

# MILLENNIUM CHALLENGE CORPORATION CONGRESSIONAL NOTIFICATION

March 7, 2006

PROGRAM: FY 2004 Eligible Countries  
APPROPRIATIONS CATEGORY: FY 2005 Program Funds  
OBLIGATION AMOUNT: \$65,690,000

In accordance with section 610 (b)(1) of the Millennium Challenge Act of 2003 (the “Act,” Pub. L. 108-199, Division D), this is to advise that the Millennium Challenge Corporation (MCC) has entered into a Compact with the Government of Vanuatu pursuant to Section 609 of the Act. The United States, acting through MCC, and the Government of Vanuatu executed the Compact on March 2, 2006. The provisions of the Compact will enter into force pursuant to Section 1.3 of the Compact, including satisfaction of certain conditions set forth in Section 4.1.

A detailed summary of the Compact follows along with a copy of the text of the Compact.

## **I. Introduction**

Vanuatu is a small island nation in the South Pacific comprised of 83 separate islands, where approximately half of the population lives in poverty. As a small, open, island economy, agriculture and tourism are central to Vanuatu’s growth. These two sectors together employ more than 70% of Vanuatu’s working population<sup>1</sup> and represent approximately 34% of Vanuatu’s GDP<sup>2</sup>. Vanuatu’s poor transportation infrastructure, however, continues to hinder formal economic activity and investment in the agriculture and tourism sectors, thereby constraining private-sector led economic growth. Vanuatu’s capital outlays, at 7% of national expenditures, are the lowest in the Pacific region<sup>3</sup>.

The five-year, \$65.69 million Vanuatu Compact provides an in-depth focus on one economic development priority: overcoming transport infrastructure constraints to poverty reduction and economic growth, specifically for rural areas. Consisting of eleven infrastructure projects – including roads, wharves, an airstrip, and warehouses, as well as institutional strengthening initiatives for enhanced maintenance capacity, the program aims to benefit poor, rural agricultural producers and providers of tourist-related goods and services by reducing transportation costs and improving the reliability of access to transportation services (the “MCA Program”).

## **II. Program Overview and Budget**

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<sup>1</sup> Source: Vanuatu Labor Market Survey (2000).

<sup>2</sup> Derived from IMF Article IV Consultation statistics and WTTC Satellite Account data

<sup>3</sup> IMF Article IV Consultation (2005)

Vanuatu's MCA Program consists of two principal components: (i) civil works for the reconstruction of priority transport infrastructure on eight islands, covering roads, wharfs, airstrips, and warehouses (the "Transport Infrastructure Project"); and (ii) institutional strengthening efforts in Vanuatu's Public Works Department ("PWD"), including the provision of plant and equipment for maintenance, in order to facilitate enhanced sustainability and maintenance of infrastructure assets (the "Institutional Strengthening Project"). Technical, economic, environmental, and social assessments were completed on each of the eleven civil works subprojects and institutional strengthening components contained in the MCA Program.

The following eleven sub-projects are included as part of the US \$54.47 million Transport Infrastructure Project:

1. Efate island – Upgrade 90km of the Ring Road;
2. Santo island – Upgrade 70km of the East Coast Road from Luganville to Port Orly;
3. Santo island – Upgrade South Coast Road Bridges (5);
4. Malekula island – Reconstruct 11km of the Norsup Lakatoro Lits Lits Road;
5. Malekula island – Upgrade South West Bay Airstrip;
6. Pentecost island – Construct the Lol tong Wharf and Upgrade of North-South Road to Wharf;
7. Tanna island – Reconstruct the Whitesands Road;
8. Epi island – Upgrade Lam en Bay Wharf;
9. Ambae island – Reconstruct Creek Crossings on 50km Road section;
10. Malo island – Upgrade 15km of Roads; and
11. Warehouses (for produce and freight storage):
  - (i) Ambae island (Lolowai)
  - (ii) Epi island (Lamen Bay)
  - (iii) Pentecost island (Lol tong)
  - (iv) Malo island (Nunuka)
  - (v) Malekula island (South West Bay)

Recognizing the importance of the maintenance of transport infrastructure in meeting program objectives, the Vanuatu Compact will provide focused assistance of US \$ 6.22 million to the principal institution in the Transport Infrastructure Project, namely PWD, to remove key constraints that face the institution in effectively delivering maintenance and repair services. The MCA Program also provides support for the sustainability and viability of the institution through organizational reform and policy changes. (Refer to Sections V. C. Government Commitment and Effectiveness and D. Sustainability, for further information on these maintenance initiatives.)

The following table presents the total Compact cost, by component:

Description	Timeline					TOTAL
	CY1	CY2	CY3	CY4	CY5	
	(\$US Mil)	(\$US Mil)	(\$US Mil)	(\$US Mil)	(\$US Mil)	
Transport Infrastructure Project	4.00	22.45	25.80	2.21	0.03	<b>54.47</b>
Institutional Strengthening for Sustainability/Maintenance	5.47	0.48	0.09	0.09	0.09	<b>6.22</b>
Program Administration & Audits	1.67	0.53	0.49	0.49	0.49	<b>3.63</b>
Monitoring & Evaluation	0.28	0.06	0.06	0.06	0.91	<b>1.37</b>
<b>TOTAL</b>	<b>11.42</b>	<b>23.51</b>	<b>26.43</b>	<b>2.85</b>	<b>1.52</b>	<b>65.69</b>

### III. Impact

The Transport Infrastructure Project is expected to have a transformational impact on Vanuatu’s economic development, increasing average income per capita (in real terms) by approximately \$200, or 15% of current income per capita, by 2010. GDP is expected to increase by an additional 3% a year as a result of the program.

Based on the areas covered by the transport assets, the program can be expected to benefit approximately 65,000 poor, rural inhabitants living nearby and using the roads to access markets and social services. The program is also expected to expand the tourism sector by approximately 15% once construction is complete. Based on the most recent employment data<sup>4</sup> this translates to the creation of 280 additional formal sector jobs and 25 new locally-owned businesses *each year* in this sector, impacting the lives of over 1,300 people. The total number of beneficiaries would be higher if the spillover impact of tourism activities on agriculture, fishery and construction sectors – as well as impact of the national maintenance strengthening component – could be measured.

### IV. Program Management

The Government of Vanuatu (“GOV”) is creating an independent entity, MCA-Vanuatu, housed within the Ministry of Finance and Economic Management, with primary responsibility for oversight and management of Compact implementation, particularly all monitoring and evaluation activities. To oversee MCA-Vanuatu, the GOV has established a Steering Committee consisting of five Director General-level and four Director-level civil servants, one private sector representative (General Manager of Vanuatu Chamber of Commerce), and one civil society representative (Secretary General of Vanuatu Association of NGOs), with all members of the Steering Committee possessing voting rights. Observers to the Steering Committee will include two Government Directors and an MCC representative.

The PWD will serve as the project manager, holding responsibility for oversight of the specific

<sup>4</sup> National Tourism Development Office (2000) and assuming 2% growth rate based on labor force growth.

activities of the Transport Infrastructure Project. External professional services (for construction supervision) will be contracted through MCA-Vanuatu to assist PWD in its functions.

The Department of Finance in the Ministry of Finance and Economic Management will serve as the fiscal agent on behalf of MCA-Vanuatu. For procurements, an external procurement agent will be used, and is currently being selected through a competitive process. Procurements will be conducted in accordance with MCC-modified World Bank Procurement Guidelines. A special US Dollar account will be established at the Reserve Bank of Vanuatu for receipt of MCC disbursements.

## **V. Assessment**

### **A. Economic Analysis**

The economic internal rate of return (“ERR”) for the overall program is estimated to be 25%, calculated over a twenty-year time horizon. Expected benefits include: increased agricultural and fisheries production, induced tourism investment and expenditures, reduced transport operating costs, reduced infrastructure closures, reduced freight spoilage, value-added from storage warehouses, and maintenance cost savings.

In addition to the quantifiable benefits described above, the upgraded road network is expected to improve the quality of life of all ni-Vanuatu living within the vicinity of the road by improving access (via lower costs and shorter travel times) to social services, such as health centers and schools.

### **B. Consultative Process:**

I. Vanuatu engaged in a comprehensive consultative process, consisting of: (i) ongoing national and provincial public forums, such as the Comprehensive Reform Program Summit, National Business Forum, Rural Economic Development Initiative, and Government Investment Program workshops, which included specific discussion on priorities and projects for the MCA proposal; and (ii) public outreach meetings in four of Vanuatu’s six provinces. Consulted groups included Vanuatu’s council of chiefs, women’s group leaders, the private sector, NGOs, church leaders, and government officials from Vanuatu’s provinces. The proposed projects for MCC consideration were derived from each province’s Rural Economic Development Plan, which included extensive local-level stakeholder consultation forums in each of Vanuatu’s six provinces.

II. To sustain public awareness and participation in the Compact development process, the GOV held MCA public outreach meetings in various provinces and engaged local media regarding proposal due diligence, project selection, and Compact development.

### **C. Government Commitment and Effectiveness:**

The GOV is undertaking several major policy changes as a part of the MCA Program. These include:

- Policy changes to ensure sufficient budget allocations for road maintenance activities by the GOV. This policy change will provide PWD with sufficient means to maintain all new and existing transport infrastructure.
- The GOV or the respective province will develop a revenue collection mechanism and an implementation plan for the collection of wharf user fees and their application towards wharf maintenance. This policy change would provide sufficient funds for maintenance of the wharves, thereby preserving their useful life and ability to contribute to economic growth and higher incomes.

D. Sustainability:

In addition to the efforts mentioned above, the program will support the following major institutional changes to promote enhanced maintenance and sustainability of infrastructure assets:

- Establishment of a service performance contract between the Ministry of Infrastructure and Public Utilities and PWD in order to make PWD accountable for service delivery against targets set on an annual basis (the “Service Performance Contract”). The Service Performance Contract is expected to reduce the overall cost of maintenance on an annual basis, and assure proper and timely maintenance of infrastructure assets.
- Establishment of maintenance contracts with community representatives for various sub-projects to involve local communities (users) in maintenance activities.

E. Environment and Social Impacts:

Initial environmental and social assessment of each of the eleven proposed projects included in the Transport Infrastructure Project has been completed. Impacts associated with these projects, which primarily involve the rehabilitation of existing infrastructure, are likely to be site-specific and readily mitigable, and are therefore screened as Category B activities in accordance with the MCC Environmental Guidelines. No significant adverse environmental or social impacts, such as the need for resettlement, were identified in the initial assessment. However, further environmental and social assessment will be required during the design stage to confirm the findings of the initial assessment and to address design alternatives. Project-specific environmental management plans will be completed prior to construction.

To address environmental and social issues during program implementation, MCA-Vanuatu will select in an open and competitive process, subject to the approval of MCC, an environmental and social impact officer (“ESI Officer”). The ESI Officer will provide MCA-Vanuatu with expertise in environmental, social, and gender impact assessment, and will be responsible for ensuring that the activities related to the Transport Infrastructure Project and Institutional Strengthening Project are undertaken in accordance with the MCC Environmental Guidelines and safeguard policies. The ESI Officer will be located within the Environmental Unit of the Government, but will be dedicated to the management of environmental and social issues associated with implementation of the Transport Infrastructure Project and Institutional Strengthening Project. The ESI Officer will convene periodic public meetings to provide implementation updates to identify and address public concerns.

F. Donor Coordination:

The GOV and MCC have convened various meetings with donor partners such as Australia, New Zealand, France, the European Union, Japan, the Asian Development Bank (“ADB”), the World Bank, and the IMF to discuss potential project-level coordination opportunities and collaborative partnerships for implementation and monitoring. It is widely accepted among donors that Vanuatu has a substantial need for investments in transport infrastructure, particularly for rural areas and the outer islands. The MCA Program builds upon analytical work previously conducted by the ADB on outer island transport infrastructure development in Vanuatu.

Donors such as Australia and New Zealand have recently committed to enlarging their assistance to the productive sectors in response to the priorities for growth and poverty reduction outlined in the GOV’s National Priorities and Action Agenda. MCC’s focus on transport infrastructure presents a number of mutually beneficial coordination opportunities with ongoing and planned donor programs, such as: the EU and France’s Agricultural Producers Organization Project; the EU and ADB’s Tourism Training and Education project; ADB’s Rural Credit Strengthening and Secured Transaction Framework projects; AusAID’s Business Climate Reform program; the EU and France’s International Airport upgrading; and the EU and JICA’s Institutional Strengthening for Infrastructure Maintenance programs. Moreover, AusAID is providing funding for key household data surveys (such as the Household Income and Expenditure Survey), which will be used in monitoring program impacts.