



Report and Recommendation of the President to the Board of Directors

Project Number: 54179-001
November 2020

Proposed Countercyclical Support Facility Grant Republic of Vanuatu: COVID-19 Fiscal Response Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 12 November 2020)

Currency unit	–	vatu (Vt)
Vt1.00	=	\$0.0090
\$1.00	=	Vt111.61

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
CPRO	–	COVID-19 pandemic response option
ESP	–	Economic Stimulus Program
GBV	–	gender-based violence
GDP	–	gross domestic product
HPRP	–	Health Preparedness and Response Plan
IMF	–	International Monetary Fund
MFEM	–	Ministry of Finance and Economic Management
MOH	–	Ministry of Health
MSMEs	–	micro, small, and medium-sized enterprises
NGO	–	nongovernment organization
RBV	–	Reserve Bank of Vanuatu
VNPF	–	Vanuatu National Provident Fund
WHO	–	World Health Organization

NOTE

In this report, “\$” refers to United States dollars, unless otherwise stated.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 54179-001	
Project Name	COVID-19 Fiscal Response Program	Department/Division	PARD/PLCO
Country	Vanuatu	Executing Agency	Ministry of Finance & Economic Management
Recipient	Republic of Vanuatu		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=54179-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=54179-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		2.00
	Social protection initiatives		1.93
	Agriculture, natural resources and rural development		8.00
	Finance		2.00
	Health		3.00
		Total	16.93
3. Operational Priorities		Climate Change Information	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
	✓ Accelerating progress in gender equality	Climate Change impact on the Project	Low
	✓ Promoting rural development and food security		
	✓ Strengthening governance and institutional capacity		
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.5		Effective gender mainstreaming (EGM)	✓
SDG 2.4			
SDG 3.3			
SDG 5.2			
SDG 8.1, 8.8			
SDG 9.3			
SDG 10.4			
SDG 17.4			
4. Risk Categorization:		Low	
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		16.93	
Sovereign COVID19 Pandemic Response Option: Asian Development Fund		16.93	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		16.93	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed grant to the Republic of Vanuatu for the COVID-19 Fiscal Response Program (the program) under the Countercyclical Support Facility's COVID-19 pandemic response option (CPRO).¹

2. Vanuatu has avoided an outbreak of the coronavirus disease (COVID-19) through decisive early action to close borders and adopt prevention and containment measures. As of 12 November 2020, the country had only one confirmed case of COVID-19 contained in quarantine after being identified from a repatriation flight. Vanuatu's efforts to prevent the spread of COVID-19 have come at significant economic and social costs. The program will help finance the implementation of the government's countercyclical response, which is anchored on the Health Preparedness and Response Plan (HPRP) and the Economic Stimulus Program (ESP), to mitigate the socioeconomic consequences of COVID-19. The proposed program is aligned with four operational priorities of the Asian Development Bank (ADB) Strategy 2030—(i) addressing remaining poverty and addressing inequalities, (ii) accelerating progress in gender equality, (iii) strengthening governance and institutional capacity, and (iv) promoting rural development and food security.² It is also aligned with the Pacific Approach priority of managing risks and building resilience by strengthening the health and agriculture sectors.³ Vanuatu meets all the CPRO access criteria (Table 1).⁴

Table 1: Compliance with Access Criteria for the COVID-19 Pandemic Response Option

Access Criteria	ADB Staff Assessment
1. Adverse impact of exogenous shocks	After growing by 2.8% annually during 2015–2019, Vanuatu's GDP is likely to contract by 9.8% in 2020 because of COVID-19-related declines in tourism, remittances, and exports, which are exacerbated by damages from Cyclone Harold. A fiscal deficit of 6.0% of GDP is expected in 2020 driven by lower revenues and higher stimulus spending, after surpluses averaging 6.2% annually in 2018–2019. The expected current account deficit of 5.8% of GDP in 2020 compares with an average annual surplus of 3.7% in 2015–2019. Up to 70% of the 29,000 workers employed in tourism in 2019 could lose their jobs by the end of 2020. It is estimated that the pre-COVID-19 share of the population living below \$1.90/day was 13.9% in 2020. This could rise to 18.3%, with a 10% decline in consumption due to COVID-19.
2. Countercyclical development expenditures	The government is implementing a \$44 million countercyclical response focusing on public health and the economy. The HPRP aims to prevent the import of COVID-19 and mitigate infection risks while preparing to manage a potential outbreak through detection, isolation, and clinical management. The ESP seeks to alleviate the impact of COVID-19 on individuals and businesses. It includes employment support, grants and fee relief for MSMEs, and support for agricultural production and education to assist poor and vulnerable groups, including women. The ESP is complemented by the distribution of food to needy households. Assistance to agriculture will be extended, and MSMEs will have access to credit of up to \$90,000 at 1.0% interest to support the economic recovery.
3. Pre-shock record of generally sound macroeconomic management	The government's pre-pandemic macroeconomic management record was generally sound. The IMF confirms that the economy was growing, prices were stable, fiscal balances were aligned with the economy's cyclical position, and foreign exchange reserves were strong. Vanuatu's economy grew by 2.9% in 2019 and was forecast to grow at a similar rate in 2020. Inflation was 2.8% in 2019 and was expected to remain within the Reserve Bank of Vanuatu's target of 0.0%–4.0% in 2020. The fiscal deficit fell from 7.3% of GDP in 2015 when Cyclone Pam damages required reconstruction expenditures. The government reported a fiscal surplus of 4.9% of GDP in 2019. A fiscal deficit of 1.0% of GDP was expected in 2020 because of lower revenues from its citizenship program. Foreign exchange reserves were equivalent to about 12 months of imports at the end of 2019 and were expected to remain at similar levels in 2020.

¹ Asian Development Bank (ADB). 2020. Policy Paper: *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.

² ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

³ ADB. 2016. *Pacific Approach 2016–2020*. Manila.

⁴ A detailed assessment is in Appendix 4.

4. Structural reforms	Public health measures were implemented early to prevent COVID-19 from entering Vanuatu and to prepare the health system. Borders were closed on 23 March 2020, and a national state of emergency has been in place since 26 March 2020. Repatriation flights commenced after establishing limited testing capacity on 25 May 2020, and, with a single case of COVID-19 identified from the repatriation flights, the system has proven to work well. Hospitals were upgraded, medical personnel were trained on infection prevention control and contact tracing, and personal protective equipment was distributed to Vila Central Hospital and Northern Provincial Hospital. The government intends to maintain and expand public health programs and requested ADB support to prepare for introducing a COVID-19 vaccine when it becomes available. Measures to mitigate the pandemic's economic impact were implemented early to support employment, including 4-month salary-equivalent payments to affected businesses, fee relief for businesses, and grants for MSMEs, followed by education assistance. Support for food security is ongoing. Support for credits to MSMEs through a government-owned bank and support for the agriculture sector will be extended beyond 2020.
5. Debt sustainability	The Joint World Bank–IMF June 2019 DSA found that Vanuatu was at moderate risk of debt distress. ADB's DSA, updated in October 2020, finds that Vanuatu's short-term growth prospects deteriorated with COVID-19, and countercyclical policy will sharply worsen fiscal balances. While fiscal deficits put Vanuatu's public debt on a rising path, they will be offset by higher economic growth in the longer term. The government intends to finance fiscal deficits using development partner grants and domestic resources (including drawing down cash reserves). The ADB grant will enable it to prioritize spending on countercyclical measures. The DSA concludes that with ADB grants, the public debt–GDP ratio will remain lower than the threshold of 60%, as per Vanuatu's Debt Management Strategy (2019–2022) and will be sustainable.
6. Coordination with the IMF	The IMF supports ADB's response and provided an assessment letter. The letter presents the IMF's views on debt sustainability, is consistent with ADB's DSA findings, and reports that Vanuatu's risk of breaching the debt threshold will be elevated if another disaster occurs. ADB coordinates macroeconomic monitoring with the IMF, and Vanuatu is on a standard 12-month Article IV consultation cycle. The country continues to benefit from IMF technical assistance in areas including foreign exchange reserve management, finance sector supervision, and national statistics. ADB and the IMF also participate in annual public financial management partner meetings and share updates.

ADB = Asia Development Bank; COVID-19 = coronavirus disease; DSA = debt sustainability analysis; ESP = Economic Stimulus Program; GDP = gross domestic product; HPRP = Health Preparedness and Response Plan; IMF = International Monetary Fund; MSMEs = micro, small, and medium-sized enterprises.

Source: Asian Development Bank.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Development context.** Vanuatu is a small island developing state, vulnerable to natural hazards and global economic shocks. According to the World Risk Index Report, Vanuatu is the most at risk of disasters from natural hazards among 180 economies worldwide.⁵ It had a population of about 305,000 in 2019 and is ranked 141st of 189 economies for human development.⁶ About 75% of the population lives in rural areas. The main contributors to the economy are tourism and agriculture (crops and livestock). Major exports are beef, cocoa, copra, kava, and timber. Vanuatu depends on imported food, fuels, and machinery and equipment. The most recent national data, from 2013, shows that 38.8% of people are multidimensionally poor (reflecting deprivations in health, education, and living standards), and another 32.3% are vulnerable to multidimensional poverty.⁷ Modeled estimates of pre-COVID poverty levels put 13.9% of the population living below \$1.90/day.⁸

⁵ Ruhr University. 2019. *World Risk Report 2019*. Bochum.

⁶ United Nations. http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/VUT.pdf (accessed on 24 June 2020).

⁷ Government of Vanuatu, Vanuatu National Statistic Office, and UNDP Pacific Centre. 2013. *Vanuatu Hardship and Poverty Report – Analysis of the 2010 Household Income and Expenditure Report*. Port Vila and Suva; United Nations. http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/VUT.pdf (accessed on 24 June 2020).

⁸ J. Bulan et al. 2020. "COVID-19 and Poverty: Some Scenarios." Unpublished note prepared for ADB's Economic Research and Regional Cooperation Department.

4. **Cyclone damage.** Soon after the global outbreak of COVID-19, Vanuatu was hit by Cyclone Harold on 6–7 April 2020. Cyclone Harold was the most severe storm to strike Vanuatu since Cyclone Pam in 2015.⁹ It caused 3 deaths, affected 176,000 people, and damaged homes and infrastructure. Agricultural produce was destroyed, reducing potential exports and jeopardizing food security. Damage and loss from Cyclone Harold are estimated at 51% of GDP in 2020. Cyclone Harold compounded the socioeconomic stress caused by COVID-19 as the government struggled to manage twin shocks.

5. **Health system challenges.** Vanuatu's health system faced significant challenges even before COVID-19, including shortages of health care workers to deliver services.¹⁰ As of June 2020, more than 50 of 402 health facilities had closed because of inadequate staffing or absence of routine maintenance.¹¹ Despite these hurdles, women's health in Vanuatu has improved—skilled birth attendance rates are high, at about 90%, and maternal mortality ratios are declining (down from 225 deaths per 100,000 live births in 1990 to 72 in 2017). However, this remains higher than the Sustainable Development Goal target of 70 deaths per 100,000 live births.¹² The major causes of deaths in Vanuatu are cardiovascular diseases and diabetes, and those affected by these diseases are susceptible to severe COVID-19 symptoms.¹³ Vanuatu has established a 24-bed isolation capacity and five ventilators in its hospitals to prepare for COVID-19. The country has a minimum 1-month supply of protective equipment, and more than 2,000 personnel were trained in contact tracing and management of COVID-19. Vanuatu has established local testing capacity but needs additional health sector support in the case of a COVID-19 outbreak.

6. **Prevention and containment measures.** The government took proactive actions to prevent cases, starting from January 2020. It announced the \$6 million HPRP on 24 January 2020 to strengthen prevention and containment (para. 17) and protect public health. This included issuance of health advisories, health screenings at airports and seaports, and progressive restrictions on international travel as the pandemic evolved—culminating in the closure of borders on 23 March 2020. A state of emergency was declared on 26 March 2020 and remains in effect until 31 December 2020. Other measures implemented include social distancing, temporary closure of schools, restrictions on interisland travel, limited passengers on public transport, cancellation of mass gatherings and sporting events, early closure of businesses, and an overnight curfew. Limited testing capacity was established with support from the World Health Organization (WHO) and the Pacific Community.¹⁴ The government allowed the phased repatriation of residents stranded abroad.¹⁵ Quarantine processes are in effect for all inbound travelers to limit potential contact with the public. As of 12 November 2020, Vanuatu has only one confirmed case of COVID-19 in border quarantine. The government has since ceased repatriation flights and imposed domestic travel restrictions to minimize the risk of community transmission.

⁹ Government of Vanuatu, National Disaster Management Office. 2020. *Rapid Technical Assessment Report*. Port Vila. Cyclone Harold was the first category 5 severe tropical cyclone on the Australian scale to strike Vanuatu since Cyclone Pam in 2015, bringing wind gusts above 275 kilometers per hour and 250–450 millimeters of rain.

¹⁰ World Health Organization (WHO). 2014. *Human Resources for Health Country Profiles: Republic of Vanuatu*. Geneva.

¹¹ Government of Vanuatu, Ministry of Finance and Economic Management, 2020. *Government Assets Review*. Port Vila.

¹² The Royal Australian and New Zealand College of Obstetricians and Gynecologists. 2017. *Improving Women's Health in the Pacific*. Melbourne and Wellington.

¹³ Government of Vanuatu, Ministry of Health. 2016. NCD Policy and Strategic Plan 2016–2020. Port Vila; and WHO. 2020. COVID-19: vulnerable and high-risk groups. Geneva.

¹⁴ The Pacific Community, formerly the South Pacific Commission, is an international development organization owned and governed by 26 country and territory members, including Vanuatu.

¹⁵ Anyone entering Vanuatu had to complete an on-line Pre-Travel Health Registration Form within 72 hours of arrival. Effective from 12 November 2020, all travelers are required to provide a negative COVID-19 test result within 72-hours of their departure. The quarantine period is also increased from 14 to 28 days.

7. **Coordination of responses.** The National COVID-19 Taskforce was formed in January 2020 and merged into the National Disaster Management Office on 26 March 2020. The National Health Emergency Operations Centre under the Ministry of Health (MOH) has been coordinating COVID-19 preparedness activities. The capacity of the operations center was supplemented with support from development partners such as Australia, France, Israel, the Pacific Community, Red Cross, United Nations Children's Fund (UNICEF), United Nations Population Fund, and WHO. Provincial health emergency operations centers were also set up.

8. **Pre-COVID-19 record of generally sound macroeconomic management.** Vanuatu's economy experienced growth from 2004 to 2019, driven by expanding tourism, public investments, economic reforms, and a stable macroeconomy. Following Cyclone Pam in 2015, economic growth averaged 2.8% during 2015–2019, driven by construction and tourism. Inflation averaged 2.3% over the same period. While relief and rehabilitation expenditure resulted in a fiscal deficit of 7.3% in 2015, this was reduced subsequently, and fiscal surpluses averaging 6.2% of GDP were recorded in 2018 and 2019 (Table 2). Fiscal deficits largely related to Cyclone Pam reconstruction have led to a rise in public debt from 34.4% of GDP in 2015 to 44.4% of GDP in 2019. Vanuatu's Debt Management Strategy (2019–2022) targets nominal public debt below 60% and external debt below 40% of GDP. The strategy targets concessional debt for investment only. Current account surpluses were recorded in 2018 and 2019, averaging 11.3% of GDP, and foreign exchange reserves equaled about 12 months of imports at the end of 2019. The IMF also finds that the economy was growing, prices were stable, the external position was stronger than expected, and public finances were sound.¹⁶ Vanuatu was expecting a fiscal deficit in 2020, on the back of declining revenues from the citizenship by investment program, and this had also negatively impacted the expected current account deficit. Nonetheless, the performance was in line with the economy's cyclical position.

Table 2: Selected Macroeconomic Indicators, 2017–2021
(% of gross domestic product, unless otherwise specified)

	2017	2018	2019e	2020p Pre- COVID-19 ^a	2020p With COVID-19	2021p With COVID-19
Real GDP growth (%)	4.4	2.9	2.9	2.8	(9.8)	1.0
Inflation (CPI % change)	3.1	2.3	2.8	2.2	3.0	2.2
Current account balance	(6.1)	10.2	12.4	(5.0)	(5.8)	(9.6)
Total revenues and grants	35.6	38.8	42.0	29.2	44.3	37.4
Taxes	17.1	17.8	17.6	18.1	15.4	16.1
Nontax revenues	7.0	12.4	14.0	7.5	16.8 ^b	12.4
Grants	11.4	8.5	10.4	3.5	12.1	8.9
Total expenditures	36.8	31.3	37.1	30.2	50.3	40.4
Overall fiscal balance	(1.2)	7.5	4.9	(1.0)	(6.0)	(3.0)
Gross public debt	45.0	45.5	44.4	43.2	55.2	56.4
External debt	35.6	38.2	39.1	38.5	39.9	39.5
Gross international reserves (\$ million)	394	434	512	562	583	681
Nominal GDP (\$ million)	880	915	934	975	852	886

COVID-19 = coronavirus disease, CPI = consumer price index, e = estimates, GDP = gross domestic production, p = projections.

^a Based on *Asian Development Outlook Update*, September 2019.

^b Revenues from citizenship by investment program increased significantly during first half of 2020.

Sources: Asian Development Bank estimates and projections, Reserve Bank of Vanuatu, Vanuatu Department of Finance and Treasury, and International Monetary Fund.

9. **Transmission mechanisms.** COVID-19 had its most substantial impact on Vanuatu's tourism industry, which in 2019 contributed almost 35% of GDP, 67.3% of exports, and 29,000

¹⁶ International Monetary Fund (IMF) Assessment Letter (accessible from the list of linked documents in Appendix 2).

jobs.¹⁷ Border closures have halted tourism, a source of income in urban and rural areas, and a key generator of foreign exchange and government revenue. Service exports are expected to fall by 68% compared with 2019. Tourism is expected to recover gradually, given the economic slowdown in the two largest visitor source markets: Australia (52% of visitors) and New Zealand (13%). Remittances, estimated by the Reserve Bank of Vanuatu (RBV) at 13% of GDP in 2019, are expected to fall since workers cannot freely travel to Australia and New Zealand, which have dedicated labor mobility schemes for the Pacific. More than 10,000 workers from Vanuatu participate in seasonal work in Australia and New Zealand annually.¹⁸

10. **Economic impacts.** Vanuatu's economy is expected to contract by 9.8% in 2020 (compared with 2.9% growth in 2019) because of COVID-19 and the impacts of Cyclone Harold. Other key macroeconomic variables are expected to worsen in 2020 (Table 2). Vanuatu's merchandise exports are expected to fall by 43% from 2019 because of lower demand. The current account deficit is forecast at 5.8% of GDP in 2020 (compared with a surplus of 12.4% of GDP in 2019) because tourism stopped. Economic growth of 1.0% is expected in 2021, driven largely by a recovery in tourism, agriculture, and post-cyclone construction activities. The duration of the COVID-19 crisis poses significant risks to the outlook.

11. **Fiscal pressures.** Declining tourism, combined with lower demand under the COVID-19 containment measures, will result in lower domestic revenue in 2020.¹⁹ The government's countercyclical response will further strain the deteriorating fiscal position. The fiscal deficit, projected to reach 6.0% of GDP in 2020 (footnote 19), will be financed by domestic loans and drawdown of cash reserves accumulated from fiscal surpluses in 2018 and 2019. Economic recovery will require substantial resources beyond 2020. A fiscal deficit of 3.0% is projected in 2021. The government intends to adhere to its debt strategies and maintain public debt below 60% of GDP (and external debt below 40% of GDP), while the Debt Management Strategy (2019–2022) prevents the government from borrowing for operating payments (para. 8). Financing options are, therefore limited.

12. **Increased risks in the finance sector.** An extended period of tourism shutdown is likely to cause financial difficulties for micro, small, and medium-sized enterprises (MSMEs) that operate in tourism and related industries. About 20% of MSMEs are owned and/or led by women.²⁰ Failing MSMEs and employment losses will impact the commercial banks' loan performance and dampen prospects for Vanuatu's economic recovery.²¹ About 10% of bank loans are to the tourism sector, and 55% are for personal loans such as housing mortgages and car leases, whose servicing may become challenging. The nonperforming loan ratio was 15.5% in March 2020, increasing by 1.1 percentage points from September 2019.²²

13. **Significant poverty and social impact.** It is estimated that Vanuatu's share of the population living below \$1.90/day could rise from 13.9% (para. 3) to 18.3%, with a 10% decline in consumption because of COVID-19 (footnote 6). Poverty is higher in the two major urban centers of Port Vila and Luganville than in rural areas. While those living in rural areas are vulnerable to multidimensional poverty, those living in urban areas have had their livelihoods impacted by the collapse in tourism. Tourism, which employed 29,000 formal workers (of whom

¹⁷ World Travel and Tourism Council. 2020. *Vanuatu: 2020 Annual Research*. London.

¹⁸ Government of Vanuatu. <https://dol.gov.vu/index.php/about-us/employment-services-unit> (accessed 23 July 2020).

¹⁹ ADB. 2020. *Asian Development Outlook Update*. Manila.

²⁰ Reserve Bank of Vanuatu. 2016. *Vanuatu Micro, Small & Medium Enterprises (MSMEs) – Finance 2016 Survey: Exploring the MSMEs' Survey Challenges / Understanding the MSMEs' Characteristics for Ways Forward*. Port Vila.

²¹ Vanuatu has five commercial banks: three majority foreign-owned international banks, a foreign-owned bank that operates in Vanuatu only, and a majority government-owned bank.

²² IMF. 2020. *Vanuatu—Assessment Letter for the Asian Development Bank*. Washington, DC.

about 43% are women) in 2019, is the hardest hit, with estimates of up to 70% job losses by year-end 2020.²³ Job losses will exacerbate urban poverty since most of these workers live in urban centers and contribute to the welfare of the vulnerable and informal sector workers through traditional support systems. While most tourism activities are in urban areas, the lack of demand for agricultural produce from hotels and restaurants affects rural incomes as well. Even before COVID-19, market vendors (of whom about 91% are women) were more vulnerable to poverty than other groups.²⁴ Interventions to prevent the entry and spread of COVID-19 have already resulted in many women losing their livelihoods in the formal and informal sectors (including market vendors and lower-skilled employees in hotels and restaurants). Strict measures also resulted in declining air and sea freight volumes, which restricts the availability of food. These impacts could reduce assets, increase personal debt burdens, and lower food intake or the quality of intake—with long-term detrimental effects on social welfare.

14. Impact of both disasters on health. The co-occurrence of Cyclone Harold and the COVID-19 pandemic made it even more difficult for Vanuatu's health system to overcome the impacts on health and well-being. These include interrupted access to health services, damaged medical equipment such as the immunization cold chain, limited availability of essential medicines and equipment because of disrupted supply chains, damaged crops undermining food supply and nutrition, and contaminated water sources catalyzing the spread of diseases. Preliminary data show an increase in diarrheal diseases, respiratory infections, leptospirosis, typhoid, dengue, malnourishment, skin infections, and an elevated risk of mental illness from evacuation and unemployment.²⁵ The gains made in improving women's health are likely to be compromised by an outbreak of COVID-19, particularly if funding for essential services is not maintained. The WHO Country Preparedness and Response Status for Vanuatu remains at Level 2 as of June 2020 in the response category "high risk of imported cases," indicating the need for significant support.²⁶

15. Gender impacts. In addition to job losses by women (para. 13), COVID-19 will exacerbate gender inequalities. The prioritization of COVID-19 responses threatens women's continued access to maternal and reproductive health services, a particular issue in Vanuatu where maternal mortality ratios are still relatively high (para. 5).²⁷ Poor access to basic health services, limited availability of life-saving emergency obstetric care, inadequate infrastructure, difficult transportation, and delayed referrals of life-threatening conditions are major contributing factors. The lifetime prevalence of intimate partner violence is high in Vanuatu, with 60% of women reporting some form of this. The COVID-19 threat and associated movement restrictions have increased gender-based violence (GBV) while simultaneously making it more difficult for women and girls to access services. Data from GBV service providers suggest that already high levels of GBV are rising further, and reports of sexual exploitation as a result of economic hardship and economic abuse by partners are increasing.

B. Government Responses to COVID-19

16. The government's countercyclical response to COVID-19 amounts to 5.2% of GDP, focusing on health since January 2020 and providing economic stimulus since April 2020. The HPRP aims to keep COVID-19 out of Vanuatu and contain it if it does enter. The ESP seeks

²³ World Travel and Tourism Council. 2020. *Vanuatu: 2020 Annual Research*. London; and Department of Tourism and Vanuatu Tourism Office. 2020. *National Tourism Business Impacts Survey—TC Harold and COVID-19 Pandemic*. Port Vila.

²⁴ Government of Vanuatu, Vanuatu National Statistic Office and UNDP Pacific Centre. 2013. *Vanuatu Hardship and Poverty Report – Analysis of the 2010 Household Income and Expenditure Report*. Port Vila and Suva.

²⁵ National Health Emergency Operation Centre, 2020. Unpublished situation report. Port Vila.

²⁶ WHO. 2020. *COVID-19 Strategic Preparedness and Response Plan: Country Preparedness and Response Status for COVID-19*. Geneva.

²⁷ WHO. https://www.who.int/gho/maternal_health/countries/vut.pdf?ua=1 (accessed on 01 October 2020).

to alleviate the socioeconomic impact of the pandemic on individuals and businesses. The initial response to COVID-19 (paras. 6–7) was put in place before a new coalition government assumed office on 20 April 2020. The new administration focused on immediate cyclone relief as well as mitigation of COVID-19 impacts. It announced additional components of the countercyclical response to support economic recovery—\$26.7 million support to MSMEs with credit provided through a government-owned bank beyond 2020 and expanded support to agriculture with a \$10.6 million program in 2021 targeting agricultural production and employment while ensuring the availability of fresh and nutritious food. The government's countercyclical response to COVID-19 will continue until December 2021, and several key measures are already being implemented (paras. 17–21).

1. Health Protection

17. The HPRP, implemented by MOH, outlines (i) containment measures to prevent the import of cases and interrupt local transmission through quarantine of clusters of sporadic cases; and (ii) mitigation measures to prevent community outbreaks through isolation, infection prevention control, enhanced contact tracing and surveillance, and risk communication in communities. The HPRP adheres to the WHO's recommended operational guidelines for COVID-19 responses.²⁸ Of the \$6 million health budget, 20% is allocated for infrastructure; 40% for clinical management of suspected cases; 23% for coordination, communications, and prevention; and 17% for early detection and isolation. Personal protective equipment was provided to all health care workers who would tend to COVID-19 patients in Vila Central Hospital and Northern Provincial Hospital. More than 2,000 public and health care workers were trained in contact tracing to improve surveillance and clinical management of COVID-19. MOH is also intent on improving community awareness through ongoing public information campaigns, including a dedicated online information page on key measures to prevent and contain the virus's spread.²⁹ Hospitals were refurbished, 24 isolation beds were prepared, and local testing capacity was established. MOH plans to keep expanding laboratory facilities, isolation wards, and refresher training in the medium- and long-term. Measures to prevent and respond to GBV were also introduced (para. 34). The government intends to maintain and expand public health programs and requested ADB support to prepare for the introduction of COVID-19 vaccines, once available.

2. Economic Support

18. The government's \$38 million initial economic support will alleviate the impact of fewer employment opportunities and business activities and provide social protection.³⁰ The ESP comprises the following measures.

- (i) **Employment stabilization payment—\$22.2 million.** The government prioritized job protection in recognition of the important role of informal social protection networks, whereby those with paid employment support extended families and communities. The traditional social protection system has been an integral part of Vanuatu's post-disaster relief and recovery efforts. The employment stabilization payment supports in businesses affected by COVID-19. The government reimburses affected businesses with up to \$260 per employee on their payroll per month for 4 months (April–August). As a further incentive to retain employees, employers receive a further 12% of the amount they are reimbursed for employee wages for contributions to the Vanuatu National Provident Fund (VNPF) and administrative costs. The support was available to all industries affected by COVID-19. The scheme is available to all 7,391

²⁸ WHO. 2020. *Operational Planning Guidelines to Support Country Preparedness and Response*. Geneva.

²⁹ Government of Vanuatu, Ministry of Health. <https://covid19.gov.vu/index.php> (accessed on 21 September 2020).

³⁰ Summary of Key Social Protection Mechanisms in Stimulus Packages (accessible from the list of linked documents in Appendix 2).

registered employers in the VNPF and supports an estimated 6,000 of 77,231 employees (29,530 women and 47,701 men) registered with the VNPF.³¹ The scheme also includes part-time and casual workers who are registered with the VNPF. About 40% of beneficiaries will be women.³² Payments for claims will be processed retroactively and be made until the end of 2020.

- (ii) **Grants to micro, small, and medium-sized enterprises—\$3.5 million.** With an annual turnover of less than \$1.7 million, MSMEs can access a maximum grant of \$520 to support their operating cash flow requirements. About 450 of 1,500 potential recipients are MSMEs owned or co-owned by women. Recipients also include licensed holders of small market stalls. The government waived business license fees for 2020 or, if these were paid before 31 March 2020, will waive the fees for 2021.
- (iii) **Agriculture support—\$3.5 million.** The government will also support increased production and marketing of copra, kava, cocoa, and other commodities through price subsidies and transportation assistance from farms to urban centers. Price subsidies will supplement the incomes of smallholder farmers and allow larger farmers to employ more workers. About 31,650 households engaged in cash crop production could benefit from this support.³³
- (iv) **Tuition fee grant—\$4.5 million.** Support for households has primarily been through the exemption of the 2020 tuition fees for early childhood care and education, and primary and secondary education, along with exemptions of several other school fees—92,644 primary and secondary students (48% girls) will be able to continue schooling despite hardships faced by their families. Support for early childhood care allows working mothers to balance work and caregiving responsibilities.
- (v) **Tax and fee exemptions—\$4.3 million.** Additional measures include (a) rent tax exemptions for property owners, (b) road tax exemptions for MSMEs and individuals, (c) residence and work permit exemptions to encourage nonresidents to remain in Vanuatu, and (d) exemptions from other fees and charges applying to MSMEs and individuals.

19. **Support from the finance sector.** In addition to the HPRP and ESP support, the RBV set up a disaster recovery and import-export facility of up to \$10 million to assist exporters and importers. The RBV also reduced official interest rates from 2.90% to 2.25% and the capital adequacy ratio from 12% to 10% to align with expansionary fiscal policies. It requires foreign commercial banks to seek prior approval for repatriation of capital as an exchange control measure. Formal social protection is available to 53% of Vanuatu's workforce through the VNPF, including those who are informally employed but have registered with the VNPF through voluntary contributions (footnote 34). VNPF members who lost their jobs because of the COVID-19 crisis can access interest-free hardship relief loans up to \$850. Commercial banks in Vanuatu also offered repayment relief to their customers.

20. **Other government-supported, pro-poor programs.** Vanuatu has no formal social protection schemes for those who do not contribute to the VNPF. Still, the government supports international and local nongovernment organizations (NGOs) that assist the poor and vulnerable. The Department of Agriculture promotes the production of root crops, vegetables, and fish by providing seedlings and fingerlings for backyard gardening and fish farms to ensure affordable food supply.³⁴ The National Disaster Management Office, MOH, and several NGOs distributed

³¹ Of the workers accessing support, 683 are staff of government-owned enterprises. Of these, 438 Air Vanuatu (Operations) Limited staff and 245 Airports Vanuatu Limited staff have accessed support.

³² This is based on the percentage membership of women in the VNPF.

³³ Government of Vanuatu, Vanuatu National Statistics Office. 2017. *2016 Post TC Pam Mini Census Report*. Port Vila.

³⁴ Food and Agriculture Organization of the United States. 2020. *Impacts of COVID-19 on the food systems in the Pacific Small Island Developing States and Responses*. Rome.

food, health, and nutrition supplements to about 55,000 vulnerable families affected by COVID-19 restrictions and Cyclone Harold, which benefited many elderly people, children, people with disabilities, and pregnant women. This included distributing nutritional supplements to malnourished children under 5 years in partnership with local NGOs and UNICEF. A \$6 million cash-transfer program, funded by development partners and piloted in partnership with Oxfam, will support vulnerable households outside the employment stabilization program. The Ministry of Trade, Tourism, and Industry is training farmers on food processing to add value to their produce and improve livestock management and fish farming skills.

21. **Recovery targeted.** The initial \$3.5 million support for agriculture under the ESP will be supplemented by \$10.6 million financing in 2021 for ongoing agricultural assistance programs. This includes targeting partnerships with the private sector to deliver extension services, food crop planting materials, and additional markets; and will also assist mechanization. To further boost economic recovery, the government will provide \$26.7 million in financing to support lending to MSMEs beyond 2020. MSMEs will be able to borrow up to \$90,000 at an interest rate of 1.0%.

C. Proposed Program, Impact and ADB's Value Addition

22. **Proposed program.** ADB's fiscal response program will help the government implement its countercyclical measures to mitigate the adverse socioeconomic impacts of COVID-19. The program will provide the government with the fiscal space to meet critical public health needs while managing the effects of the economic downturn on vulnerable groups and businesses. It is aligned with the following overarching development objective: adverse impact of the COVID-19 pandemic on the economy, health systems, and social services minimized. The program outcome will be: adverse effects of the COVID-19 pandemic on individuals and businesses mitigated. The three program outputs are: (i) health sector responses to COVID-19 implemented; (ii) measures for supporting employment and businesses implemented; and (iii) food security and education support programs implemented. The design and monitoring framework is in Appendix 1.

23. **ADB's value addition.** The program builds on a strong base of country knowledge and relationships that supported investments in infrastructure, public sector management, and private sector development.³⁵ To enhance COVID-19 preparedness, ADB provided test cartridges, swabs, and other medical supplies totaling \$0.9 million.³⁶ ADB also provided support for quarantine facilities, human resources, and the expansion of isolation facilities.³⁷ A regional health project is strengthening immunization programs and access to quality-assured safe vaccines at affordable prices.³⁸ Additional financing of \$3.8 million is proposed under the regional health project to upgrade cold chains, strengthen surveillance, and procurement of the COVID-19 vaccine, once available. ADB will also support one long-term economic advisor in the Prime Minister's office to provide policy advice on economic recovery, and another in the Ministry of Finance and Economic Management (MFEM) to strengthen the oversight and monitoring of state-owned enterprises.³⁹ Technical assistance is available to support the government in collecting gender-based data and monitoring social implications, including the impact on women.⁴⁰

³⁵ ADB. [Vanuatu: Cyclone Pam Disaster Response Project](#); ADB. [Vanuatu: Cyclone Pam School Reconstruction Project](#); ADB. [Vanuatu: Energy Access Project](#); ADB. [Regional: Pacific Private Sector Development Initiative, Phase IV](#); and ADB. [Regional: Pacific Economic Management, Phase 3](#).

³⁶ ADB. [Regional Technical Assistance: Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases](#).

³⁷ ADB. [Regional: COVID-19 Emergency Response Project](#) (\$1.5 million was funded by the Japan Fund for Poverty Reduction's replenishment of the Asia Pacific Disaster Response Fund).

³⁸ ADB. [Regional: Systems Strengthening for Effective Coverage of New Vaccines in the Pacific](#).

³⁹ ADB. [Regional: Improving the Pacific Public Financial Management Facility](#).

⁴⁰ ADB. [Regional: Strengthening Gender Outcomes in Pacific COVID-19 Response and Recovery](#).

24. The program is complemented by a contingent disaster financing program (\$5.0 million grant) to strengthen resilience to disasters triggered by natural hazards and future health emergencies.⁴¹ In addition, an urban infrastructure project (\$9.6 million grant) to construct climate-resilient multipurpose community shelters that can also be used as triage facilities is under preparation.⁴² ADB will also complement the program with a proposed project (\$3.5 million grant) to assist informal workers and other vulnerable groups.⁴³ ADB will provide additional financing to improve the connectivity of the outer islands and complement the government's extended support for agriculture.⁴⁴ Infrastructure projects will play a critical role in stimulating growth and support the recovery from COVID-19. ADB will provide grants and concessional loans for energy access, urban infrastructure, and maritime transport during 2020–2023.⁴⁵

25. **Development partner coordination.** Effective development partner coordination has enabled sequenced financing and supplementation of government capacity in preparing the health sector (para. 7). ADB consulted with the World Bank, the IMF, Australia, New Zealand, the European Union, and other development partners on Vanuatu's financing needs and the timing of support. The World Bank, the European Union, Australia, and New Zealand provided budget support. Australia and the People's Republic of China contributed essential medical equipment and supplies. For the public health response, ADB worked closely with United Nations agencies in Vanuatu, including UNICEF and WHO, on technical support for health preparedness and response.⁴⁶ The IMF provides advisory and technical support with macroeconomic assessments and monetary and financial policy advice, which is in addition to staff consultations and Article IV requirements. The IMF shares its assessment reports with the ADB. IMF was consulted as the COVID-19 crisis evolved and prepared an assessment letter to confirm that Vanuatu's macroeconomic policy before COVID-19 had generally been sound and that the pandemic significantly impacted Vanuatu's economy (footnotes 16 and 22).

26. **Lessons.** The proposed program applies lessons from ADB's experience in providing economic recovery support in the Pacific during the 2008–2009 global financial crisis.⁴⁷ Earlier programs demonstrated the need to support aggregate demand while safeguarding the fiscal position and the role of development partner coordination in a comprehensive crisis response. ADB's past engagement with Vanuatu highlighted the need to overcome implementation capacity constraints. Accordingly, the new program will use existing government mechanisms for program monitoring and implementation. The ESP implementation will rely on the existing database and records of the VNPF and key government agencies to verify potential beneficiaries' eligibility. Tuition fee assistance will use the existing school grant procedures. To supplement the implementation capacity, ADB is mobilizing extensive TA support (para. 23).

D. Development Financing Needs, Budget Support and Debt Sustainability

27. Reduced government revenues and higher countercyclical development expenditures will lead to a larger financing need in 2020 than initially expected (Table 3). A fiscal deficit of \$51.1 million (6.0% of GDP) is estimated in 2020, and \$26.5 million in 2021 (para. 11). The CPRO budget support is financing 17.4% of the total financing needs for 2020. Other development partners have disbursed budget support grants equivalent to \$29.0 million in 2020. Domestic resources include \$12.7 million in domestic debt and use of \$38.4 million in cash reserves. It is

⁴¹ ADB. 2020. Pacific Disaster Resilience Program (Phase 3). Manila.

⁴² ADB. 2020. Port Vila Integrated Urban Improvement Project. Manila (proposed).

⁴³ ADB. 2020. *COVID-19 Response for Affected Vulnerable Groups in the Pacific*. Manila (proposed).

⁴⁴ ADB. [Vanuatu: Interisland Shipping Support Project](#).

⁴⁵ Vanuatu has requested grant-only financing from all its development partners.

⁴⁶ Development Coordination (accessible from the list of linked documents in Appendix 2).

⁴⁷ ADB. 2011. *Policy-based programs for the Pacific islands*. Manila.

estimated that support from development partners will be at pre-COVID-19 levels in 2021.

Table 3: Financing Needs and Support for 2020
(\$ million)

	2020		2020	
	(pre-COVID-19)		(adjusted for COVID-19)	
	(\$)	(% of GDP)	(\$)	(% of GDP)
A. Total revenues and grants	277.7	32.0	331.8	37.8
of which: other grants	33.3	3.8	57.3 ^a	5.6
B. Total expenditure	287.2	33.0	428.7	49.2
Financing requirement (A-B)	(9.6)	(1.0)	(96.9)	(11.4)
COVID-19 financing plan and budget support				
<i>Development partner budget support</i>			45.9	5.4
ADB CPRO			16.9	2.0
Australia			5.8	0.7
European Union			11.3	1.3
New Zealand			1.9	0.2
World Bank			10.0	1.2
<i>Use of domestic resources (including cash reserves)</i>	9.6	1.0	51.1	6.0

() = negative, ADB = Asian Development Bank, COVID-19 = coronavirus disease, CPRO = COVID-19 pandemic response option, GDP = gross domestic product.

^a Includes additional grants for Cyclone Harold relief and rehabilitation.

Source: Asian Development Bank estimates.

28. The government has requested a grant not exceeding \$16.925 million from ADB's Special Funds resources (Asian Development Fund) to help finance the program. The grant proceeds will support development financing needs, excluding ineligible items.⁴⁸

29. Vanuatu's public and publicly guaranteed debt was 44.4% of GDP in 2019, of which domestic debt was 5.2% of GDP.⁴⁹ Vanuatu is considered to be at moderate risk of debt distress based on the IMF's 2019 debt sustainability analysis. A substantial component of the public debt was to finance the post-Cyclone Pam reconstruction activities and infrastructure investments. ADB's October 2020 debt sustainability analysis suggests that without grants from its development partners, the debt–GDP ratio will breach the threshold of 60% by 2024. However, with grants, the public debt–GDP ratio will reach 48.7% by 2024 and remain sustainable.⁵⁰ The government intends to use development partner grants and domestic resources (including the drawdown of cash reserves) to meet its financing needs in 2020.⁵¹ The IMF's September 2020 assessment finds that even though the risk of debt distress remains moderate, risks will be elevated with another disaster (footnotes 16 and 22).

E. Implementation Arrangements

30. The program will be implemented from 1 February 2020 to 31 December 2021, using primarily existing mechanisms and platforms (para. 26). The MFEM will be the executing agency. The government formed an implementation team to execute, supervise, and monitor compliance with set guidelines, and ensure communication and information dissemination to potential beneficiaries. The implementing agencies are MOH for health measures, the Ministry of Agriculture, Livestock, Forestry, Fisheries and Biosecurity and the Ministry of Education and Training. Through the MFEM, the government will monitor budget execution under the ESP and

⁴⁸ List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

⁴⁹ ADB estimates based on: Reserve Bank of Vanuatu. 2020. Central Government Gross Debt. <https://www.rbv.gov.vu/index.php/en/e-gdds-statistics>. The IMF estimates public debt at 46.1% of GDP in its 2020 assessment letter to ADB (footnotes 16 and 22).

⁵⁰ Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2).

⁵¹ Cash reserves held by government as at end of 2019 was \$73.2 million.

produce quarterly and midyear reports. The government also separated bank accounts and cost centers to facilitate reporting and monitoring. While general capacity constraints exist, risks are mitigated because the government has successfully implemented countercyclical measures through its regular systems. ADB technical assistance will support the government in collecting sex-disaggregated data and monitoring social implications, including the impact on women (para. 23). Grant proceeds will be withdrawn in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

31. **Safeguards.** In compliance with ADB's Safeguard Policy Statement (2009), the program is classified as *category C* for environment, involuntary resettlement, and indigenous peoples safeguards.⁵² The actions were assessed and are not expected to have any adverse environmental or social safeguard impacts within the meaning of the Safeguard Policy Statement.

32. **Poverty and social.** Despite Vanuatu's lack of formal social protection programs, the employment stabilization payments will prevent affected workers from falling into poverty. They will also generate traditional support for those outside the formal support schemes. Assistance to MSMEs will help them stay in business, including self-employed workers who depend on a single income source, such as market stall owners. Households have been relieved of paying school fees, estimated at \$290, equivalent to 3 months of household income. Most producers in Vanuatu are smallholder farmers. Support for agriculture will address food security and provide income to help meet nonfood essentials such as access to basic services, transport, and communication, especially during the pandemic. Support to agriculture will be expanded in 2021. Transport and logistics are significant constraints and a critical cost component of supply chains for cocoa, copra, and other crops. Assistance from the stimulus package will support smallholder farmers to maximize income opportunities from cash crops. Distribution of food and health supplies to an estimated 55,000 households complements the ESP (para. 20).

33. **Gender.** The program is categorized as *effective gender mainstreaming*.⁵³ The health response to COVID-19 ensures that (i) health workers in hospitals and subnational laboratories, including 40% women, receive personal protective equipment; (ii) proactive health messages on COVID-19 and pregnancy, childbirth, and breastfeeding are disseminated widely; (iii) nutrition supplies are provided to 3,000 pregnant and lactating women, and children; and (iv) funding for maternal and reproductive health services will be continued. Also, socioeconomic impacts on women will be mitigated through support for employment and MSMEs. The ESP also assists businesses owned by women in retaining employees and supports female employees in "at risk" industries. The one-off grant provided to MSMEs will benefit women-owned businesses (about 18% of all MSMEs), including licensed microentrepreneurs such as market vendors. Public sector employment, where women make up 40% of the workforce, will be maintained. Free tuition was introduced for early childhood education and public schools to reduce hardships and safeguard previous gender gap reductions in education enrollment.

34. Finally, measures taken to prevent and respond to GBV include (i) activation of the gender and protection subcommittee; (ii) provision of remote GBV services (through a telephone hotline); (iii) continued employment of all GBV staff (45 staff in five centers); (iv) upgrade of centers to include additional handwashing facilities; (v) public campaigns in national newspapers to provide information on GBV and COVID-19; (vi) activation of "authorized persons" to help women access services in rural areas; (vii) police training on GBV and the provision of police rotations to

⁵² ADB. [Safeguard Categories](#).

⁵³ Gender Monitoring Matrix (accessible from the list of linked documents in Appendix 2).

investigate GBV; and (viii) agreement that GBV prevention and response services are mandated as "essential services" in states of emergency and lockdown.

35. **Governance.** A public expenditure and financial accountability self-assessment was completed in 2015. Subsequently, the MFEM prepared a Public Financial Management Reform Roadmap 2017–2021.⁵⁴ The road map focuses on (i) enhancing controls to ensure compliance in procurement, debt management, and payroll management; (ii) adopting medium-term planning and budgeting; (iii) strengthening budget accountability; (iv) improving domestic revenue; and (v) improving public investment and asset management. Vanuatu has recently improved its rank from 71st in 2017 to 64th of 180 economies in 2018 and 2019 in Transparency International's Corruption Perception Index.⁵⁵ Development partners such as Australia and the European Union have supported public financial management improvements in Vanuatu. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

36. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.⁵⁶

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Prolonged COVID-19 pandemic and border closures render the ESP less effective, leading to a continued economic slowdown, disruption of business activities, and further loss of income and employment.	ADB engages continuously with the government and other development partners to provide an effective and appropriate response, including additional support if required. Other initiatives in the pipeline will continue to support private sector investment, alternative employment and generate additional economic activities.
Another external shock, such as a disaster, plunges the country into a deeper recession and debt distress.	ADB will coordinate with other development partners to provide emergency support guided by follow-on International Monetary Fund assessments. ADB is providing contingent disaster financing for future disasters caused by natural hazards and health emergencies.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, ESP = Economic Stimulus Program.

Source: Asian Development Bank.

IV. ASSURANCES

37. The government has assured ADB that the implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the grant agreement.

V. RECOMMENDATION

38. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$16,925,000 to the Republic of Vanuatu from ADB's Special Funds resources (Asian Development Fund) for the COVID-19 Fiscal Response Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

25 November 2020

Masatsugu Asakawa
President

⁵⁴ Government of Vanuatu. 2016. *Public Financial Management Reform Roadmap 2017–2021*. Port Vila.

⁵⁵ Transparency International. 2019. Corruption Perceptions Index 2019. Berlin (available at <https://www.transparency.org/en/countries/vanuatu>).

⁵⁶ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK ^a

[illegible]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>Hospital and Northern Provincial Hospital (at least 40% of them women) equipped with PPE appropriate for supporting COVID-19 treatment as per WHO guidelines on PPE^d (February 2020 baseline: 0)</p> <p>1d. 5 GBV centers upgraded to include additional handwashing facilities (February 2020 baseline: 0)</p>		
2. Measures for supporting employment and businesses implemented	<p>By December 2020</p> <p>2a. At least 6,000 employees (including 40% women) received employment support (April 2020 baseline: 0)</p> <p>2b. At least 1,500 businesses (including 450 businesses led by women) accessed grant support under the Economic Stimulus Program (April 2020 baseline: 0)</p>	2a.–b. MFEM reports	
3. Food security and education support programs implemented	<p>By December 2021</p> <p>3a. Agriculture support program of at least Vt1 billion in place (2020 baseline: not applicable)</p> <p>By December 2020</p> <p>3b. At least 90,000 students enrolled for early childhood, primary, and secondary education (including 50% girls) received tuition fee subsidies (2019 baseline: 0)</p>	<p>3a. MFEM–Ministry of Agriculture, Livestock, Forestry, Fishery and Biosecurity reports</p> <p>3b. Ministry of Education and Training reports</p>	
Budget Support ADB: \$16.925 million (grant)			

ADB = Asian Development Bank, COVID-19 = coronavirus disease, ESP = Economic Stimulus Program, GBV = gender-based violence, MFEM = Ministry of Finance and Economic Management, MOH = Ministry of Health, PPE = personal protective equipment, WHO = World Health Organization.

^a Contribution to the ADB Corporate Results Framework will be determined after project approval.

^b Government of Vanuatu, Ministry of Finance and Economic Management. *Economic Stimulus Program*. Port Vila; Government of Vanuatu, Ministry of Health. *COVID-19 Health Sector Preparedness and Response Plan*. Port Vila.

^c It is not possible to set more specific and realistic program target effects than those presented in the design and monitoring framework because of uncertainties regarding how the outbreak will unfold, its economic effects, the need for government responses to be flexible as the situation evolves, and since new data collection and reporting systems to monitor the crisis are being developed and evolving. Additional indicators to measure the effects will be identified later and reported on the program's effectiveness as comprehensively as possible in the program completion report.

^d WHO. 2020. *Pacific-Adapted Guidance on Rational Use of Personal Protective Equipment*. Suva.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=54179-001-3>

1. Grant Agreement
2. Development Coordination
3. Country Economic Indicators
4. International Monetary Fund Assessment Letter
5. Summary of Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. Debt Sustainability Analysis
8. List of Ineligible Items

Supplementary Documents

9. Gender Monitoring Matrix
10. Safeguards Assessment Matrix
11. Summary of Key Social Protection Mechanisms in Stimulus Packages

DEVELOPMENT POLICY LETTER

**GOVERNMENT OF THE
REPUBLIC OF VANUATU**

**MINISTRY OF FINANCE
AND ECONOMIC
MANAGEMENT**

Private Mail Bag 9058
PORT VILA, VANUATU
Tel: 23032 Tel/Fax: 27937



**GOUVERNEMENT DE LA
RÉPUBLIQUE DE VANOUATOU**

**MINISTÈRE DES FINANCES
ET DE LA GESTION
ÉCONOMIQUE**

Sac Postal Privé 9058
PORT VILA, VANUATU
Tel: 23032 Tel/Fax: 27937

Le Ministre – The Minister

Date: Friday 06th of November 2020

Mr. Masatsugu Asakawa
President
Asian Development Bank
6 ADB Avenue
Mandaluyong, Metro Manila
Philippines

Dear Mr. Asakawa,

DEVELOPMENT POLICY LETTER: VANUATU

On behalf of the Government of the Republic of Vanuatu, I thank the Asian Development Bank (ADB) for continued support to our country's efforts to overcome the challenges brought by the COVID-19 pandemic. The development policy letter signifies our interest in obtaining a \$16.925 million grant under the COVID-19 Fiscal Response Program that is provided under ADB's Countercyclical Support Facility COVID-19 Pandemic Response Option (CPRO).

Measures to prevent the importation of COVID-19 began in late January 2020, involving health screenings at air and seaports and progressive restrictions as the pandemic evolved. With the World Health Organization (WHO) declaring COVID-19 a pandemic on 11 March 2020, Vanuatu suspended all international travel on 23 March 2020, and declared a state of emergency (SOE) on 26 March 2020. The SOE imposed restrictions and curfews for public health reasons but had to be removed once Tropical Cyclone Harold struck to enable people to congregate in safe areas. The SOE remains in effect, and as of 5 November 2020, Vanuatu did not have any confirmed cases of COVID-19. Vanuatu has strengthened its health system with assistance from development partners to be able to manage border quarantine cases.

Border closures containing COVID-19 have halted tourism, a key generator of employment, foreign exchange, and government revenue. Visitor arrivals are expected to fall by around 60% in 2020 compared with 2019. The recovery of tourism is expected to be gradual, owing to the economic slowdown in source markets for tourism. Remittances, a growing income source for the country, are expected to fall because workers cannot freely travel to Australia and New Zealand under labor mobility schemes. Tropical Cyclone Harold has compounded these challenges by damaging agricultural crops that supply the country's merchandise exports. As a result, Vanuatu's economy is expected to suffer losses—the most significant since its independence in 1980. Assuming a gradual recovery in tourism and agriculture occurs in 2021, combined with increased construction to rebuild infrastructure, some economic recovery is expected. The economic outlook remains uncertain, however, is dependent on the length of the COVID-19 crisis.

Declining tourism, combined with lower domestic demand due to COVID-19 containment measures, is expected to result in lower government revenues in 2020. The government's response to COVID-19 will put further strain on the fiscal position this year. Additional financing needs will be met with development partner grants, domestic loans and the use of cash balances. The government intends to maintain fiscal prudence despite the need to stimulate the economy.

The government's initial response to COVID-19, totaling 5.2% of GDP, has two major components: (i) the \$6 million Health Preparedness and Response Plan (HPRP), and (ii) the \$38 million Economic Stimulus Program (ESP). The HPRP aims to keep the virus out of Vanuatu and to be able to contain it if the virus does enter. The ESP aims to alleviate the socioeconomic impact of the pandemic on individuals and businesses.

Health Sector Support. The National COVID-19 Taskforce was formed in January 2020 and was merged into the National Disaster Management Office (NDMO) on 26 March 2020. National Health Emergency Operations Centre (NHEOC) coordinates COVID-19 preparedness activities. The government's capacity in NHEOC was supplemented by development partners. The Ministry of Health leads health responses which has two distinct phases: containment and mitigation. The containment phase aims to prevent the importation of cases and interrupt local transmission through quarantine of clusters of sporadic cases. The mitigation phase aims to prevent large outbreaks of local transmission through interventions such as isolation and infection prevention measures, enhanced contact tracing and surveillance, and risk communication in communities. The HPRP follows WHO's recommended operational guidelines for the COVID-19 response. Appropriate personal protective equipment, is available to all healthcare workers in the country's main healthcare centers, including Vila Central Hospital and Northern Provincial Hospital. In addition, 2000 public or healthcare workers were trained, including in contact tracing.

Economic stimulus program to provide social protection and support businesses. The government approved the ESP for COVID-19 response of about \$38 million to alleviate the impact of reduced employment opportunities and business activities. The ESP includes:

- (i) **Employment stabilization payment—\$22.2 million.** The employment stabilization payment is supporting the employment of workers in businesses affected by COVID-19. Government reimburses up to \$260 (VT30,000 per employee on their payroll each month for four months. In addition, and as a further incentive to retain employees, employers receive 12% of the amount they are reimbursed for wages under this payment

to cover both employer and employee's contribution to VNPF and administrative costs. The scheme was available to support 7,391 registered employers in VNPF, with an estimated 77,231 total employees. About 40% of the beneficiaries are women.

(ii) **Small and medium enterprises grant and revenue exemption measures—\$3.5 million.** Grant recipients with a turnover of less than VT200 million can access an additional payment equal to the full-year business license fee, in addition to the business license fee cancellation or refund. The small and medium-sized enterprises (SMEs) accessed a maximum grant of VT60,000 to support their operating cash flow requirements. Approximately 420 (13%) of 3,293 potential business recipients are owned or co-owned by women. Recipients include 34 licensed stall holders in markets. Additional revenue exemption measures include (i) business license exemptions to support SMEs, (ii) residence and work permit exemptions that encourage non-residents to remain in Vanuatu to contribute to demand, (iii) road tax exemptions that support both SMEs and individuals, (iv) rent tax exemptions to support property owners during the economic downturn, and (v) other fees and charges supporting SMEs and individuals.

(iii) **Agriculture support—\$3.5 million.** The government will also support increased production and marketing of copra, kava, cocoa, and other crops through price subsidies and transportation assistance from farms to urban centers. Price subsidies will supplement smallholder/informal farmers' incomes and allow larger farmers to employ more workers.

(iv) **Tuition fee grant—\$4.5 million.** Support for households has been through tuition fee exemptions in 2020 for all education levels along with exemptions of several other school fees, except for private and international schools. There was a total of 92,644 primary and secondary students (48% of girls) enrolled in 2019.

(v) **Tax and fee exemptions—\$4.3 million.** Additional revenue exemption measures include (i) residence and work permit exemptions that encourage non-residents to remain in Vanuatu, (ii) road tax exemptions that support both MSMEs and individuals, (iii) rent tax exemptions to support property owners during the economic downturn, and (iv) other fees supporting MSMEs and individuals.

Other initiatives to supplement initial fiscal measures. Members of the VNPF that lost their jobs due to the COVID-19 pandemic have accessed interest free loans under the Members Financial Services Limited (MFSL) to support them financially. Under the hardship loan, members can access loans from VT10,000 to VT100,000. Commercial banks in Vanuatu have also offered repayment relief to their customers. The Reserve Bank of Vanuatu has reduced official interest rates from 2.90 to 2.25 percent, and the capital adequacy ratio is reduced from 12 to 10 percent to align with expansionary fiscal policies. It also requires foreign commercial banks to seek prior approval for the repatriation of capital. A disaster recovery and import/export facility of up to USD10 million (about VT1 billion) has been established.

Recovery targeted. The initial \$3.5 million support for agriculture under the ESP will be supplemented by additional financing of \$10.6 million to ongoing agricultural support programs in 2021 to support economic recovery. The extended support will target partnerships with private sector to deliver extension services, planting services and markets. Support will also be provided for mechanization. The government will also provide \$26.7 million financing to support lending to MSMEs by a government-owned bank beyond 2020. MSMEs will be able to borrow up to \$90,000 at 1.0% interest rate.

The budget support grant of \$16.9 million under ADB's Program is important for the government's ability to mitigate the adverse impact of the COVID-19 pandemic on the economy, health systems, and social services and help finance; (i) health sector responses to COVID-19; (ii) employment support, including for employment of women; (iii) support to SMEs, including women owned SMEs; (iv) support for agriculture and food security; and (v) support for continuing education.

As with the rest of the world, the extent of the already devastating health, economic and social impacts of COVID-19 on Vanuatu's economy and its population will become more evident during the remainder of 2020 and early 2021. Despite these challenges, the Government of Vanuatu remains committed to implementing its development priorities. We appreciate ADB's financing assistance under the proposed COVID-19 Fiscal Response Program and are committed to its implementation for the purposes intended. We look forward to furthering our cooperation in advancing Vanuatu's development agenda.

Yours Sincerely




Hon. Johnny Koanapo Nies RASOU (MP)
Minister of Finance and Economic Management
The Republic of Vanuatu

**ASSESSMENT OF COMPLIANCE WITH THE COUNTERCYCLICAL SUPPORT FACILITY
COVID-19 PANDEMIC RESPONSE OPTION ACCESS CRITERIA**

CPRO Criteria and indicators	ADB Staff Assessment	
1. Adverse Impact of Exogenous Shocks	✓	<p>Vanuatu's economy is forecasted to decline significantly in 2020 as a result of the COVID-19 pandemic. Its economic growth averaged 2.8% from 2015 to 2019. As of 12 November 2020, the country reported its first confirmed case of COVID-19 from a repatriation flight, in border quarantine. Although Vanuatu did not have any confirmed cases of COVID-19 until 11 November 2020, border closures have stopped all visitor arrivals since April 2020.</p> <p>With tourism declining significantly and agricultural crops damaged due to Cyclone Harold, the economy is forecast to decline by 9.8% in 2020.</p> <p>Without tourism, the government's tax revenues are expected to decline significantly, and combined with higher expenditures related to COVID-19, lead to reduced fiscal buffers. A fiscal deficit equivalent to 6.0% of GDP is projected in 2020, and a further deficit of 3.0% is projected in 2021.</p> <p>With higher levels of expenditure and reduced revenue, the government relies on development partner grants and domestic resources (including cash reserves to meet financing shortfalls. At the end of 2019, Vanuatu had foreign exchange reserves equivalent to about 12 months of imports. Given their high pre-pandemic levels, foreign exchange reserves are expected to remain adequate despite a decline in tourism and export earnings. The final magnitude of the economic losses will depend on how the outbreak evolves and the tourism industry's recovery.</p>
2. Counter-cyclical Development Expenditures	✓	<p>The government's measures for addressing COVID-19 impact are included in a HPRP and an ESP.</p> <p>The HPRP has been iterated with the evolution of the pandemic with assistance from the World Health Organization. This plan focuses on preventing the virus from entering the country and getting the country ready if it enters, particularly the health sector. Increasing preventive measures have been introduced since late January 2020 through travel advisories, border closures, and quarantine measures. The government is conducting community awareness, strengthening public health systems, and enhancing preparedness for effective case management while maintaining essential health services.</p> <p>The \$38 million ESP includes revenue measures and several expenditure measures. Approximately 60% of this stimulus package consists of a pro-employment countercyclical expenditure program to support those likely to lose jobs because of the pandemic. Another 9% is allocated to help MSMEs to retain workers. The MSMEs are also supported by revenue exemptions to reduce businesses' operating costs to mitigate insolvency.</p>

CPRO Criteria and indicators	ADB Staff Assessment
	<p>The revenue measures include exemptions for business license fees, turnover taxes, rent tax, work permit fees, and several other smaller fees. The central bank has also reduced banks' capital adequacy requirements and policy interest rates to facilitate lower interest costs. The government commenced the implementation of its stimulus program approved on 30 March 2020.</p> <p>On 10 April 2020, the government mandated the implementation of the Family Protection Act and prioritized preventing and responding to domestic violence.</p> <p>Following initial short-term measures, the government has planned significant support to the agricultural sector to facilitate economic recovery and ensure food security. The government has also provided additional liquidity to government-owned commercial banks to support MSMEs through the provision of credit.</p>
<p>3. Pre-shock Record of Generally</p> <p>Sound Macro-economic Management</p>	<p>✓</p> <p>The government has a pre-shock record of generally sound macroeconomic management. The economy grew by an average of 2.8% between 2015 and 2019. Economic growth was driven by tourism growth and post-Cyclone-Pam reconstruction activities. Prices were relatively stable, with inflation averaging 2.2% over the same period, within the Reserve Bank of Vanuatu's target range of 0%–4. The fiscal deficit was high in 2015 due to relief and reconstruction needs following Cyclone Pam but was reduced in the following years.</p> <p>As a result of significant reconstruction requirements following Cyclone Pam in 2015 and a large existing infrastructure pipeline, external debt rose from 25.6% of GDP in 2015 to 39.1% of GDP in 2019. The current account surpluses averaged 3.7% from 2015 to 2019. Foreign exchange reserves were equivalent to about 12 months of imports at the end of 2019.</p>
<p>4. Structural Reforms (including health response)</p>	<p>✓</p> <p>As of 12 November 2020, Vanuatu had only one confirmed case of COVID-19 contained in quarantine after being identified from a repatriation flight.</p> <p>With a fragile health system, further compromised by damages sustained as a result of Cyclone Harold, which would quickly be overwhelmed if the virus arrived and spread rapidly, the government implemented strong measures to prevent the entry of the virus and prepare the country, particularly the health system, for an outbreak.</p> <p>Borders were closed on 23 March, and a national state of emergency was declared on 26 March 2020. It has since been renewed and was last extended to the end of 2020. The government's Preparedness and Response Plan developed in February 2020 and iterated with the evolution of the pandemic, covers coordination and response, prevention</p>

CPRO Criteria and indicators	ADB Staff Assessment
	<p>of transmission, risk communications, surveillance, and clinical management. The plan is being iterated with the evolving COVID-19 situation.</p> <p>Hospitals have been upgraded, particularly isolation units, which for use as intensive care units; medical personnel are trained on infection prevention, control, and contact tracing to improve surveillance; testing equipment and medical supplies have been procured; and public awareness campaigns are underway. Development partners have provided funding to supplement the government's efforts.</p>
5. Debt Sustainability	<p>The IMF's 2019 DSA found that Vanuatu was at moderate risk of debt distress and could take on more concessional borrowing. Public debt remains sustainable, but its rising trend adds to fiscal vulnerabilities.</p> <p>ADB's DSA, updated in October 2020, finds that Vanuatu's short-term growth prospects have deteriorated with COVID-19 and that countercyclical policy will sharply deteriorate fiscal balances. The DSA finds that higher fiscal deficits put Vanuatu's public debt on a rising trend, with public debt–GDP projected to rise from 44.4% in 2019 to more than 55.0% in 2020. The higher fiscal deficit will be partially offset by higher economic growth over the longer term. The DSA concludes that Vanuatu's public debt level is sustainable, as most debt is on concessional terms. Without grant support for Vanuatu, public debt is likely to reach unsustainable levels.</p> <p>Public external debt constitutes about 70% of the total debt stock outstanding. It is mostly contracted on concessional terms, which keeps borrowing costs low and limits rollover and interest-rate risks. However, the foreign-currency denomination of the external debt constitutes currency risk.</p> <p>Additional risks stem from the country's heavy exposure to disasters triggered by natural hazards. Air Vanuatu was financially exposed, and the government was likely to be required to guarantee debt servicing.</p> <p>IMF has assessed that Vanuatu remains at moderate risk of debt distress post-COVID-19, and risks have been elevated compared to its 2019 assessment.</p>
6. Coordination with the IMF	<p>ADB and IMF collaborate closely on macroeconomic monitoring and policy issues in Vanuatu.</p> <p>The IMF shares updates from missions and the IMF are updated about ADB's investment pipeline in Vanuatu. IMF is supportive of the ADB response and has provided an assessment letter.</p>

CPRO Criteria and indicators	ADB Staff Assessment	
		Vanuatu's foreign exchange reserves levels were equivalent to 12 months of imports at the end of 2019. As of 12 November 2020, the government had not requested IMF financing.

ADB = Asia Development Bank; COVID-19 = coronavirus disease; CPRO = COVID-19 pandemic response option; DSA = debt sustainability analysis; ESP = Economic Stimulus Program; GDP = gross domestic product; HPRP = Health Preparedness and Response Plan; IMF = International Monetary Fund; MSMEs = micro, small, and medium-sized enterprises.

Source: Asian Development Bank.