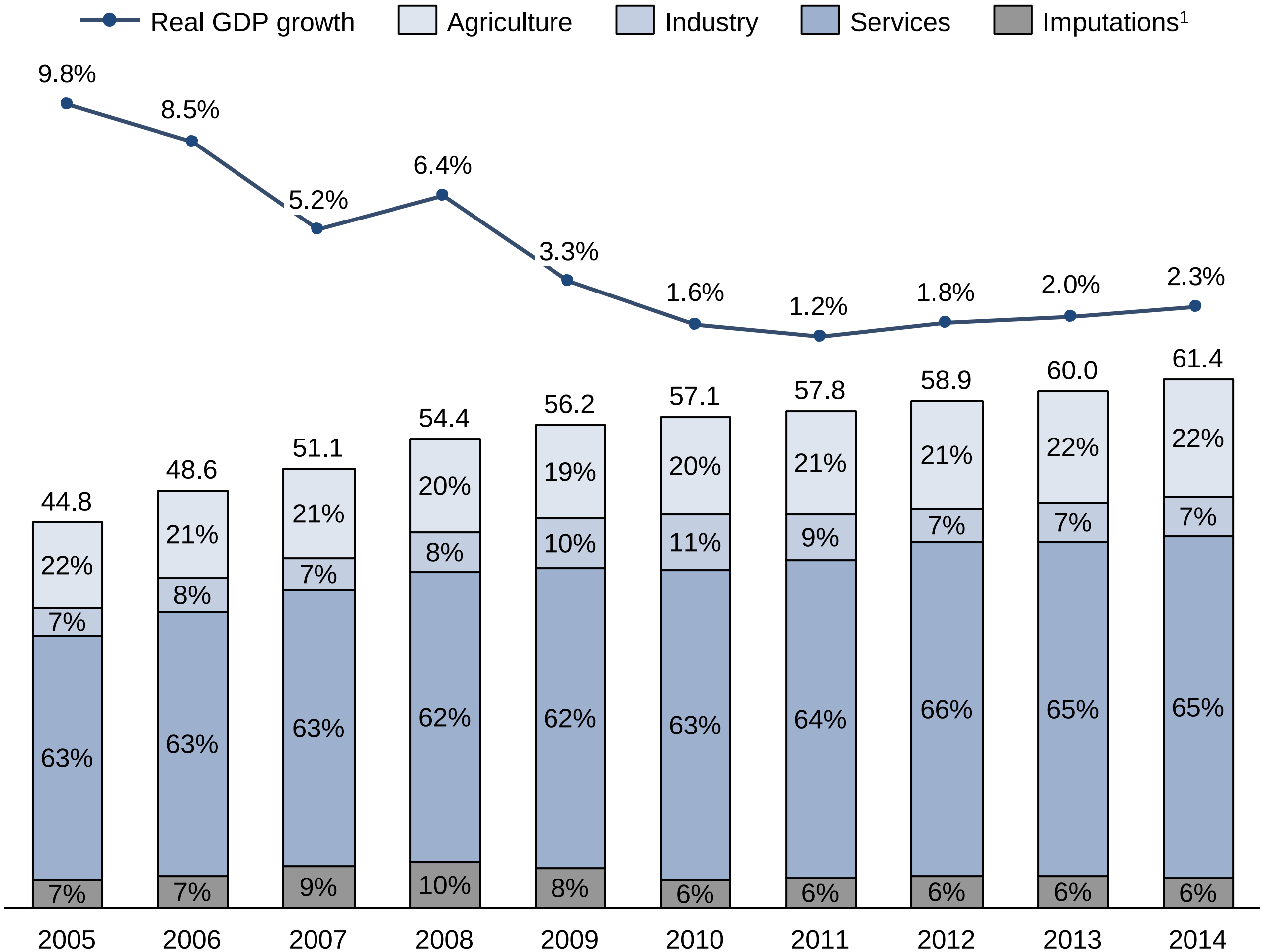
Services industry accounts for over 65% of Vanuatu economy

GDP by sector (bn VT, constant 2006 prices) and real GDP growth (%)



[1]Includes Taxes, Subsidies, and Bank service charge

Source: Vanuatu 2014 GDP report

Highlights

- Retail trade (21%), Government services (18%), Real estate (11%) and Finance and Insurance (11%) are the largest sectors within the Services industry
- Services industry is considerably more productive – it contributes 65% to GDP while employing only 32% of the workforce
- GDP per person employed in services is estimated to be 6 times higher than in agriculture and 30% higher than in industry
- Tax reform should ensure incentives for workforce to shift towards higher value-added sectors (services and industry)

Having contributed nearly 70% to GDP expansion in the last decade, Services industry is at the core of economic growth

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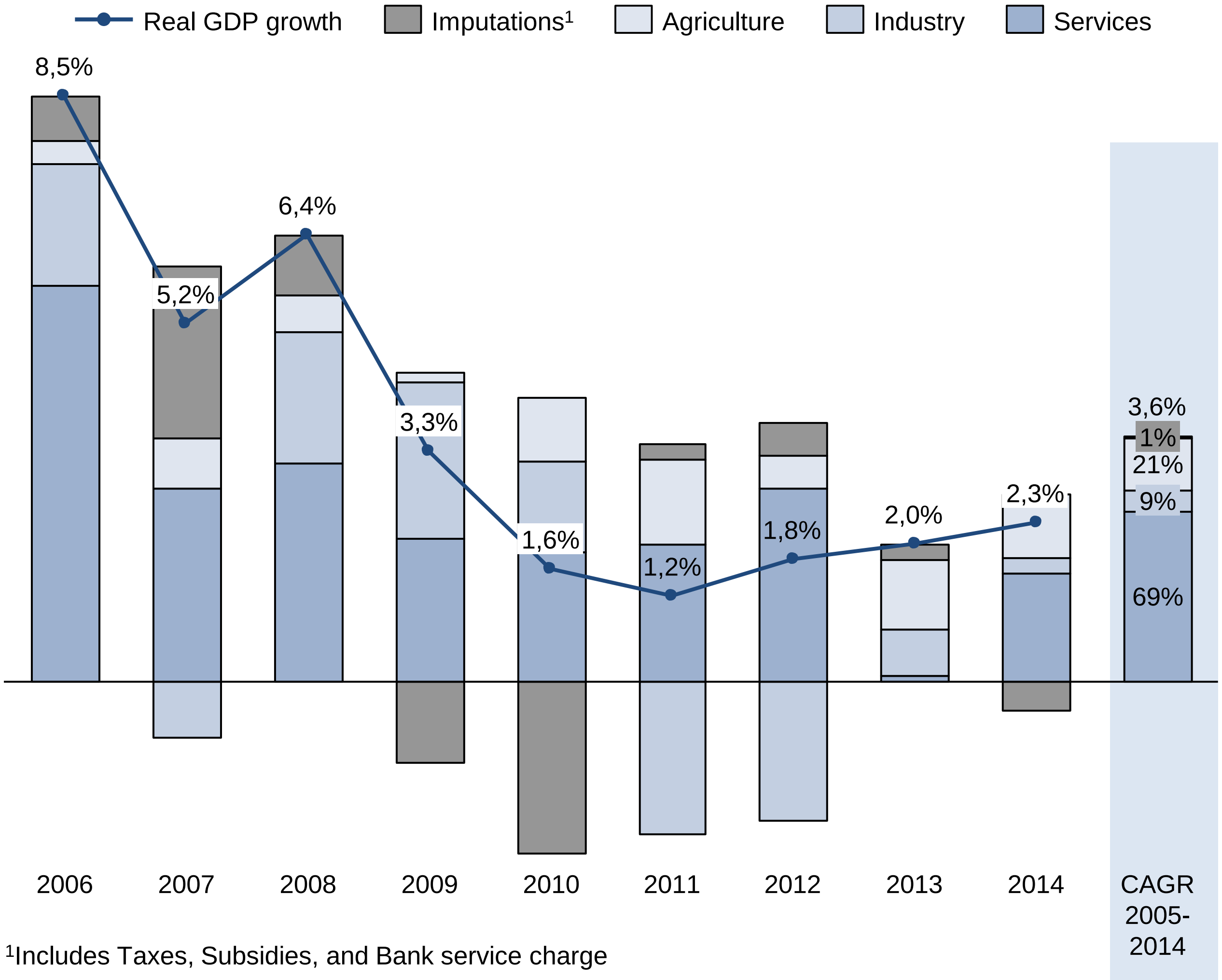
Real GDP growth (%) and contribution by sector



[1]Includes Taxes, Subsidies, and Bank service charge

Source: GDP report 2014

Highlights

- Due to tropical cyclone damage, Vanuatu is expected to have a negative real GDP growth rate of around -2% in 2015, followed by a rapid recovery of 5% in 2016
- Economic growth is projected to average 2.7% during 2015-2020. In the long run, the economy is assumed to grow at the rate of 3%, above the average of the last 5 years
- Historically, the majority of growth was driven by services industry which accounts for nearly 70% of total GDP increase since 2005

Rapidly growing population indicates increasing need for jobs in the medium-term

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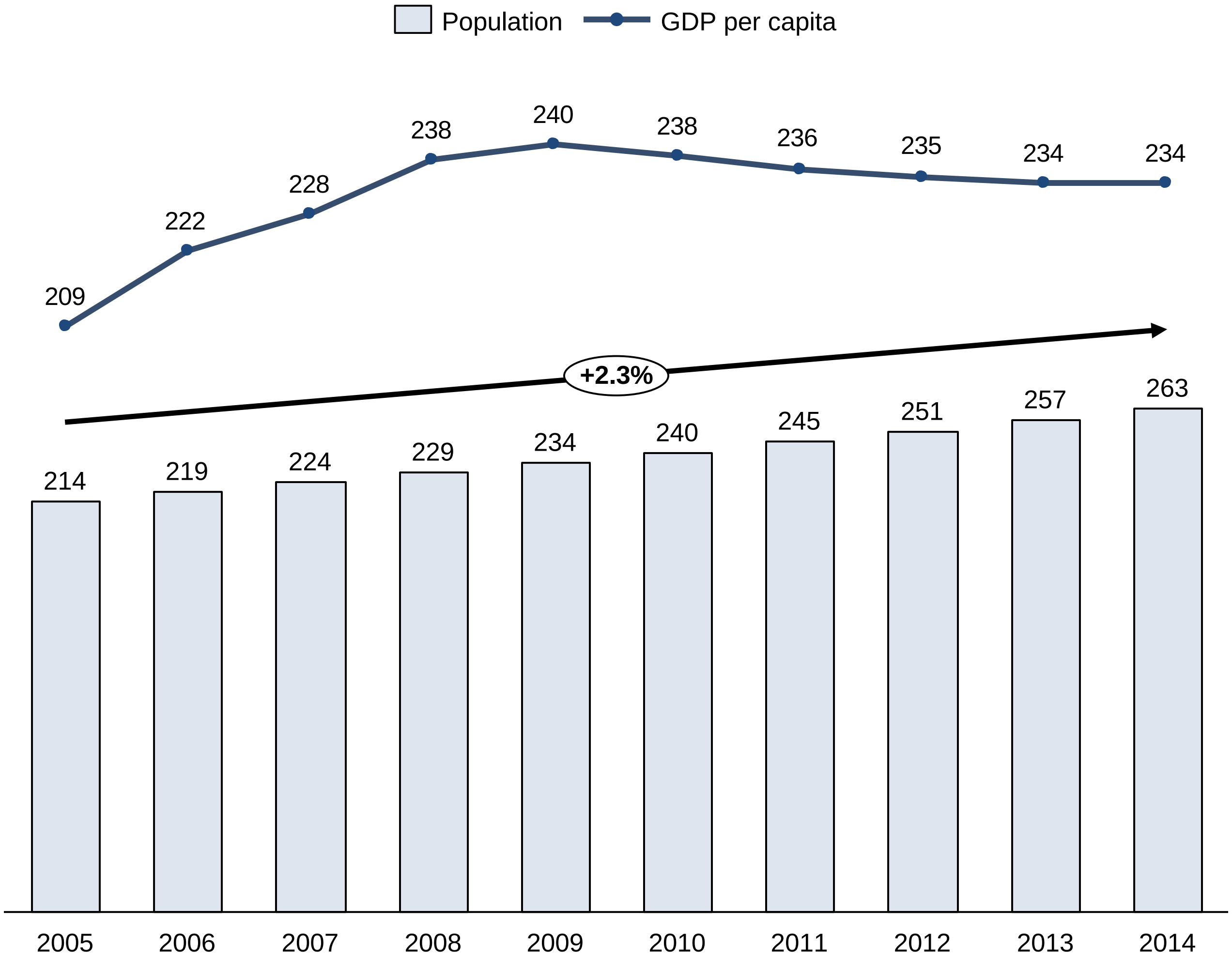
Population (thsd. people) and GDP per capita (thsd. Vatu)



Source: Vanuatu 2014 GDP report

Highlights

- Vanuatu population is growing stably at an average annual rate of 2.3%
- Population growth has outpaced GDP growth in the period of 2010-2014 resulting in declining GDP per capita. The situation may be an indicator for the government to prioritize job creation in the medium-term
- Job creation in high-value added industries should be prioritized. Developing tourism sector could prove to be the most reliable strategy as it would give a considerable boost to a wide range of local businesses
- Structuring tax incentives for industries and individual businesses which promote more employment opportunities for the local population could become one of the key instruments and should be incorporated in potential the tax reforms

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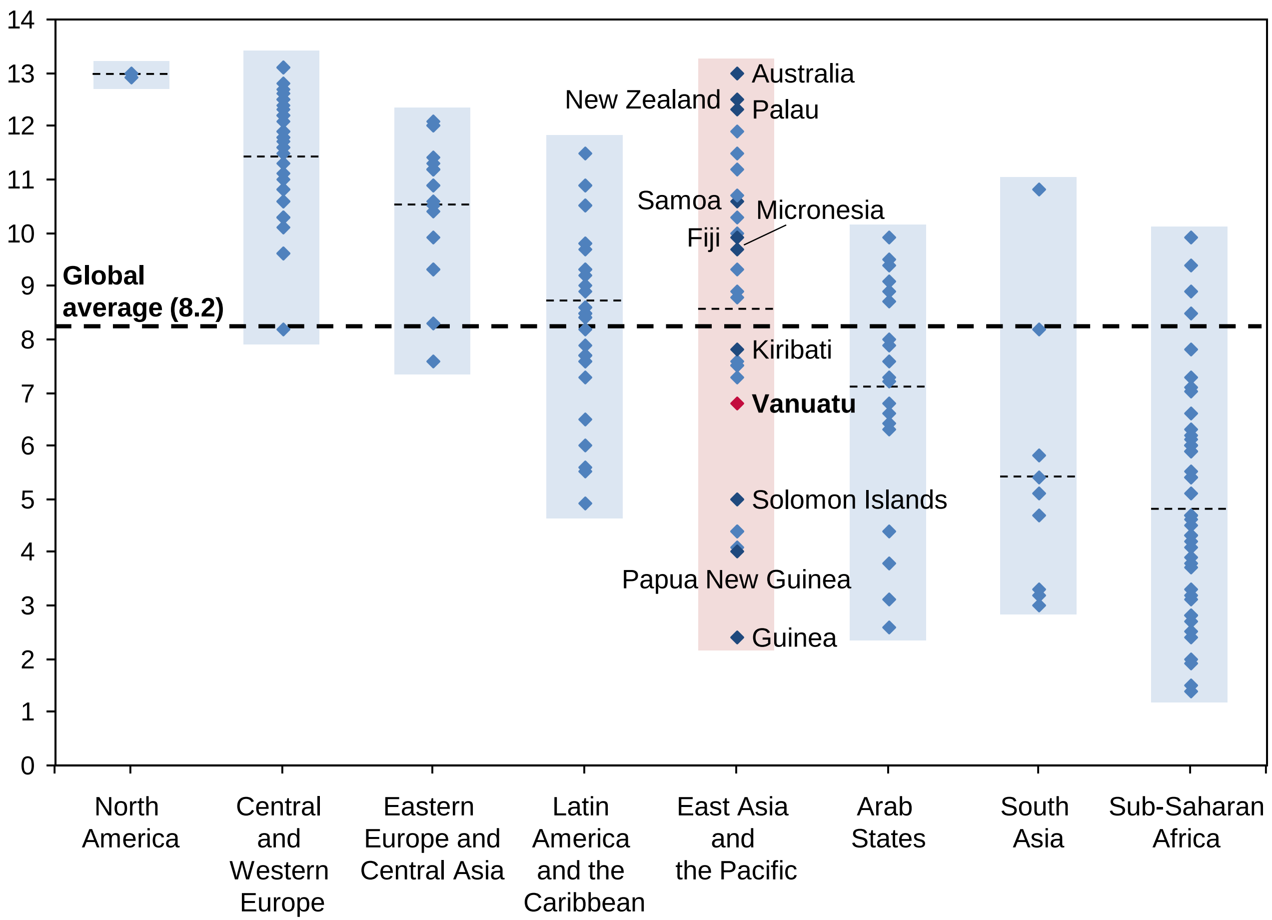
Human capital is a scarce and valuable resource in Vanuatu

Mean years of schooling by countries and regions, 2014



Highlights

- At 6.8 mean years of schooling Vanuatu sits lower than both the global average (8.2 years) and the average in East Asia and the Pacific region (8.6 years) making intellectual capital a particularly scarce resource
- Only about 5% of total Vanuatu population has higher than secondary education
- Having limited intellectual capital, considerable efforts should be put to ensure attraction and retention of talent in the short and medium-term. Development of local education should be the top strategic priority in the long-term
- According to United Nations 2014 Education Index report, Vanuatu is number 134 out of 188 countries listed by Human Development Index. Human Development Index includes: Life expectancy at birth, Expected years of schooling, Mean years of schooling, Gross National Income

Source: United Nations Human Development Index report 2014

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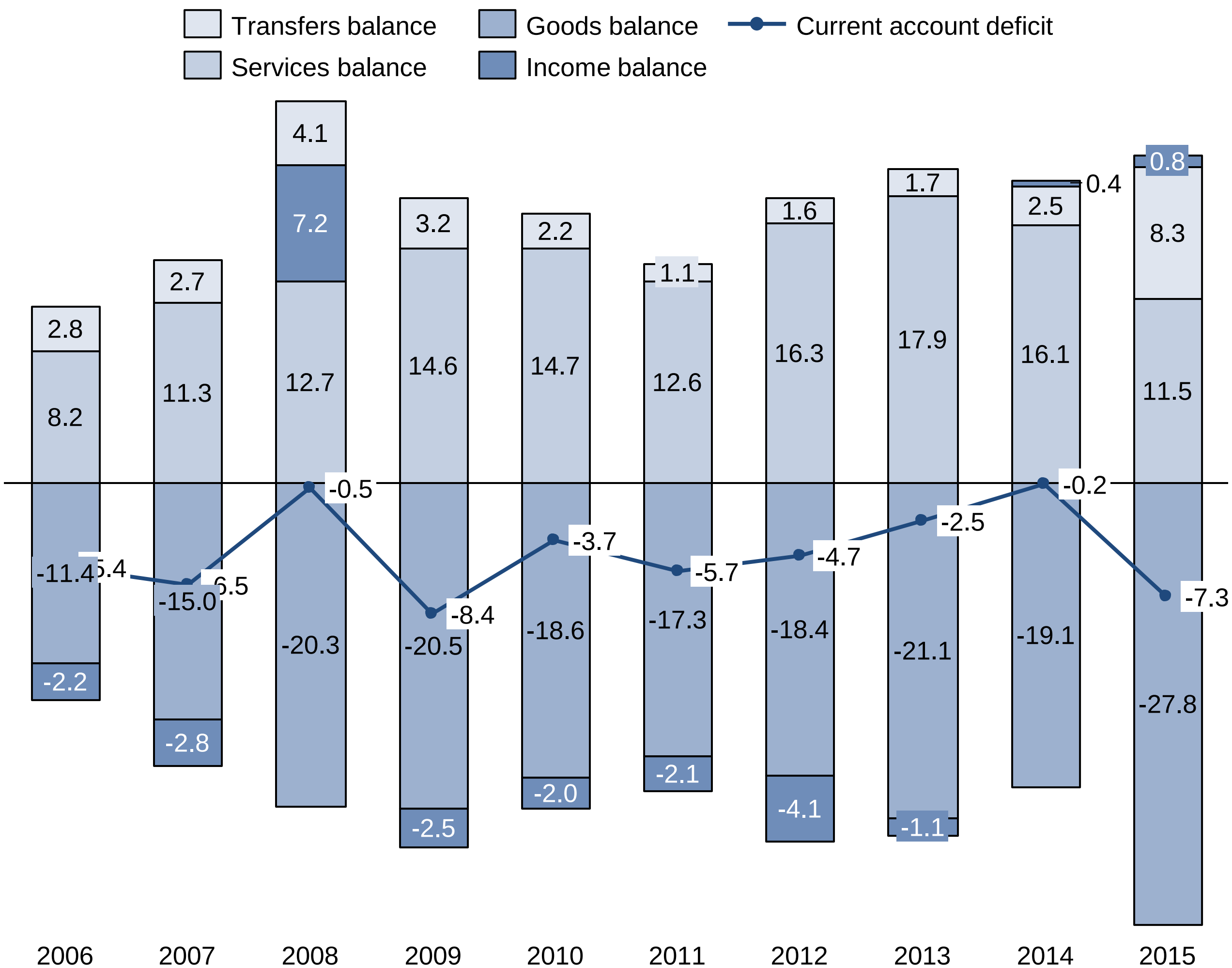
Vanuatu is typically running moderate current account deficits

Current account balance, bn VT



Source: QER_December 2015

Highlights

- At a net goods balance of -26% of GDP in 2014, Vanuatu is a net importer
- Positive services balance is largely comprised of tourism receipts
- Noticeable trade balance improvement in 2014 is due to favorable terms of trade including a decline in oil prices and rising prices of key agricultural products. Due to cyclone damage, however, current account will run a significant deficit in 2015
- Current account deficits have to be financed through positive capital and financial account balance
- Compliance with PACER Plus terms of agreement is expected to further increase the negative goods balance as lower import tariffs will drive consumption of imported goods

Stable inflows of FDI and capital transfers are critical to finance current account deficits

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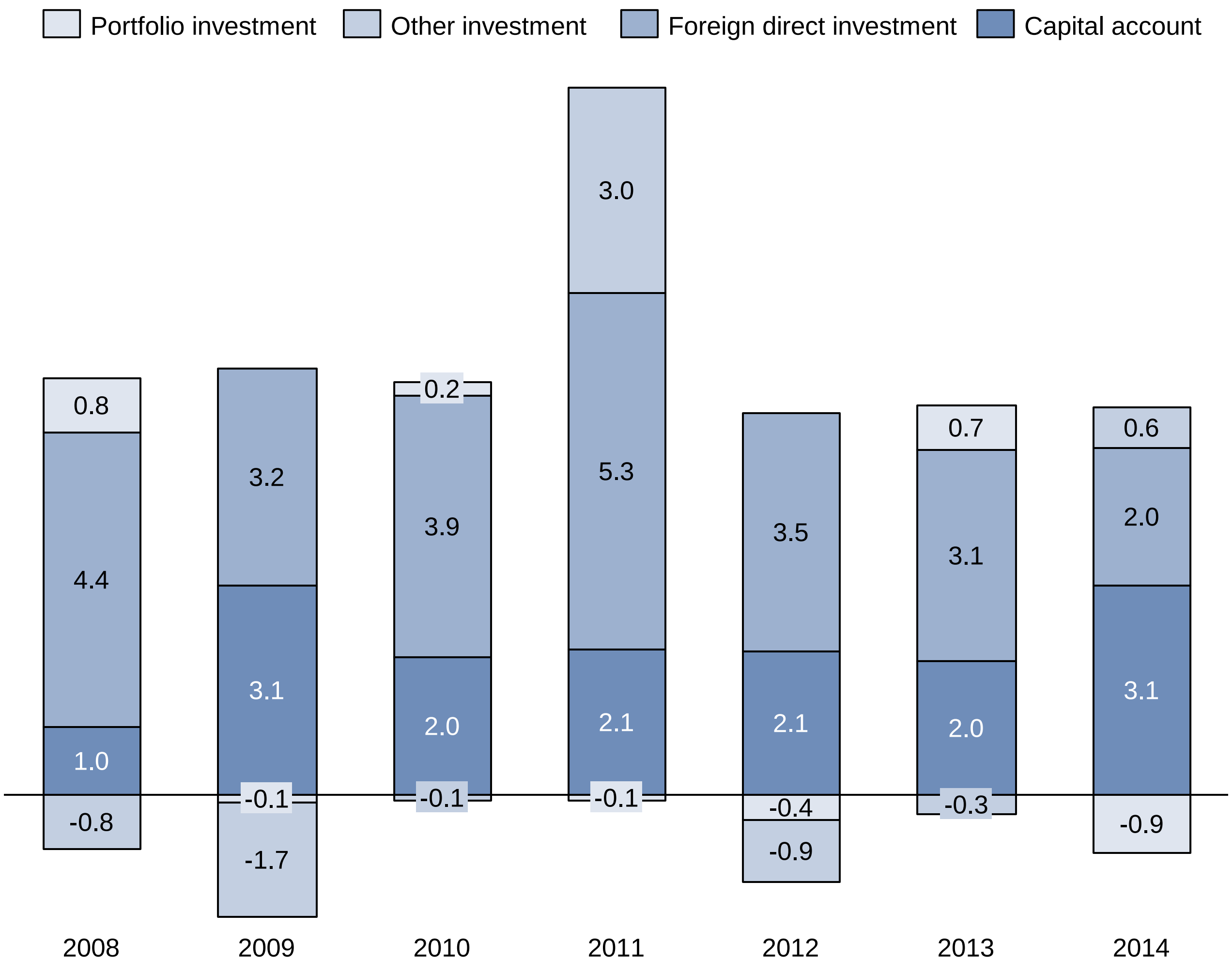
Capital and financial accounts, bn VT



Source: IMF Country report 2013, 2015

Highlights

- Foreign direct investment and capital flows are vital parts of Vanuatu economy with average contributions in the period of 2010-2014 of 5% and 3% GDP respectively
- Current account deficits in the past had been more than fully financed by stable inflows of FDI as well as foreign capital grants
- Vanuatu positions itself as a region's foremost financial center emphasizing on investment-friendly tax structure with no income or company tax for residents, no capital gains tax, no withholding tax. To maintain tax structure stability and continuous inflow of foreign investment, changes in tax system should be focused on other potential sources of revenue

Historically, Vanuatu was running small budget deficits of around 1.1% GDP

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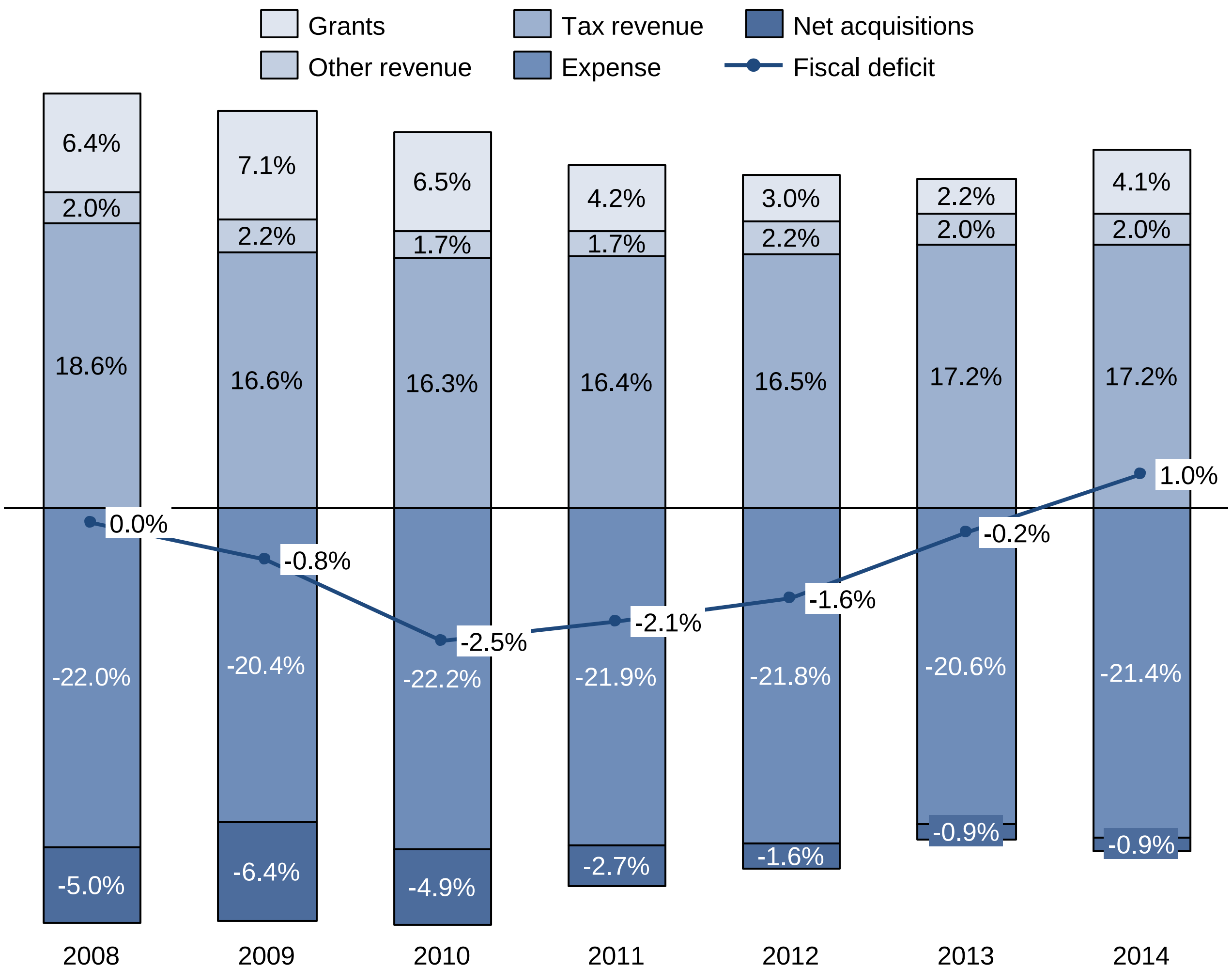
Fiscal revenue and expenditure, % GDP



Source: IMF Country report 2013, 2015

Highlights

- Grants make up a significant share of fiscal revenue but are expected to decline in the long term following the expected graduation from the Least Developed Countries list in 2020
- Due to recovery needs and public infrastructure investment plans fiscal deficits of 12% GDP are expected in 2015 and 2016
- In the past Vanuatu had relatively low public debt (~20% of GDP in 2014), compared to such countries as Solomon Islands, Samoa, Fiji, where public debt is at 30-50% of GDP
- IMF projects that under the baseline of unchanged policies, central government debt is projected to continue rising for several years after the cyclone, reaching 58% of GDP in 2020

Value Added Tax contributes nearly 43% to tax collections and is by far the largest source of public revenue

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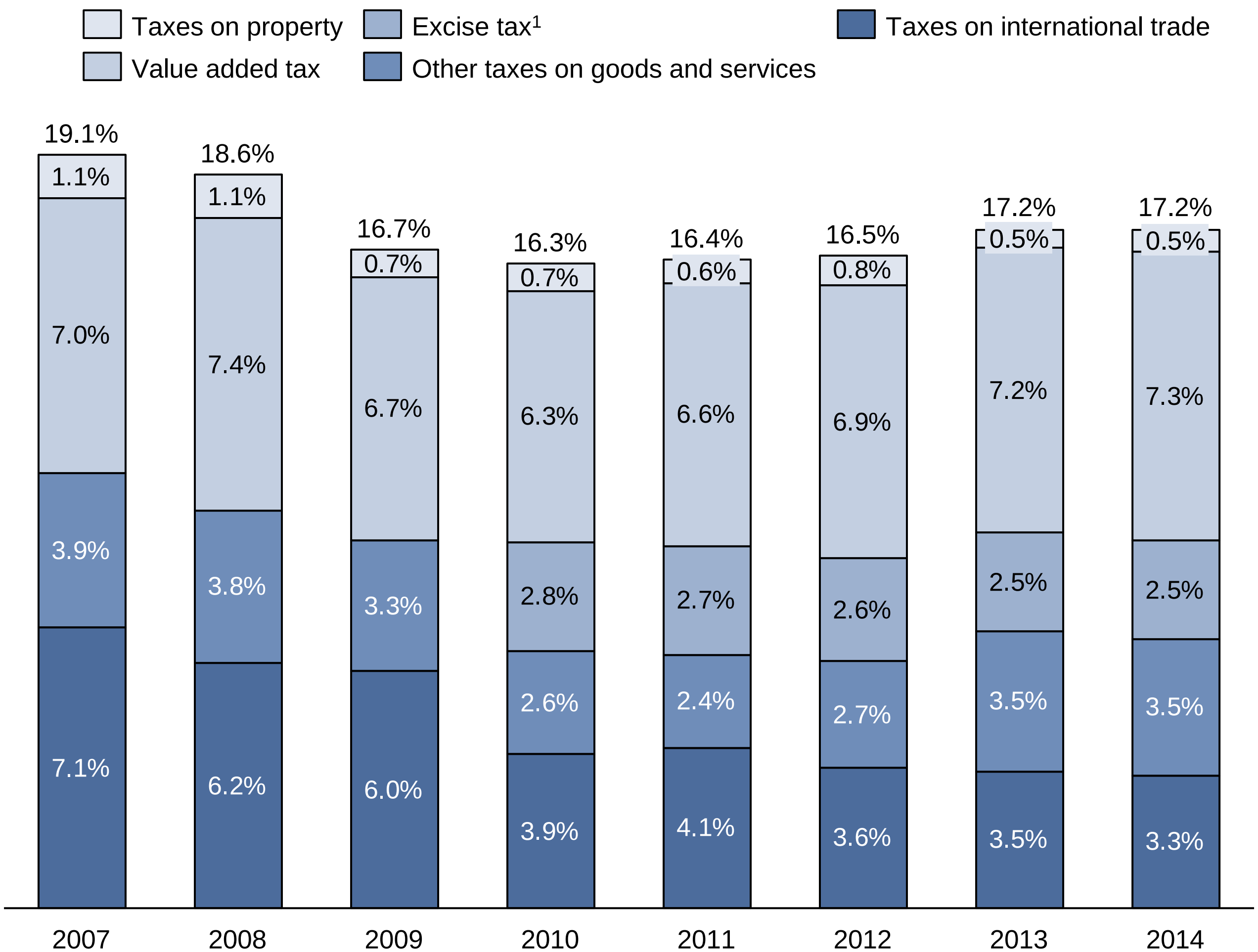
Tax revenue by type, % GDP



[1]Excise tax shown explicitly starting from 2010; split is not available for previous years

Source: QER December 2010, QER December 2015, Vanuatu 2014 GDP report

Highlights

- Currently the major source of tax revenue comes from indirect taxes
- There are around 26 thsd. active members of the National provident fund which represents less than 10% of the total population indicating very low potential base for personal income taxation

Tax reforms should aim to raise additional revenues of 5.3% GDP to compensate for budget deficit, loss of import duties and grants

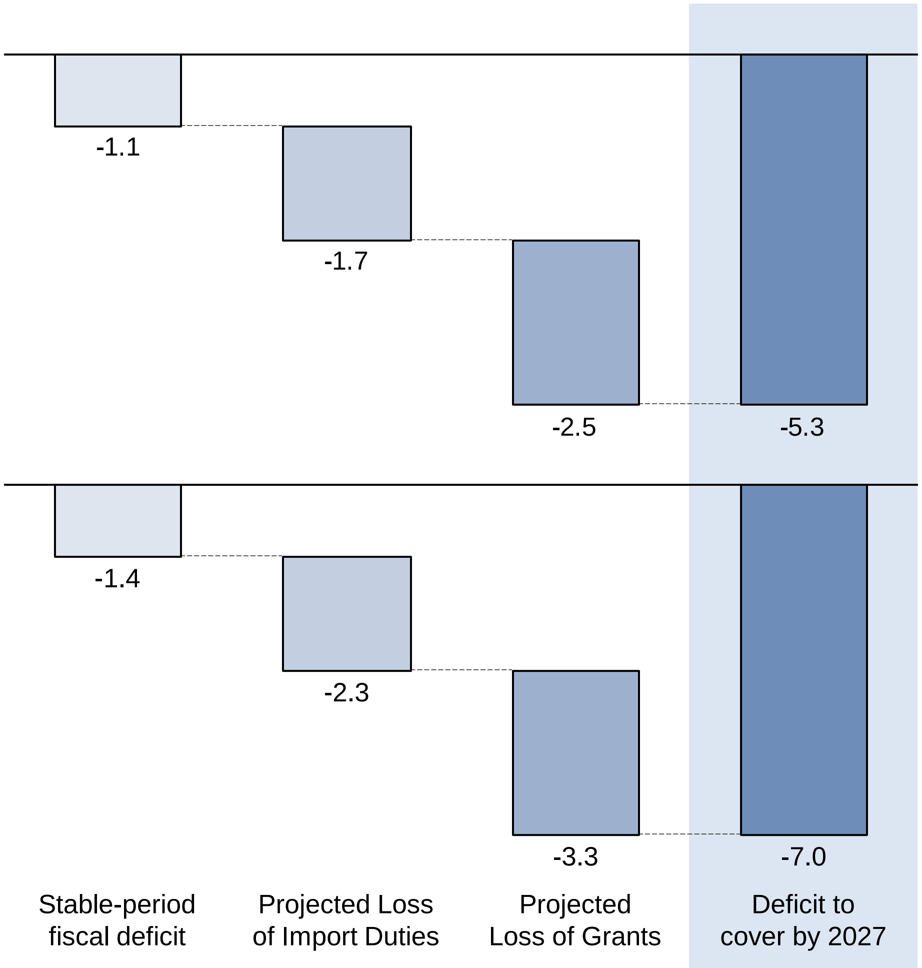
Estimated annual budget deficit to be covered in 2027

- *In relative terms*

  (% GDP)

- *In nominal terms*

  (bn VT at 2015 prices)



Highlights

- Baseline estimates are based on the period of 2010-2014 and do not include 2015 to reflect Vanuatu economy in its steady state
- Average fiscal deficit in 2010-2014 was 1.1%
- In 2012-2015 Australia, New Zealand, Fiji accounted for 47,5% of Vanuatu imports
- In 2010-2014 government revenue from import tax was at 3.7% of GDP. Assuming that by 2027 import tax to goods from Australia, New Zealand, Fiji will be 0%, the loss of government revenues from PACER Plus agreement is estimated to be at 1.7% GDP
- In 2010-2014 grants accounted on average for 4% of GDP, IMF projects grants after 2020 at 1.5% of GDP, the loss of grants will equal to 2.5% of GDP
- By continuing IMF projections after 2020 at the rate of 2.5% GDP growth, 2027 GDP is estimated at 131 bn VT.

Source: QER December 2015, Vanuatu 2014 GDP report, United Nations, Strategy Labs team analysis

Introducing income taxes is not recommended; sale of assets, broadening tax base and increasing existing rates should be considered instead

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Revenue collection alternatives

Recommended | Not recommended

- **Increase revenue by 5.3 p.p. GDP**
  - **Sale of assets** (Recommended)
  - **Broaden tax base** (Recommended)
    - **Increase compliance** (Recommended)
    - **Reduce exemptions** (Recommended)
  - **Increase existing taxes** (Recommended)
    - **VAT** (Recommended)
    - **Land** (Recommended)
    - **Excise** (Recommended)
    - **Licenses** (Recommended)
    - **Other** (Not recommended)
  - **Introduce new taxes** (Not recommended)
    - **Corporate income tax** (Not recommended)
    - **Personal income tax** (Not recommended)
    - **Other** (Not recommended)

Key supporting arguments

X Refer to further parts for more detailed analysis

D Government owns some well-located underused property which, if privatized, could provide a boost for the local business community and tourism sector as well as bring in additional financing of 0.8% GDP per year

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C Comparison with other PICs indicates up to 3% additional revenues from VAT collections through reduction of exemptions and/or increase in level of compliance

- Experts argue that improving collections via existing tax regime is preferred to introducing new taxes in Vanuatu as it may take several years to finalize the legal base, requires considerable investments in IT systems, and is highly dependent on available human capital and expertise

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B VAT rate increases is a preferred tool to raise additional government revenues globally. Moderate hikes in VAT are preferred as they have little to no effect on the economy as the price effect felt by consumers is marginal. In the case of Vanuatu, 1 p.p. change in VAT could increase collections by 8%, while prices would increase only 0.9%)

F Taxes on consumption and property are generally associated with higher economic growth than income taxes. Pursuing economic growth strategy is highly recommended for Vanuatu in order to increase the tax base and ensure population welfare in the long run

- Consumption taxation would affect all industries more evenly and would create indirect incentives for the labor force to move to higher value-added sectors (industry and services)

A Current Vanuatu tax structure is a significant advantage to attracting foreign capital and talented workforce compared to other PICs, which would be lost with the introduction of income taxes

E Introduction of direct taxes discourages savings, foreign investments and capital flows which are critical for maintaining stable foreign reserves and financing imports

G Corporate tax revenue is considerably more volatile than taxes on consumption and could significantly affect government revenue stability over the business cycle

H Corporate and personal income tax would increase business compliance burden and time spent on tax filing by around 60%

- Experts agree that income taxes are generally easier to plan and avoid compared to VAT

Source: Expert interviews, Strategy Labs team analysis

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Current Vanuatu tax structure is largely based on indirect taxes

✓ Tax implemented in Vanuatu ✗ Tax not implemented in Vanuatu

Indirect taxes	Direct taxes	Other non-tax revenue
✓ Value added tax (VAT)	✗ Personal income tax (PIT)	Social security contributions
✗ Other types of goods and services tax (GST)	✗ Corporate income tax (CIT)	Revenue from government assets (e.g. SWFs, oil fields)
✓ Customs duty	✗ Payroll tax	Revenue from government provided services
✓ Excise duty	✗ Capital gains tax (CGT)	Fines
✓ Stamp duty	✓ Property tax	Grants
✓ License and registration fees	✗ Wealth tax	Other
	✗ Inheritance tax	
	✗ Gift tax	

Source: OECD, expert interviews, Strategy Labs team analysis

Tax regimes of 13 relevant countries were analyzed in order to compare how their governments generate revenue

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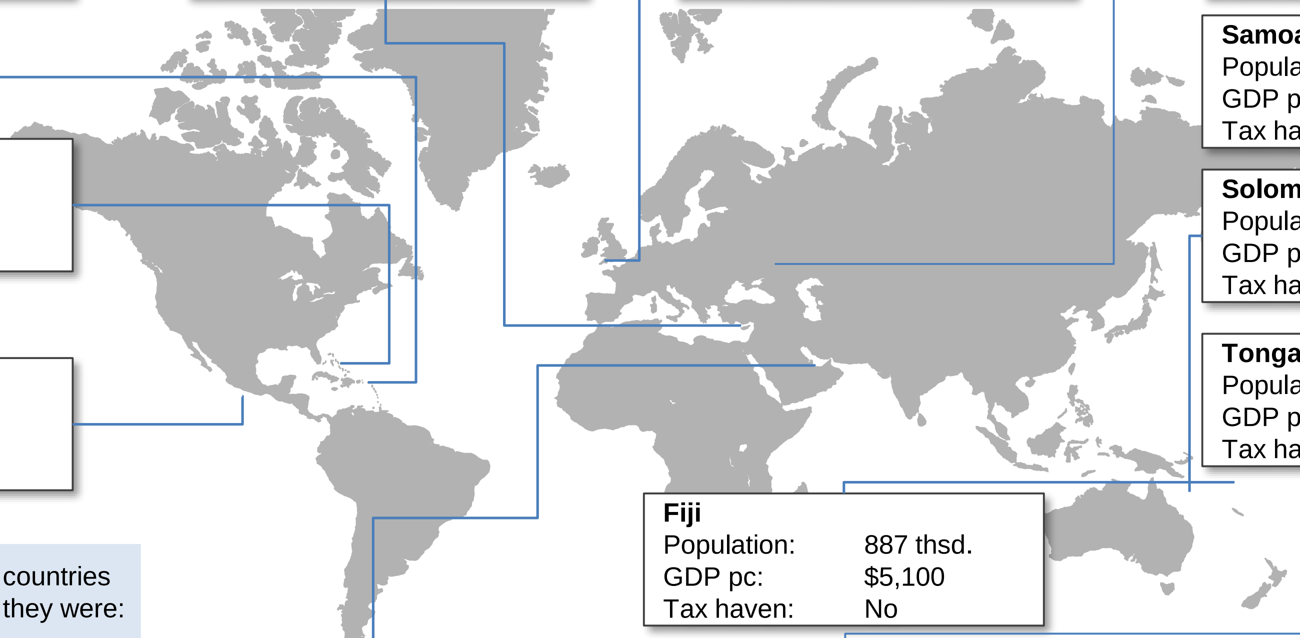

British Virgin Islands
Population: 28 thsd.
GDP pc[1]: $32,300
Tax haven[3]: Yes

Cyprus
Population: 1,153 thsd.
GDP pc: $27,700
Tax haven: Yes

Guernsey
Population: 63 thsd.
GDP pc: $59,200
Tax haven: Yes

Jersey
Population: 98 thsd.
GDP pc: $61,400
Tax haven: Yes

Samoa
Population: 192 thsd.
GDP pc: $3600
Tax haven: Yes

The Bahamas
Population: 383 thsd.
GDP pc: $22,300
Tax haven: Yes

Solomon Islands
Population: 562 thsd.
GDP pc: $1,900
Tax haven: No

Cayman Islands
Population: 54 thsd.
GDP pc: $51,500
Tax haven: Yes

Tonga
Population: 103 thsd.
GDP pc: $4,200
Tax haven: Yes

Fiji
Population: 887 thsd.
GDP pc: $5,100
Tax haven: No

We selectively chosen the countries for comparative analysis if they were:

- Pacific Islands Country (PIC)
  OR
- A tax haven[2]

Bahrain
Population: 1,300 thsd.
GDP pc: $24,700
Tax haven: Yes

Kiribati
Population: 108 thsd.
GDP pc: $1,700
Tax haven: No

Vanuatu
Population: 261 thsd.
GDP pc: $3100
Tax haven: Yes

[1]GDP per capita in US$. If figures were provided in local currency, yearly average exchange rate was used to calculate US$ amount
[2]According to a compilation of tax haven lists in Gravelle (2015) 'Tax Havens: International Tax Avoidance and Evasion'

Source: IMF, UN Data, National Bureaus of Statistics, Strategy Labs team analysis

A Current Vanuatu tax structure is a significant advantage to attracting foreign capital and talented workforce compared to other PICs

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xx% Tax revenue as % GDP

PICs

Countries without direct taxes

Vanuatu 17.2%
PIT: none | CIT: none
VAT: 12.5%
Other: customs and excise, rent, licenses, gambling, stamp duty

Current Vanuatu tax structure puts the country at a unique advantage over other local economies for international investment consideration and movement of talent

Countries with direct taxes

Fiji 24.8%
PIT: 0% - 20% | CIT: 20%
VAT: 9%
Other: CGT, customs and excise, stamp duty, tourism, social sec.

Tonga 17.1%
PIT: 0% - 20% | CIT: 25%
VAT: 15%
Other: customs and excise. small business tax

Kiribati 13.8%
PIT: 0% - 30% | CIT: 20% - 35%
VAT: 10%
Other: customs and excise, fishing license fees

Samoa 23.5%
PIT: 0% - 27% | CIT: 27%
VAGST: 15%
Other: customs and excise

Solomon Islands 29.2%
PIT: 11% - 40% | CIT: 30% - 35%
GST: 10%
Other: customs and excise

Global peers

Countries without direct taxes

Cayman Islands 22.7%
PIT: none | CIT: none
VAT: none
Other: customs and excise, annual license fees, stamp duty

The Bahamas 16.6%
PIT: none | CIT: none
VAT: 7.5%
Other: customs and excise, license fees, stamp duty, social sec.

Bahrain 2.9%
PIT: none | CIT: none
VAT: none
Other: oil companies tax, customs and excise, license fees

International peer examples suggest that government revenue can be raised without the introduction of corporate and income taxes

Countries with direct taxes

Jersey 16.8%
PIT: 0% - 20% | CIT: 0%
GST: 5%
Other: customs and excise, stamp duty, social security

Guernsey 16.3%
PIT: 0% - 20% | CIT: 0%
GST: none
Other: customs and excise, property tax, social security

Cyprus 26.8%
PIT: 0% - 35% | CIT: 12.5%
VAT: 19%
Other: customs and excise, property tax, social contributions

British Virgin Islands 30.2%
PIT: 14% | CIT: none
VAT: none
Other: customs and excise, license fees, stamp duty, prop. tax

Source: National tax agencies, Government websites, Expert interviews, Strategy Labs

B VAT rate increases is a preferred tool to raise additional government revenues globally

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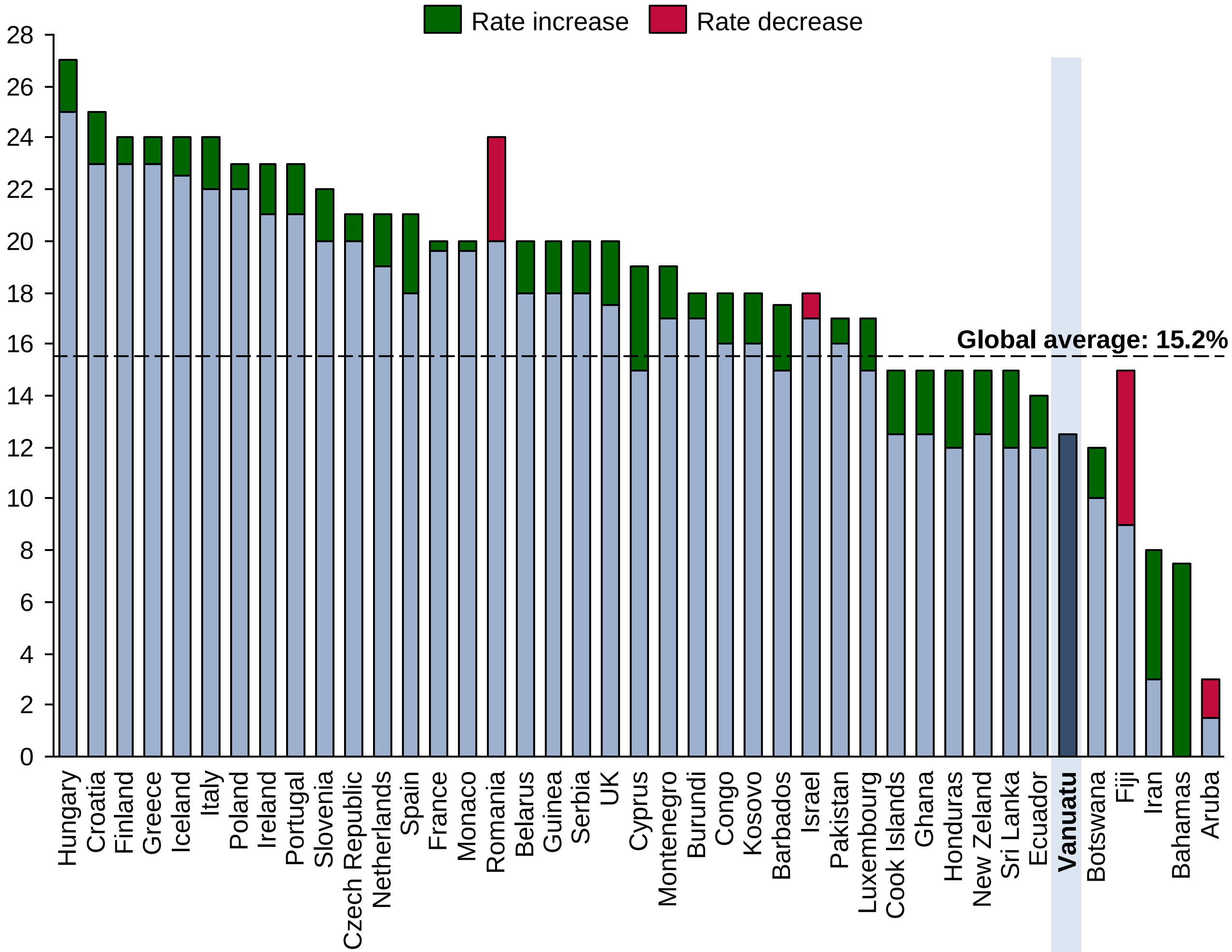
Global changes in VAT since 2011, percent



Source: TradingEconomics.com, PwC World Tax Guide, Strategy Labs team analysis

Highlights

- Moderate hikes in VAT have little to no effect on the economy as the price effect felt by consumers is marginal. In the case of Vanuatu, 1 p.p. change in VAT could increase collections by 8%, while prices would increase only 0.9%)
- VAT (or equivalent tax) rates of 198 countries were analyzed. Since 2011, 40 countries changed their VAT rates, of which only 4 reduced it, while the remaining 36 increased their VAT rates by an average of 2.2 p.p.
- With VAT rate at 12.5%, Vanuatu VAT rate is below global average (15.2%) and signals room for potential increase
- Introduction of income taxes would require Vanuatu to negotiate double taxation treaties with its main trading partners, a technical process which can take up to 2-3 years to finalize. Raising VAT rate does not require any of this

C Vanuatu is underperforming in its VAT revenue collections; up to 3% GDP in additional public revenue could be unlocked

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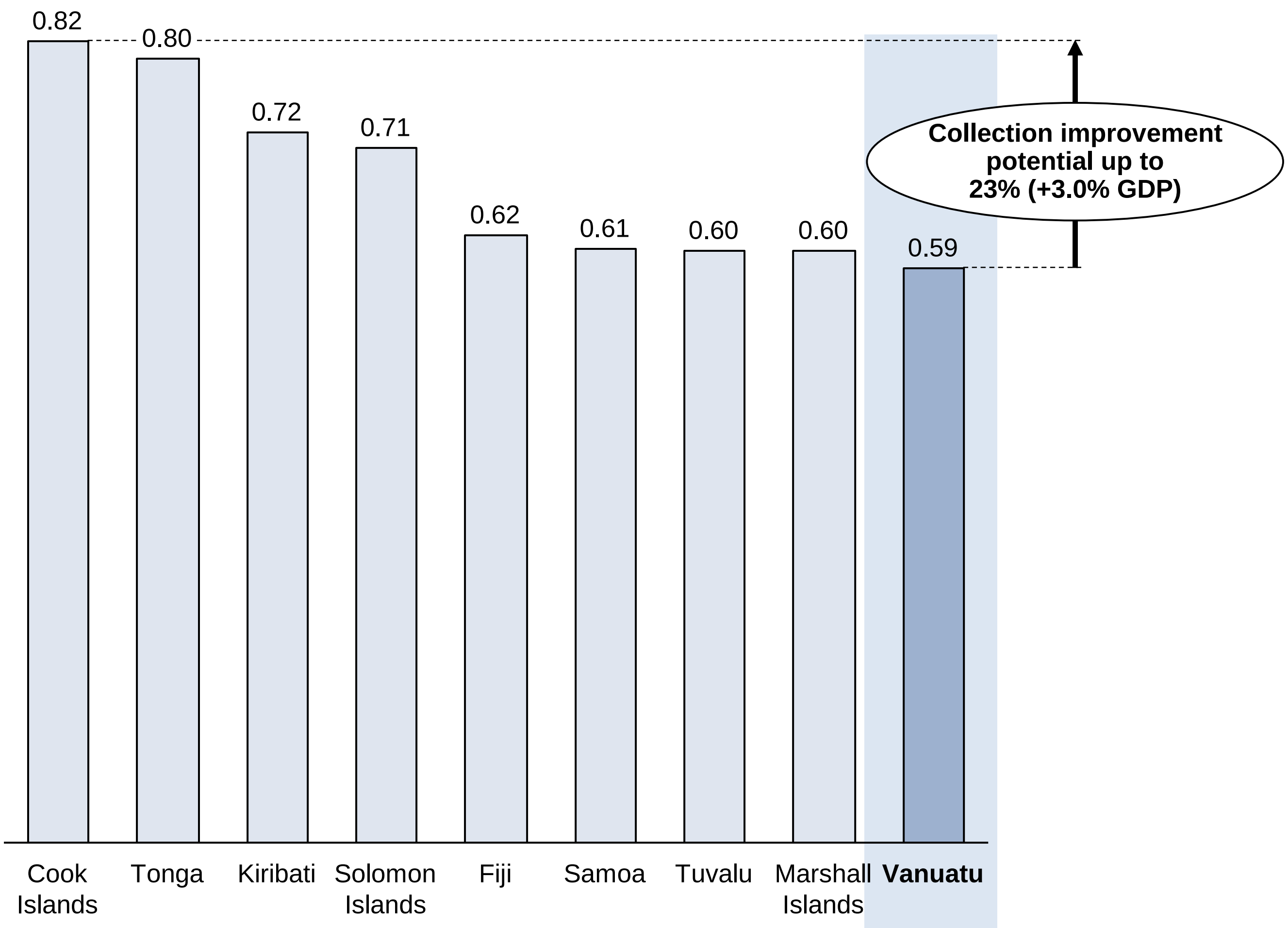
VAT collections as % GDP / Nominal VAT rate



Highlights

- As a proportion of actual collections to nominal VAT rate, Vanuatu is underperforming in the PICs region
- Lack of collections indicates low level of compliance and/or high exemptions
- Based on peer performance, we estimate that increasing compliance and reducing exceptions could unlock up to 3% GDP in additional government revenues (if Cook Islands level were to be reached)
- As a more conservative scenario, we project that a ratio of 0.75 could be reached unlocking 1.5% GDP in government revenue

Source: IMF country reports, country statistics offices, Strategy Labs team analysis

D Selling off non-essential government assets could bring in 0.8% GDP annual revenues for the next 10 years

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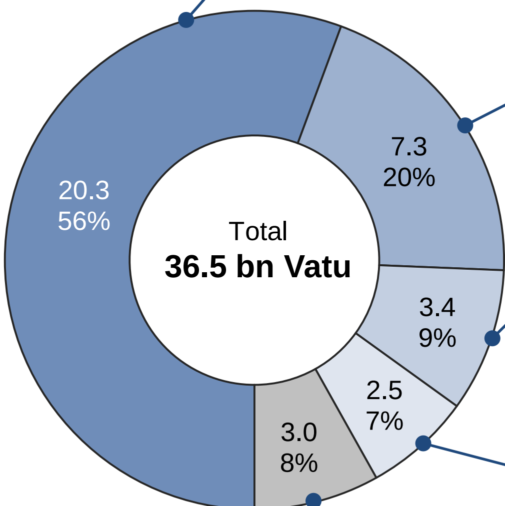
Government property, plants and equipment at net carrying value in 2012, bn Vatu



Land
Sell-off of 25% of land assets over the period of 10 years would add 0.7% GDP to government revenues annually

Roads and bridges

Buildings
Sell-off of 25% of buildings assets over the period of 10 years would add 0.1% GDP to government revenues annually

Computers

Other

Highlights

- Managing assets effectively is a challenge for a strained local bureaucracy which lacks people and resources – as a result, swaths of land are uncultivated and some buildings are underused or abandoned
- Government owns some well-located underused property which, if privatized, could provide a boost for the local business community and tourism sector
- Assumed 25% of land and buildings (worth 8.2% of GDP) are underutilized and could be privatized over the next 10 years, bringing in annual revenues of 0.8% GDP

Source: Financial Statements of the Government of the Republic of Vanuatu 2012

E Consumption-based tax system encourages savings, creates friendlier climate to attract businesses and investments

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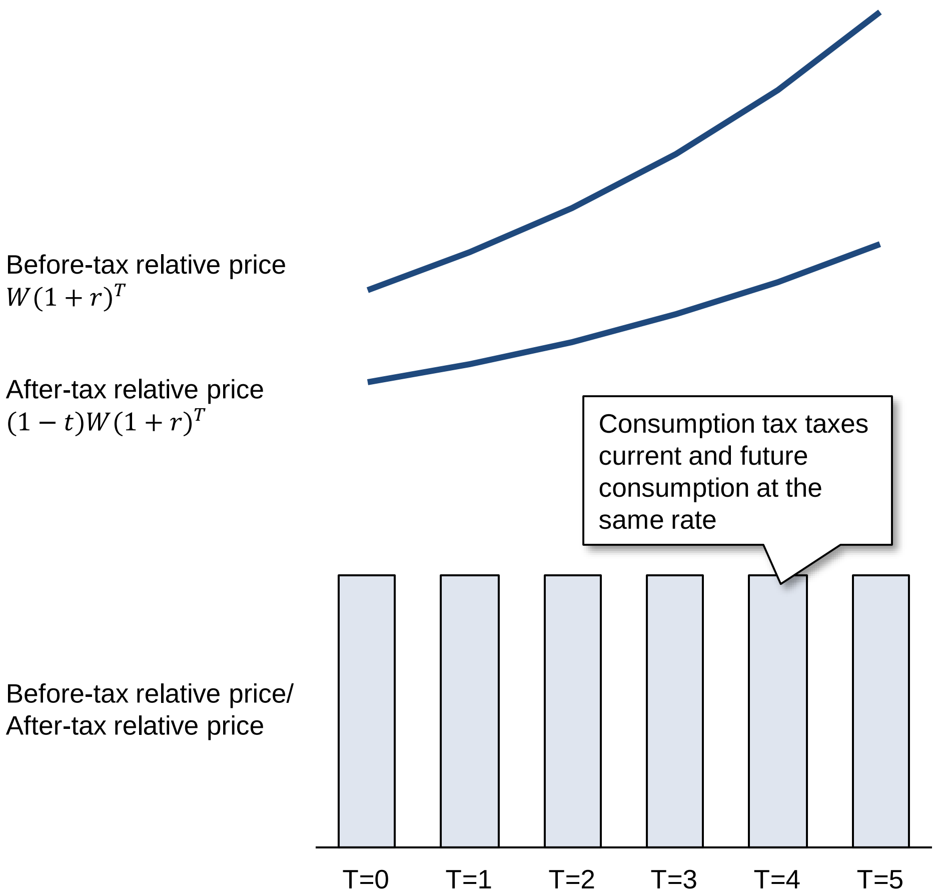
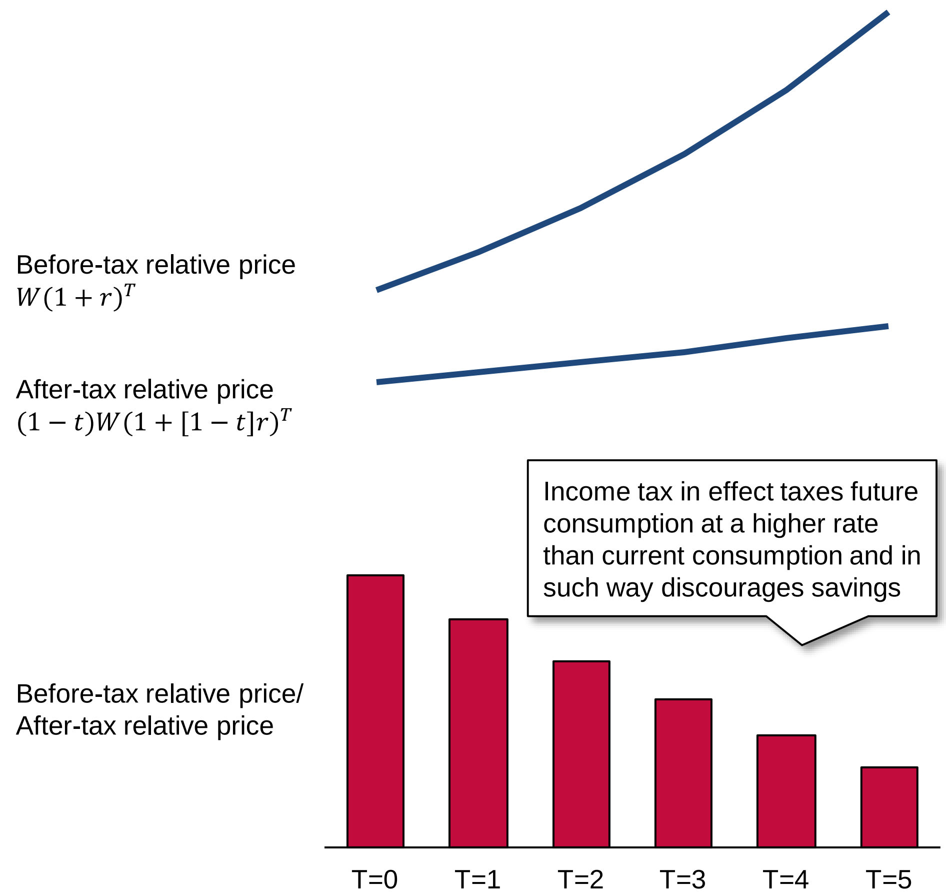
In the model, W refers to real wage, r to the interest rate, t to the tax rate, and T to the saving period. Below is presented the amount of consumption an individual gets for one hour of work under two scenarios: Income-based taxation and consumption-based taxation:

Consumption tax



Income tax



Source: Greg Mankiw, Consumption vs Income Taxation, Strategy Labs team analysis

F Empirical evidence suggests that taxes on consumption and property are associated with higher economic growth than income taxes

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The estimated empirical model: $\Delta \ln y_{it} = -\Phi_i (\ln y_{it-1} - \theta_1 \ln s^k{}_{it} - \theta_2 \ln h_{it} + \theta_3 n_{it} + \sum \theta_j \ln V^j{}_{it} - a_{it}) + b_{1i} \Delta \ln s^k{}_{it} + b_{2i} \Delta \ln h_{it} + b_{3i} \Delta n_{it} + \sum b_{ji} \Delta \ln V^j{}_{it} + \varepsilon_{it}$

Dependent Variable: Log GDP p.c.	(1)	(2)	(3)	(4)	(5)
Baseline Model					
Physical capital	0.18 ***	0.25 ***	0.18 ***	0.16 ***	0.21
	(0.05)	*(0.05)*	*(0.05)*	*(0.05)*	*(0.45)*
Human capital	1.19 ***	1.30 ***	1.18 ***	1.40 ***	1.57 ***
	(0.13)	*(0.12)*	*(0.13)*	*(0.11)*	*(0.11)*
Population Growth	-0.08 ***	-0.08 ***	-0.07 ***	-0.07 ***	-0.07 ***
	(0.01)	*(0.01)*	*(0.01)*	*(0.01)*	*(0.01)*
Control variable					
Overall Tax Burden (total revenues/GDP)	-0.27 ***	-0.24 ***	-0.26 ***	-0.22 ***	-0.14 ***
	(0.05)	*(0.05)*	*(0.05)*	*(0.04)*	*(0.04)*
Tax structure variables					
Income Taxes	**-0.98 *****				
	(0.20)				
Personal Income Taxes		**-1.13 *****			
		(0.19)			
Corporate Income Taxes		**-2.01 *****			
		(0.32)			
Consumption & Property Taxes			**0.93 *****		
			(0.20)		
Consumption taxes (excl. property taxes)				**0.74 *****	**0.72 *****
				(0.18)	*(0.19)*
Property taxes				**1.45 *****	
				(0.43)	
Property taxes: Recurrent Taxes on Immovable Property					**2.47 *****
					(0.84)
Property taxes: Other property taxes					-0.34
					(0.51)
Observations	696	675	696	696	698
Revenue-neutrality achieved by adjusting	Cons. & Prop. Taxes	Cons. & Prop. Taxes	Income Taxes	Income Taxes	Income Taxes

Corporate income taxes appear to have most negative consequences for GDP per capita, followed by personal income taxes

Consumption taxes seem to have considerably less negative effects on economic performance, while property taxes, and in particular recurrent taxes on immovable property appear to be the least harmful

In the estimated model, y refers to output per capita, s_k to the investment rate into physical capital, h to human capital, n to the population growth rate, respectively. The vector V contains a set of policy variables. All equations include short-run dynamics, country-specific intercepts and country-specific time controls. Standard errors are in brackets. *: significant at 10% level; ** at 5% level; *** at 1% level.

Source: Arnold, J. (2008), Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries, OECD Economics Department, Working Paper No. 643

G Corporate tax revenue is significantly more volatile

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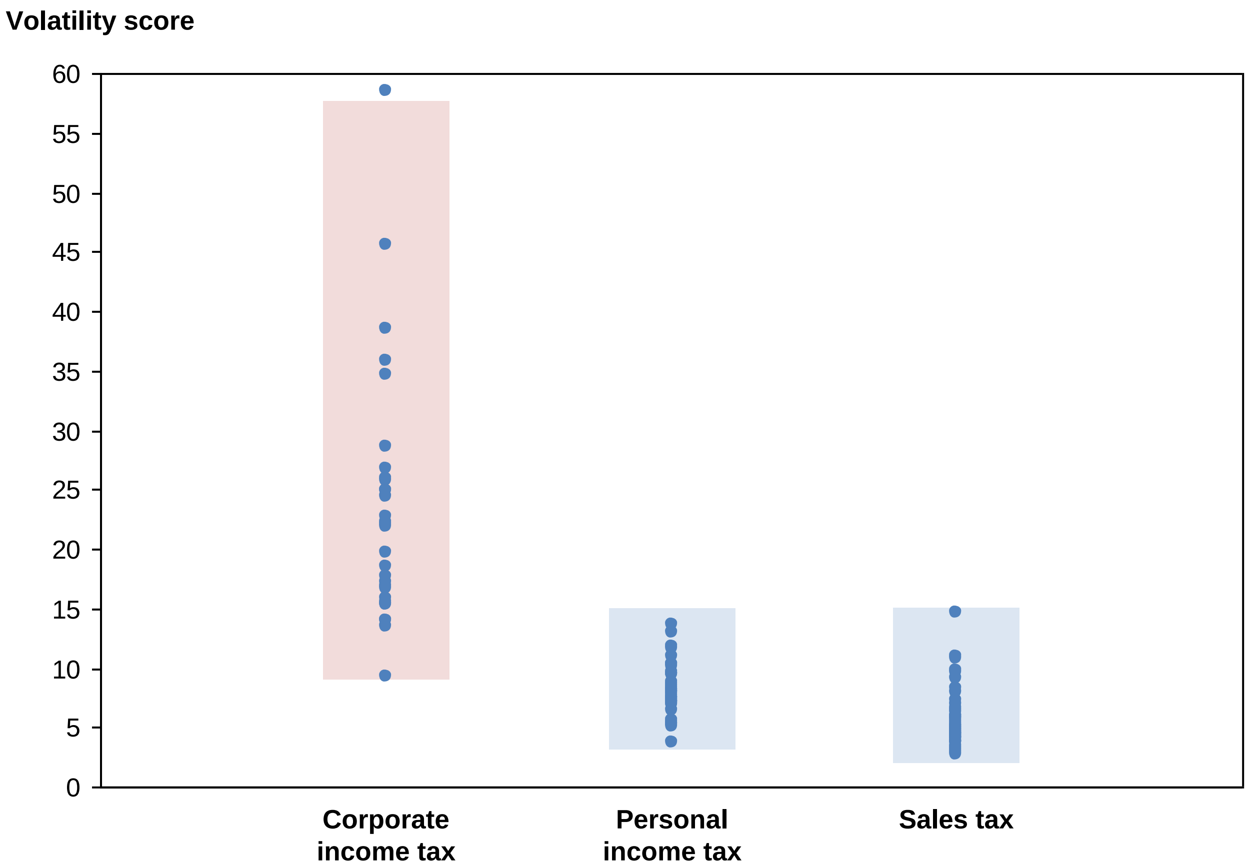
U.S. state tax revenue volatility score[1] by major revenue source, 1995-2014



[1]Each state's major revenue source volatility score is based on its standard deviation of the year-over-year percent change adjusted for all known tax changes.

Source: The Pew Charitable Trusts, Strategy Labs team analysis

Highlights

- Tax collections are largely pro-cyclical, i.e. revenue growth generally slows during recessions and accelerates during expansions
- Recessions cause demand for public services to rise and therefore it is absolutely critical that the government is able to maintain relatively stable tax revenues
- Corporate income tax is particularly volatile because in a recession corporate profits fall much more precipitously than overall economic growth and is therefore significantly less desirable as a component the overall tax structure
- Empirical studies on volatility of personal income taxes and consumption taxes provide conflicting evidence; however, it is generally accepted that they are considerably less volatile than corporate income tax

H Introducing corporate income tax would increase time spent on tax filing by around 70 hours, or 58% for an average local business

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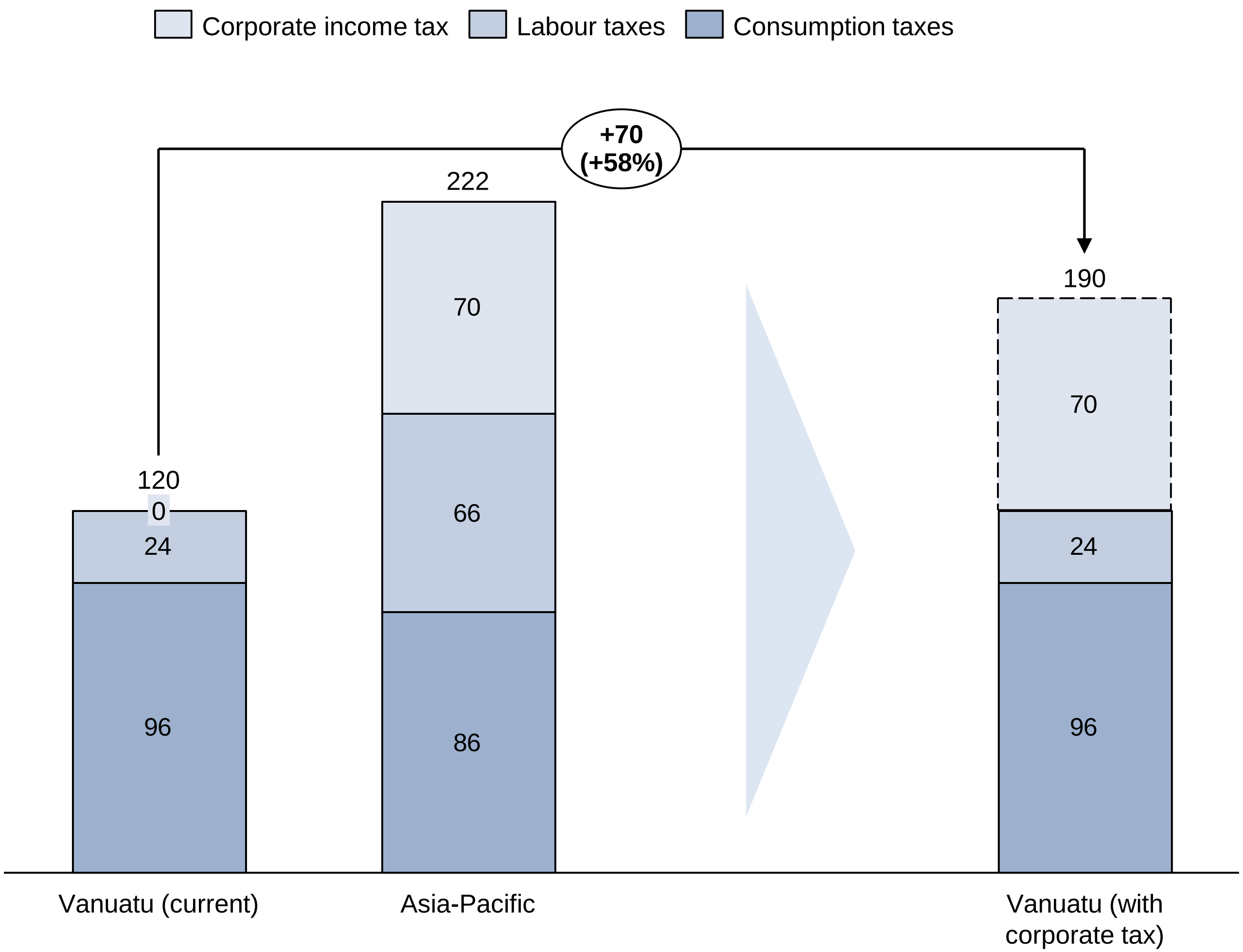
Time to comply, hours per year



Highlights

- Projected increase (+70 hours) in tax compliance burden in the case of introduction of corporate income taxes is estimated based on the average time spent by businesses in the Asia-Pacific region
- Introduction of personal income tax is also likely to result in more time spent on labor taxes – the effect could further increase compliance burden to around 232 hours, nearly double the current level
- If income taxes were to be introduced, switching from cash basis to accrual basis would be needed. Such transition is a costly process for both business and tax authorities as new systems would have to be installed and people trained. The costs of transition may outweigh the benefits of income tax
- Human capital is limited in Vanuatu and should be better spent on high value-added activities like work in hospitals, schools and business rather than tax audit
- Consumption tax rate changes are preferred as no additional resources would need to be allocated for compliance

Source: Paying Taxes 2016, Strategy Labs team analysis

We propose to close the gap by increasing VAT to 15%, improving compliance, raising other taxes and selling-off government assets

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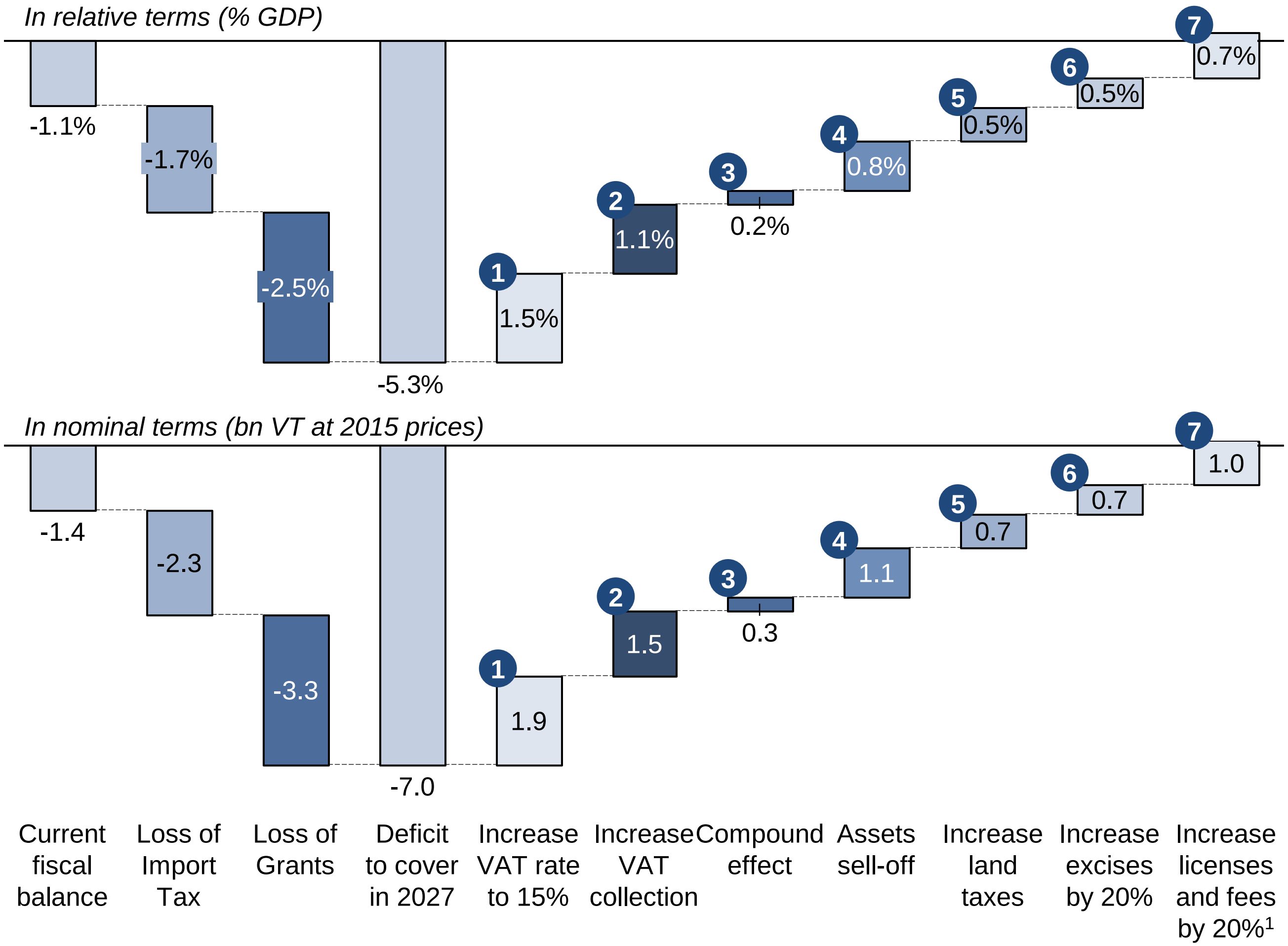
Proposed scenario to close budget gap



Highlights

1. Increasing VAT rate from the current 12.5% to 15% would add 1.5% of GDP to government revenues
2. Improving VAT collection to the PICs average of 68% would add 1.1% of GDP to government revenues. The largest potential is in ensuring compliance, lowering VAT threshold and removing exemptions
3. The compound effect of both increasing VAT rate and improving its collection would be at around 0.2% GDP
4. Selling-off currently mismanaged lands and buildings that belong to the government could bring in 0.8% GDP annually
5. Increasing land taxes and government land leases could add 0.5% GDP annually
6. Increasing revenue from excises by 20% would provide further 0.5% GDP to the government. The main additions would have to come from products which do not affect Vanuatu's tourism competitiveness - tobacco, strong spirits and cars
7. Finally, increasing revenue from business licenses and other fees by 20% would close the deficit by adding further 0.7% GDP

[1]All calculations are *ceteris paribus*, that is, assuming that relative sizes of various sources of government revenue remain the same in 2027

Source: Strategy Labs team analysis

Glossary

Full concept	Acronym	Explanation
Gross domestic product	**GDP**	The monetary value of all the finished goods and services produced within a country's borders in a specific time period.
GDP per capita	**GDP pc**	Measure of the total output of a country that takes the gross domestic product (GDP) and divides it by the number of people in the country.
Foreign direct investment	**FDI**	An investment made by a company or entity based in one country, into a company or entity based in another country.
The International Monetary Fund	**IMF**	An international organization created for the purpose of standardizing global financial relations and exchange rates. Monitors the global economy, and its core goal is to economically strengthen its member countries.
Pacific Island Countries	**PICs**	Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor Leste, Tonga, Tuvalu, Vanuatu
Vanuatu vatu	**VT**	National currency of Vanuatu.
Current account	**-**	Defined as the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers.
Financial account	**-**	Financial account components include direct investment, portfolio investment and reserve assets, and are broken down by sector.
Capital account	**-**	A capital account shows the net change in physical or financial asset ownership for a nation and, together with the current account, constitutes a nation's balance of payments.
Tax base	**-**	Total of taxable assets, income, and assessed value of property within the tax jurisdiction of a government.
Value-added tax	**VAT**	A type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale.
Capital gains tax	**CGT**	Tax levied on capital gains incurred by individuals and corporations. Capital gains are the profits that an investor realizes when he or she sells the capital asset for a price that is higher than the purchase price.
Goods & services tax	**GST**	Value-added tax levied on most goods and services sold for domestic consumption.
Corporate income tax	**CIT**	Corporate income tax is a levy placed on the profit of a firm to raise taxes.
Personal income tax	**PIT**	Personal income tax is a direct tax levied on income of a person.

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About Strategy Labs

Strategy Labs is a management consulting firm. We work with top executives and board members to help them shape company strategy, improve performance and drive organizational change.

As of 2014 Strategy Labs is a part of Lewben Group.

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