Economic survey

Recent developments in Samoa

Kolone Vaai

Amongst the South Pacific island economies, Samoa is now seen to be an exception. Positive growth has been posted when others have experienced negative results. Driving the optimistic outlook, rare in the South Pacific, has been a reform policy that has embraced getting the private sector underway by removing constraints to its development.

Reforms have been wide ranging, covering the financial sector, privatisation and corporatisation, trade reform, broadening the tax base, government budgetary process and public sector institutional reforms.

Kolone Vaai is Managing Director, Kolone Vaai and Associates, Apia, Samoa.

Samoa is a small open economy that has structural weaknesses manifested by significant trade imbalances and heavy reliance on development assistance and concessional external borrowing. It has a relatively large public sector in which state-owned enterprises and utilities are a major drain on scarce resources. The country suffers from periodic natural disasters which, over recent years, have caused serious damage to domestic infrastructure and output and have adversely affected economic growth and development. The country also faces development constraints similar to other Pacific island nations, in respect of its limited natural resource base, small domestic market, limited scope for economies of scale, and isolation from major international markets. It also has to contend with increasingly global competition for tourism and foreign direct investments, on which its future growth prospects are likely to depend.

Recent economic developments

Growth

During 1998, the Samoan economy registered real GDP growth of 1.1 per cent continuing the declining trend in economic growth from the peak of 9.6 per cent during 1995. The slowdown in the Samoan economy reflected the completion of the major infrastructural projects under the cyclone rehabilitation program of the early 1990s and the impact

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of the East Asian crisis on the production levels of Yazaki (the largest operator in the manufacturing sector).

Despite this declining trend in the rate of economic growth, the Samoan economy is considered an exception when compared to the other Pacific island economies in the region which experienced negative average economic growth during 1995–98.

Production

The primary sector registered overall growth in production of 6.3 per cent in 1998 compared to a decline of 5.9 per cent in 1997. The improvement in the primary sector was driven mainly by the boom in the commercial fisheries sub-sector.

During 1998, the secondary sector declined by 11.7 per cent, reflecting the closure in the second half of 1998 of the coconut oil mill operations and the declining trend in the production levels of Yazaki. Construction activity declined by 5.8 per cent during 1998 after a succession of annual increases since the start of the cyclone rehabilitation programs in the early 1990s. The electricity and water sub-sectors also registered a decline of 1.4 per cent during 1998.

The tertiary sector registered a growth rate of 5.9 per cent in 1998 compared to 4.3 per cent in 1997. Commerce, business and other services grew by an average of 6 per cent during 1998, reflecting strong whole-saling and retailing performance. Transport and communications registered 10.4 per cent growth in 1998, with telecommunications being the major component. The accommodation and restaurant sector did not register any growth in 1998.

Government finances

The 1998/99 Budget is expected to be neutral with an overall budget deficit of ST$300,000 (US$107,913) relative to planned expenditures of ST$273.3 (US$98.3) million. Budgeted revenues of ST$273.0 (US$98.2) million are expected from revenues of ST$187.9 (US$67.6) million and external grants of ST$85.1 (US$30.6) million.

Government finances during 1995/96 to 1997/98 have consistently been effectively managed. Overall budget surpluses registered for 1995/96 (1.5 per cent of GDP), 1996/97 (2.4 per cent of GDP) and 1997/98 (2 per cent of GDP) have improved the overall financial position of the government. This has been achieved mainly through expenditure controls.

Inflation

The annual average rate of inflation at end-1998 was recorded at 2.2 per cent, reflecting a sharp fall from 6.9 per cent in 1997. The fall in inflation was caused mainly by the decline in prices of local goods as supplies of local goods improved throughout 1998. The reduction in import tariff rates introduced during the second half of 1998 also contained the price increases of imported goods in the last quarter of 1998.

External trade and balance of payments

Total exports amounted to ST$50.9 (US$18.3) million for 1998, an increase of ST$13.42 (US$4.8) million above the total exports for 1997. About 54 per cent in the improvement in 1998 exports was attributable to the sale proceeds of the Forum Samoa Vessel, with the remaining 46 per cent due to improve-ments in kava and fish exports. Kava exports, at ST$5.5 (US$1.9) million, were close to four times greater than 1997 whilst fresh fish increased by 81 per cent to ST$23.3 (US$8.4) million. In contrast, all coconut-based export products declined during 1998 due to declines in both volumes and international prices for copra, coconut oil and coconut cream trading.

Total imports amounted to ST$285.7 (US$102.7) million for 1998, an increase of ST$29.5 (US$10.6) million above 1997.

About 95 per cent of the increase in imports is attributable to the stronger demand for imports by the non-government sector.

As a result of the increase in imports outstripping the improvement in exports, the trade deficit worsened during 1998 to ST$234.8 (US$84.4) million from ST$218.8 (US$78.7) million in 1997. However, the improvement in net services and net private transfers resulted in a current account deficit of ST$24.6 (US$8.8) million in 1998 compared to ST$21.7 (US$7.8) million for 1997. The improvement in net services to ST$100.3 (US$36.1) million in 1998 compared to ST$89.6 (US$32.2) million reflected mainly the increase in tourism earnings as tourist numbers rose by 14 per cent in 1998. Export processing revenues from the Yazaki operations—which contributed ST$25 (US$9) million to the net services account during 1997—declined by half in 1998. Private transfers increased by 2 per cent in 1998 to ST$109.9 (US$39.5) million, continuing the steady increase since 1993.

The net capital account surplus of ST$43.5 (US$15.6) million in 1998 was a decline from the net capital account surplus of ST$47.8 (US$17.2) million in 1997. The decline in the net capital account surplus reflected mainly the significant outflow of private capital for acquisition of an aircraft and fishing boats.

The net capital surplus more than offset the current account deficit resulting in an overall balance of payments of ST$18.9 (US$6.8) million for 1998, compared to ST$26.1 (US$9.4) million for 1997. The balance of payments surpluses registered in the last four consecutive years have led to an increase in foreign exchange reserves (net foreign assets) to ST$172.5 (US$62.0) million at end-1998, an equivalent of 7.2 months of current imports. Import cover of foreign exchange reserves has steadily increased over the last four years, reflecting a continuing strengthening in the external position of the Samoan economy.

Money and credit

Money supply (M_2) grew by 5 per cent during 1998 to ST$210.2 (US$75.6) million at end December 1998. The growth in M_2 reflected the increase in savings and time deposits which more than offset the marginal decrease in currency and demand deposits. M_2 changes were caused by the increase in net foreign assets which more than offset the decline in net domestic assets. The decline in net domestic assets reflected the decline in domestic credit from ST$65.5 (US$23.5) million to ST$62.6 (US$22.5) million at the end of 1997 and 1998 respectively. Whilst there was a significant increase in credit to the private sector from ST$139.4 (US$50.1) million to ST$165.5 (US$59.5) million, the improvement in the deposits of the government and decline in credit to non-financial public enterprises resulted in an overall decline of domestic credit at end 1998.

Impact of policy reforms

The economic and financial performance of 1998 has seen the emergence of positive trends as a result of a wide range of policy reforms the Government of Samoa has undertaken. An increasingly active private sector has been driving growth in new export production areas in the primary, secondary and tertiary sectors. A more efficient and responsive public sector has emerged with the financial position of government stabilised as government budgets are effectively controlled and managed. Relatively stable fiscal and monetary conditions have led to stable prices and reduced pressures on the external account. Liberalisation of the financial sector has meant that the sector has become more responsive to the country's development requirements, albeit at a relatively slow rate. Parallel to the economic and financial reforms are the sociopolitical reforms which have assisted in maintaining a relatively long period of sociopolitical stability.

The combination of economic, financial and sociopolitical stability has positioned the Samoan economy in a relatively resilient position. Given the significant influences of these policy reforms, the remaining part of this survey will outline the background and main parameters of the range of reforms which are currently being pursued by the Government of Samoa.

Status of reforms

Following the focus on cyclone rehabilitation in the early 1990s, the government in 1996 released its first Statement of Economic Strategy (SES) ('A New Partnership') to replace the traditional five-year development plans. The 1996/97 SES outlined a medium-term strategy, identifying a range of economic, financial and institutional reforms.

Besides emphasising the need to maintain macroeconomic stability as a condition for sustained economic growth, the 1996/97 SES also called for

- private sector-led economic growth, based on the establishment of a 'new partnership' between the government and the private sector
- continued reengineering of the public sector, by reducing the size of the public service and improving its efficiency and accountability
- reduced government involvement in commercially-oriented enterprises and activities, through privatisation and/ or corporatisation of state-owned enterprises and utilities
- the strengthening of human resources, through increased budgetary expenditures for health and education
- the restructuring of the tax and tariff regime, to enhance private sector competitiveness and provide a level playing field for business and investment
- enhancing efficiency in allocating financial resources, through the establishment of financial markets and use of indirect instruments for monetary management.

To further clarify and reinforce the medium-term strategy, the government released in 1998 its second 1998/99 SES ('Strengthening the Partnership'). The government intends to update the SES every two years to adapt to any significant change in the economic and financial environment.

Key reforms

Consultative planning process reforms

Since setting up the consultative processes for the development of the 1996/97 SES there has been a significant change in the attitudes between the private sector and the government as both increasingly share information and collaborate on the development of the medium-term development strategy and the specific economic and financial policies. The government has worked with the private sector primarily through the Chamber of Commerce and the Manufacturers' Association. To strengthen the organisational structures of the private sector, the government has, since 1997, started to provide annual grants to the Chamber of Commerce and Manufacturers Association to assist these organisations in funding their annual administrative overheads. The government has also widened the scope of membership of the private sector in policymaking committees and statutory boards which were in the past mainly restricted to the boards of government corporations. In 1997, the government set up its Trade, Commerce and Industry Development Board with a number of private sector representatives. The Board has been instrumental in setting the scope and direction of the country's trade and investment strategies and policies.

Public service institutional reforms

The Samoan Public Service, comprising 25 Departments and 6,000 employees, has been identified as a strategic target in terms of policy coordination and financial sustainability of the government. In the 1980s the government pursued a 'sinking lid' policy to reduce the number of public service employees progressively as positions became vacant. While such a policy resulted in the containment of the increase in the level of employment in the public sector, there was no set policy target. The 1998/99 SES is targeting an overall reduction of public service employees by 20 per cent over the medium term.

To improve the effectiveness and efficiency of the public service, all departments have been required to re-examine their activities and to reorganise in order to focus on their core outputs and related skills. The institutional strengthening of major departments—Treasury, Trade Commerce and Industry, and Customs—have been substantially completed. The Education, Health, Justice and Public Works Departments are in the process of implementing institutional reforms. To coordinate the public service institutional reforms, a Public Service Commission Steering Committee has been established to guide the reforms.

Public sector financial management reforms

Since independence in 1962, the government budget had been based on a line-item format which was centrally controlled through the Treasury Department. The National Development Plans were developed independently of the budget and development projects were integrated into a format which would facilitate evaluation of the outputs relative to the project inputs. The government budget format incorporated *ad hoc* adjustments over the years, leading to a number of inconsistencies and making it a difficult document to analyse and interpret for evaluation of development programs. For the 1998/99 Budget the government expenditures totalling ST$237.8 (US$85.5) million are financed from revenues of ST$173.9 (US$62.5) million and external grants of ST$60.5 (US$21.7) million.

To underpin financial reforms in the public sector, in 1996 the government changed its budget format and financial management from a line-item to an output budget system. These reforms aim to improve the quality of decision-making by relating inputs to outputs and to devolve financial control and management of the budget from the Treasury Department to the heads of departments.

To improve transparency and accountability of its financial operations, the government has improved its procurement systems. This reform became critical with the phasing out of centralised purchasing through the Treasury Stores and increased outsourcing of government work to the private sector. The main improvement to the procurement systems includes increasing the expenditure authorities and decentralisation of purchasing systems to the individual government departments.

The significant backlog of government annual accounts, which was particularly acute in the 1970s and 1980s, had been a serious impediment to improving government's accountability to Parliament and the general public. The lack of financial and accounting skills in the government causing the backlog of accounts had been addressed by the government in the early 1990s with the recruitment of overseas personnel to clear the backlog and set up a system to ensure timely preparation of accounts. Publication of comprehensive and timely public accounts is seen by the government as critical to improving the financial decisions made by government and also to informing the public on the impact of the financial reforms in the public sector.

Public sector revenue reforms

Central to the public sector revenue reforms is the shifting of emphasis from direct to indirect taxation. Within the indirect taxes, the shift from import and excise duties to a value-added tax is seen as a more responsive and equitable tax measure. The introduction of the across-the-board 10 per cent value-added goods and services tax (VAGST) in 1994 has now become generally accepted after its controversial introduction.

The introduction of the VAGST tax was difficult due to the perceived inequity of the tax measure for the most disadvantaged groups in the community, and government administrative problems. These led to confusion about the initial impact of the tax on basic food items. To address the initial concerns about the adverse impact of VAGST on low-income earners, the government introduced special exemptions for VAGST and also a range of special import tariff reductions on basic food imports. Linked to the VAGST have been corresponding reductions in income tax rates and import tariff levels.

When comparing the 1997/98 and 1998/99 Budget estimates, the main changes in the government revenues have been in the following areas

- import duties and excise taxes have declined from ST$90.5 (US$32.5) million in 1997/98 to ST$81 (US$29.1) million in 1998/99
- VAGST has increased from ST$51.9 (US$18.6) million in 1997/98 to ST$62.9 (US$22.6) million in 1998/99.

In 1998, a major import tariff reform was introduced, resulting in substantial reductions in import duties, simplification of the overall tariff structure and removal of discretionary concessions. In addition, excise taxes were abolished, except for alcohol, soft drinks and tobacco. With the exception of import duties on vehicles, alcohol and tobacco, the highest rate is now 20 per cent compared to the pre-1998 60 per cent. Most of the imported raw materials are now in the 15 per cent to 20 per cent range. There are now only five categories of import duties compared to the pre-1998 situation of at least eight categories.

Investment incentives reforms

To encourage private investments in 'pioneer projects' the government has relied on the granting of enterprise incentives as its main development tool. During 1988/89 the government introduced its enterprise incentives scheme for domestic and export enterprises. A 'domestic enterprise' is an enterprise producing mainly for the domestic market, while an 'export enterprise' exports at least 95 per cent of its production.

The revenue reforms of direct and indirect taxes provided the opportunity in 1998 for the income tax regime and import duty concessions to be overhauled. This overhaul has resulted in income tax and duty concessions for domestic enterprises being phased out, while concessions for export enterprises are still available. The key rationale to the reforms has been the removal of discretionary incentives and the creation of a more open, liberal and transparent investor environment for Samoa. Related to these reforms are a number of measures that private investors have to work through to access licences and other government regulatory requirements to streamline the procedures.

Financial sector reforms

The Samoan financial sector consists of the Central Bank of Samoa, three commercial banks and a number of non-bank financial institutions. An informal credit market exists but it is not significant. Credit unions are an established part of the financial system and some (insignificant) credit is also provided by solicitors and money lenders. The Central Bank of Samoa is responsible for monetary policy and general development of the financial sector. Before 1998, monetary policy was implemented mainly through controlled interest rates and quantitative limits on commercial bank lending. This policy regime was appropriate during the period of financial stabilisation, but it was becoming restrictive in creating an innovative financial sector to respond to the increasing private sector development demands. Fixed interest rates became impediments to the banks' pricing of the risks of development projects. The quantitative credit controls on commercial bank lending led to the Central Bank of Samoa having less control over the money supply as government statutory non-banks, which are outside the control of the Central Bank of Samoa, took on an increasing share of the demand for credit.

Controls on the financial sector were liberalised in 1998. The reforms have involved the relaxation of quantitative central bank controls on commercial bank lending and interest rates. Central to these reforms is the encouragement of competition among the financial institutions in delivery of their financial services. Relaxation of interest rate controls is expected to enhance the capacity of financial institutions to lend to high-risk projects through flexible interest rates. Use of open-market operations for Central Bank securities is seen as a critical measure in the control of conditions in the financial sector. To support financial sector liberalisation, the Asian Development Bank has provided a program loan linked to the implementation of the key parameters of the liberalisation program.

Corporatisation and privatisation reforms

The development strategies of the 1970s involved the active use of government corporations and companies in undertaking commercial and development projects. In 1997, state-owned enterprises employed 2,200 employees and total sales exceeded 40 per cent of GDP. The rapid growth in the number of state-owned enterprises in the absence of appropriate governance systems and lack of managerial skills led to acute financial problems for most of these enterprises which relied on the government budget to subsidise their annual operations.

Corporatisation and privatisation of inefficient state-owned enterprises reflects concerns about their increasing financial burden on public finances and constraining influence on private sector growth.

To improve government capacity to monitor and supervise the state-owned and controlled enterprises, a State-Owned Enterprise Monitoring Unit (SOEMU) has been set up within the Treasury Department.

To enhance the accountability and managerial autonomy of selected commercial activities within government departments, steps have been taken to corporatise the Post and Telecommunications Department and the Marine Division of the Ministry of Transport during 1999.

The current privatisation program, guided by a Ministerial Privatisation Steering Committee, targets the sale of government equity during 1999–2001 in

- Western Samoa Breweries Ltd
- BOC Gas Ltd
- Agriculture Store Corporation
- Samoa Forest Corporation
- Computer Services Ltd
- Hellaby Samoa Ltd
- Brugger Industries Ltd
- Samoa Coconut Products Ltd.

Implementation of part of the planned privatisation program has now been linked to the disbursement of the Asian Development Bank program loan supporting the financial sector liberalisation program.

Legislative reforms

A number of legislative reforms have been implemented or planned and the increase in the Parliamentary term from 3 to 5 years allows more time for effective planning and implementation of development programs. A review of corporate legislation is to be undertaken in 1999.

Institutional strengthening of the Justice Department and establishment of a Law Commission is also planned for 1999.

Coordination and sequencing of reforms

The government decided in early 1999 to establish an independent focal point to monitor and guide all its economic, financial and social reforms. A National Reforms Commission is now planned to be established to coordinate the direction, sequencing and pace of all reforms. The structure of the Commission and its relationship to the development planning functions of the Treasury Department and the aid coordination role of the Ministry of Foreign Affairs have yet to be finalised.

The future

The wide range of reforms being pursued in Samoa are being supported by relatively high inputs of overseas expertise. One of the main challenges to sustaining the momentum of the reforms, is for the local counterparts to effectively take over and manage the tasks currently being undertaken with overseas expertise.

Note

Exchange rate at 1998: ST$2.78=US$1

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