

# Samoa economic update 2007

KVAConsult Ltd

There is general optimism about the short-term economic and financial prospects of the Samoan economy. Economic growth is expected to be sustained at around 3 per cent per annum over the next three years, driven mainly by continuing rapid growth in the tourism, commerce, and financial services sectors. On the inflation front, it is estimated that increases in prices will average around 3 per cent per annum during 2007/08. Budget expenditure pressures arising from the need to construct infrastructure for the South Pacific Games in 2007 will now ease, thus helping to keep the budget deficit on target at less than one per cent of GDP. Although the balance of payments structure is fragile, it is forecast that there will be surpluses in the next three years from expected strong earnings from tourism and remittances.

Agriculture however is declining, leading to the pressure of lost employment opportunities in rural areas. Significant reforms in telecommunications and a new focus on tourism, together with continuing commitment to earlier public sector reforms offer positive lessons to other small and vulnerable economies.

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There is general optimism and relatively high confidence about Samoa's economic prospects as of August 2007. International organisations such as the International Monetary Fund and Asian Development Bank have given optimistic assessments of the country's policy planning and management capabilities and the medium-term economic prospects for the economy.

In September 2007, Samoa is likely to be graduated from least developed country status by the United Nations General Assembly. The proposed graduation follows from the major economic transformation that has occurred over the past decade,

resulting in an annual average real GDP growth rate of 3 per cent. In terms of the United Nations' criteria for least developed country category, Samoa exceeds the human asset index and per capita income thresholds but fails significantly in terms of the economic vulnerability index. Samoa remains a small, geographically isolated and highly vulnerable island economy. Potential fiscal pressures from natural disasters, an aging and diabetes-prone population, and possible resource flow constraints from effective graduation out of the least developed country status in 2010, are major medium-term risks facing the Samoan economy.

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Immediate challenges are expected from optimising the utilisation and maintenance of the large investments recently made in sports facilities for the South Pacific Games and instituting transitional measures on a timely basis following an expected further downturn in the manufacturing sector with the scaling down of the Yazaki operations. The unemployment situation is also likely to be aggravated by the possible scaling down of the operations of the fish canneries in American Samoa.

The strengths of the Samoan economy are in its relatively stable and resilient social and traditional systems, which have provided a socially and politically stable environment conducive for economic growth over a long period. A growing pool of financial and economic expertise in the management of reforms has also become a real asset for maintaining the momentum of the broad-based reform program undertaken over the past two decades.

The latest Samoan economic transformation has been driven by recent major innovations in airline transportation and telecommunications, providing a solid platform for rapid growth in tourism, commerce, and financial services sectors. The expected linking of Samoa to an international marine telecommunications cable by early 2009 is expected to improve the capabilities of the services sector further in competing in global markets. The availability of a wide range of sporting facilities of international standard has also provided opportunities for the development of local sports talent and sports-related tourism activities in the medium term.

## **Economic and social profile**

Samoa is a small, open, island economy, geographically isolated in the middle of the Pacific Ocean, which creates transportation

and international trade challenges. Samoa has become increasingly prone to cyclones over the past two decades, and these have often inflicted extensive damage on its productive capacity.

The Samoan economy is largely agriculture based with a high dependence on external personal remittances and external development aid. Despite the challenging environment, from 2002–06 the economy grew at an average real rate of 3.5 per cent per annum. Samoa's real (GDP) is now estimated to have reached ST\$1.03 billion at the end of 2006. Therefore, Samoa's real GDP per capita is now estimated to be ST\$5,581 (US\$2,078), assuming a population of 179,186 at the end of 2006.

The structure of the Samoan economy as at the end of 2006 shows that the leading four industries are commerce, transport and communications, public administration and finance and business services, which together make up 53.4 per cent of total GDP (Table 1).

Significant changes to the structure of GDP have been registered in agriculture, which has shrunk from 15.4 per cent of GDP in 1994, to the present 6.7 per cent of GDP. A similar trend has also been recorded in the other manufacturing industry, which has dropped from 16.9 per cent of GDP in 1994 to its present level of 8.8 per cent of GDP.

The United Nations Development Program's (UNDP) Human Development Report 2006 placed Samoa with an index of 0.778 at 75th place with respect to the human development ranking in 2004. Among the Pacific island countries, the ranking is next only to Tonga, which is ranked in 55th place. Fiji, which had a human development index higher than Samoa in 1995, slipped in ranking behind Samoa in 2004 with a ranking of 90th place. Life expectancy in Samoa has improved from about 63 years in 1980 to 70.5 years in 2004 and the literacy rate has increased from 96.2 per cent to 98.7

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Table 1 Samoa: contribution to real GDP, by industry, 2006 (per cent)

Real GDP by industry	Contribution (per cent)
Commerce	19.70
Transport and communication	12.80
Public administration	10.90
Finance and business services	10.00
Other manufacturing	8.80
Construction	8.60
Agriculture	6.70
Personal and other services	5.30
Fishing	4.70
Electricity and water	4.50
Ownership of dwellings	3.50
Food and beverage manufacturing	3.00
Hotels and restaurants	2.70

**Source:** Samoa, Ministry of Finance, Economic Planning and Policy Division, 2006. *Quarterly Economic Review*, October–December, Government of Samoa, Apia.

per cent during the same period. However, there has been an alarming increase in the incidence of lifestyle-related diseases, which could pose a large threat to development prospects for Samoa. The education index for Samoa, which is the combined gross enrolment ratios for primary and secondary education, is 0.90 which lower than Tonga's index of 0.93 but higher than Fiji's of 0.87.

The Samoan population is relatively young; almost 41 per cent of the population was under 15 years of age during 2002. With around 54 per cent of the population falling between 15 and 65 years (both years inclusive), it is worth noting that Samoa has a high dependency ratio of about 0.82 (UNDP 2006). According to the population census of 2001, about 49 per cent of the population in Samoa is economically inactive, while about 5 per cent of the economically active population was unemployed.

In Samoa, poverty does not exist in terms of destitution and starvation. However, this does not mean that there is no hardship or situations where there is no freedom

of choice or access to basic services and amenities.

Based on the household income and expenditure survey (HIES) in 2002, the basic needs poverty line was estimated at ST\$37.49 per capita per week. Accordingly, 20.3 per cent of the population in Samoa was defined as living in conditions that were below an acceptable standard and under the national poverty line. On the basis of these figures, the national food poverty line for 2002 was estimated at ST\$24.68 per capita per week. Nationally, this meant that 7.6 per cent of families were under the food poverty line. This estimate was based on the 'cost' of a low-cost, minimally nutritious diet, with a daily energy value of approximately 2,200 kilocalorie per adult per day. This diet was made up of store-bought goods, plus the value of own-production food consumed or gifts received.

Within Samoa, the basic needs poverty line is estimated to be the highest in Apia, while it is the lowest in Savaii. In urban areas the relatively poor are mostly people

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who live on leased land, without enough area to grow crops, in flood-prone areas, or on traditional lands but with little access to transport, communication facilities, and water. In rural areas the relatively poor are most likely to be found among the youth, the elderly, and people living inland who have limited or no access to land, product markets, and basic public services.

There is growing evidence that inequality is increasing as economic activity becomes more concentrated in and around Apia. The greater Apia urban area (accounting for approximately 40 per cent of the nation's population) is estimated to generate 70 per cent of the country's national income. This estimate is supported somewhat by the data from the 2002 HIES, which gives a national Gini coefficient of 0.44 for Apia, 0.41 for the rest of Upolu, and 0.40 for Savaii. As economic growth accelerates, the Gini coefficients are likely to rise as income distribution disparities become compounded if there is no effective national poverty and hardship strategy in place.

## Economic growth

The Samoan economy slowed in 2006, registering a real growth rate of 3.4 per cent of GDP, compared to the 5.2 per cent growth rate of 2005 (Figure 1). This slowdown reflected mainly a slowing of the growth of the manufacturing and agricultural sectors, which more than offset the gains made by commerce, hotel/restaurant and public administration activities in 2006. It is now forecast that real growth in GDP will be in the range of 3–4 per cent per annum during 2007 to 2010.

In 2006, the manufacturing sector, which made up 11.8 per cent of GDP, declined mainly due to a reduction in production in the food and beverage manufacturing operations of nonu juice and beer by 6.3

per cent and 'other manufacturing' (which accounts mainly for the Yazaki operations) by 9.8 per cent. Manufacturing output is expected to decline further in 2007 as Yazaki steps up its measures to phase out their operations in Samoa.

The construction industry, which made up 8.6 per cent of GDP, grew by 4 per cent in 2006, driven mainly by the activities related to infrastructure development for the 2007 South Pacific Games and the major building projects such as the Development Bank of Samoa.

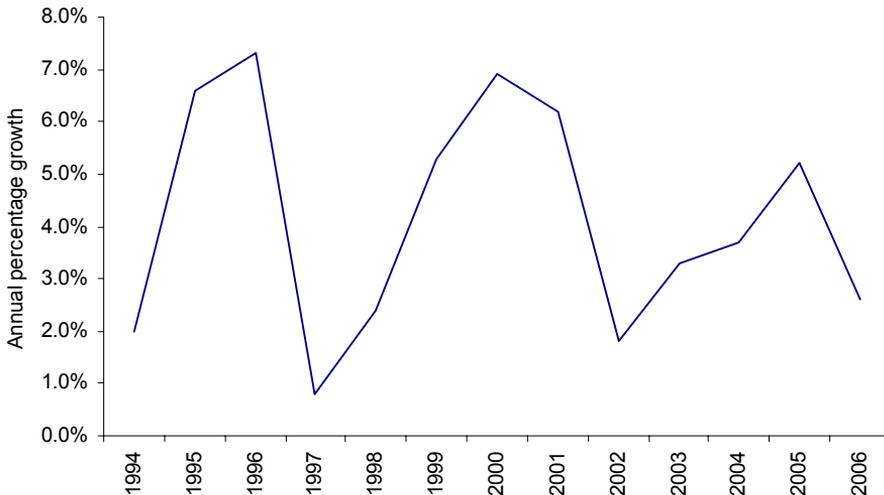
Agricultural sector output, which accounted for 6.7 per cent of GDP, is estimated to have declined by 6.6 per cent in 2006, in contrast to the significant increase in output of 15.5 per cent recorded in 2005. However, the downturn in agricultural output is expected to be reversed in 2007 as the demand for agricultural products are driven up by the South Pacific Games and the general improvement in access to export markets due to the expansion of the heat treatment facilities for agricultural products for exports.

The fishing industry, which made up 4.7 per cent of GDP, registered a decline in value of 0.4 per cent in 2006. However, there were signs of recovery in this sector in 2006, particularly in the last two quarters when output increased by an average of 4 per cent compared to the same quarters in 2005. However, prospects for the fisheries industry in 2007 are not clear following the downturn experienced by the commercial fishing industry in the first two quarters of 2007.

The commerce industry, comprising 19.7 per cent of GDP, grew by 5.4 per cent in 2006, fuelled mainly by the increased disposal incomes due to an average 14 per cent increase in the salary levels of the Public Service and the 25 per cent increase in the level of remittances recorded in 2006. The commerce industry is expected to continue

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Figure 1 Samoa: real GDP growth, 1994–2006 (per cent)



Source: Samoa, Ministry of Finance, Economic Planning and Policy Division, 2006. *Quarterly Economic Review*, October–December, Government of Samoa, Apia.

its strong growth in 2007, stimulated by a further increase in salary levels of the public service following the implementation of the final instalment of the 42 per cent salary increase phased in over a three-year period, and demand from the major sporting events including the South Pacific Games, as well as further growth in remittances.

The transport and communications industry, comprising 12.8 per cent of GDP, grew by 3.4 per cent in 2006, reflecting mainly the expansion of land and sea transport infrastructure and the rapid expansion and coverage of the telecommunications sector following the entry of Digicel as a competitor in the provision of cell phones. In 2007 the transport and communications sector is expected to register further strong growth, fuelled by the expansion of the telecommunications networks and services.

Finance and business services, which accounts for 10 per cent of GDP, has been

the fastest growing industry, registering an average growth rate of 8.3 per cent annually over the past five years. During 2006, the finance and business services industry grew by 7.8 per cent. The high growth path registered by this industry has been driven mainly by the liberalisation of the financial sector and the increased demand for business and professional services stimulated by the rapid expansion of the construction industry and the Samoa International Finance Centre. For 2007, the finance and business services industry is expected to continue its recent growth pattern.

The hotel and restaurant industry, which accounts for 2.7 per cent of GDP, grew by 2.4 per cent in 2006—in contrast to its growth rate of 9.7 per cent in 2005. The restaurant and hotel industry is expected to register at least 3 per cent growth in 2007, following the completion of several small motels to cater for the South Pacific Games. There are also several major pipeline projects whose

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construction has been delayed to 2008 and beyond; their construction will further expand the hotel and restaurant industry in the medium term.

The public administration sector, which made up 10.9 per cent of GDP, grew by 23.1 per cent in 2006. This increase reflects the implementation of the second phase of the 42 per cent increase in public service salaries, which is being phased in over three years from July 2005.

### Prices

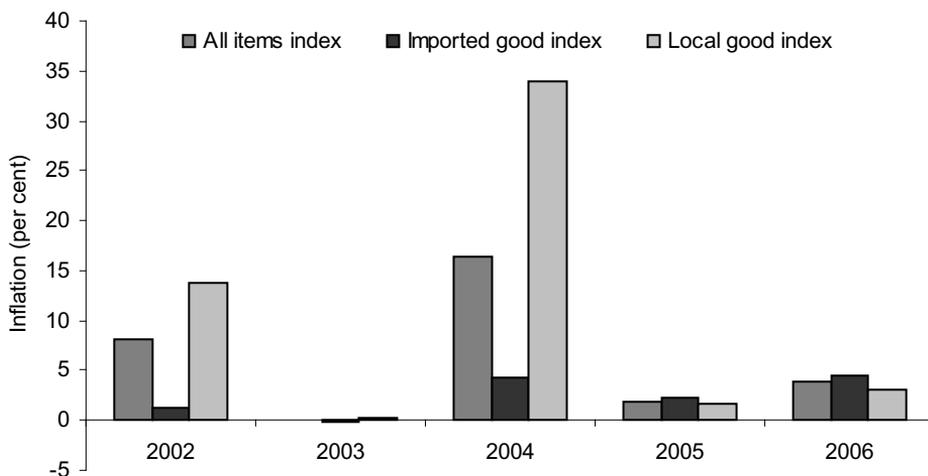
Inflation increased from 1.8 per cent at the end of December 2005 to an annual average rate of 3.8 per cent by the end of December 2006. The increase in the rate of inflation reflected the increase in prices of imported goods by 2.3 per cent and in local food prices by 1.5 per cent as supply to the Fugalei market declined due to unfavourable weather conditions. Food,

clothing, footwear, alcohol and tobacco prices also increased. This increase was a result of the increase in excise taxes on alcoholic beverages and tobacco products in July 2006 and the increase of the VAGST by 2.5 per cent in October 2006. For the medium term it is projected that the inflation rate will average in the 2.5–3.0 per cent range. The monetary policy statement for the 2006/2007 period issued by the Central Bank of Samoa in September 2006 set a policy target of a 3 per cent annual inflation rate as the basis for its package monetary policy guidelines for this period (Figure 2).

### Employment and wages

Despite the good overall economic growth performance in recent years, growth in employment has been weak. Recent stagnation in the agricultural sector is estimated to have restricted the ability of the rural sector to reduce the level of

Figure 2 Annual inflation, 2002–06 (per cent)



Source: Samoa, 2007. *2007/2008 Budget Address*, 31 May, The Hon. Niko Lee Hang, Minister of Finance, Government of Samoa, Apia.

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underemployment of the 23,433 persons in the 2001 national census, who registered as being employed in unpaid family work predominantly in the agriculture, fisheries and forestry sector. There has been a rapid shift in the formal employment sector to services reflecting the growing importance particularly of tourism, commerce and financial services. This structural shift is expected to continue in the medium term and will generate new demands on setting a conducive remuneration environment and new designs of appropriate educational and vocational training programs for the development of core skill sets required in the services sector.

The quality and timeliness of statistics on formal employment have improved since the last economic update of Samoa in 2005 (*Pacific Economic Bulletin* Volume 20 Number 3) through the monthly tracking and quarterly reporting by the Ministry of Finance in its *Quarterly Economic Review*. At the end of 2006, it is estimated that 21,047 persons were formally employed, which was an increase of 0.5 per cent in formal employment compared to the increase of 3.9 per cent registered during the similar period in 2005. The formal employment statistics show that public sector employment has continued to drop from the high of 5,309 employees in 2002 to 4,949 at the end of 2006. On the other hand, employment in the commerce and services sector has grown from 9,993 in 2002 to 11,745 at end of 2006, which is 56 per cent of total formal employment. Employment in the manufacturing sector has declined from the 2002 level of 4,298 employees to 3,949 at end of 2006. Yazaki EDS, manufacturing automotive wiring harnesses for export, is the largest single private sector employer and the fluctuations in the number of its employees have a major impact on the economy. At its high point in 1996 the

company employed around 4,000 people. The number was around 2,000 at the end of 2006.

The most recent national census (2001) estimated that 23,433 persons—49 per cent of the economically active labour force—were employed in unpaid family work activities. Almost all of those who registered as being employed in unpaid family work activities were engaged primarily in subsistence farming.

Unemployment is difficult to measure in Samoa as those without formal employment are generally absorbed into the informal or subsistence sectors. The 2001 Census records that about two-thirds of those in the 15–24 year age group were either unemployed (around 5 per cent) or ‘not economically active’ (about 60 per cent); this compares with about 56 per cent who were either unemployed (around 3 per cent) or not economically active (about 54 per cent) in the same age group in 1991. These high numbers of ‘economically inactive’, who are mainly young people, are added to by the estimated 1,500 school leavers looking for work every year.

The labour market in Samoa is making a relatively rapid transition to the setting of remuneration policies that will attract and retain highly skilled employees. When fully implemented during 2007/2008, the salary and wages restructuring in the public sector, introduced in July 2005, will result in an average increase in salaries and wages of 42 per cent in the public sector over a three-year period. Refocusing the public sector’s core policy, regulatory and facilitation functions, and divesting activities and services that can be efficiently undertaken by the private sector, necessitates the positioning of the public sector to compete effectively in attracting and retaining a pool of highly skilled employees. Following the public sector salary and wage initiatives in 2005, which set a minimum wage for

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the public service of ST\$2.40 an hour, the minimum wages in the private sector were increased in 2006 from ST\$1.60 an hour to ST\$2.00 an hour. A review of the minimum wage is currently being undertaken by the Government.

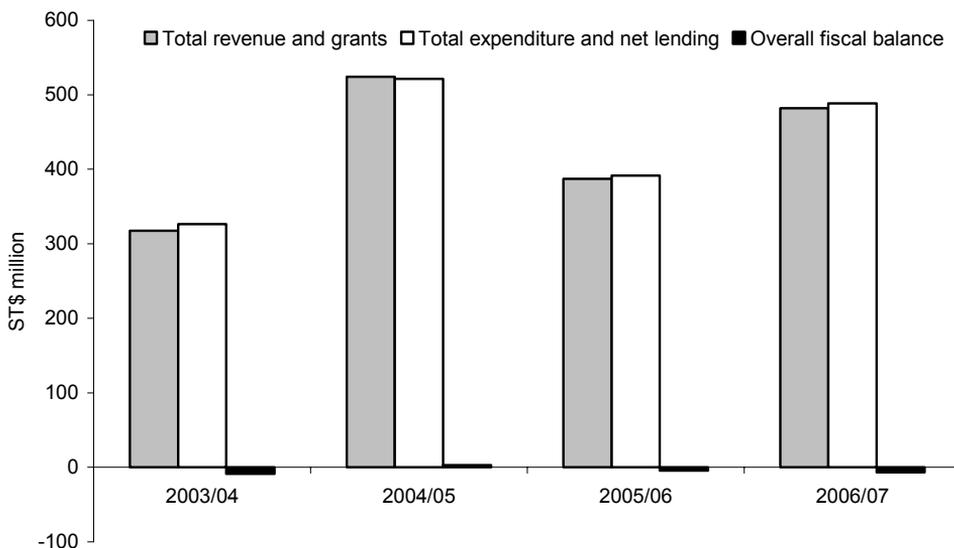
Making the transition to a relative high salary and wage island economy in the formal employment sector will have structural unemployment impacts in the medium term as the up-skilling initiatives, centred on the major reforms of the education sector, are implemented. The main short-term challenge in the labour market will be the expected scaling down of the Yazaki EDS operations. The threat by the fish canneries in American Samoa to scale down their operations, following the implementation of the US Federal minimum wage conditions in American Samoa in 2007, is also expected to have a significant impact on the unemployment situation in

Samoa—given that an estimated 60 per cent of the 4,000 employees of the fish canneries are from Samoa. The New Zealand seasonal guest worker scheme and the planned major tourism projects are expected to offset partially the anticipated unemployment impact of the Yazaki and fish cannery reductions, subject to the appropriate re-skilling programs being undertaken in a timely fashion.

### Government finances

During the 2005/06 fiscal year, the fiscal operations of the Government resulted in a budget deficit of ST\$4.53 million, which was equivalent to 0.4 per cent of GDP, as compared to the budget target of 4.3 per cent of GDP. This reduction reflected the expenditure tightening measures instituted by the Government following the March 2006 general elections. During 2006/07 it is

Figure 3 Samoa: structure of government financial operations, 2003/04–2006/07 (ST\$ million)



Source: Samoa, 2007. *2007/2008 Budget Address*, 31 May, The Hon. Niko Lee Hang, Minister of Finance, Government of Samoa, Apia.

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estimated that the budget deficit will slightly worsen to ST\$6.6 million. As a percentage of GDP, the budget deficits for 2005/06 and 2006/07 of 0.4 per cent and 0.5 per cent, respectively, are considered conservative and manageable. For the 2007/08 fiscal year, the budget deficit is projected to be 0.3 per cent of GDP (Figure 3).

Tax revenue and grants collected during the 2005/06 fiscal year amounted to ST\$387.19 million, comprising ST\$315.4 million in current receipts (81 per cent) and ST\$71.8 million in grants (19 per cent). Current receipts were made up of ST\$273.1 million in tax revenues and ST\$42.2 million in non-tax revenues. The 12.7 per cent increase in tax revenues in 2005/06 reflects improvements in compliance and the widening of the tax base generated from continued economic growth. The 2006 increases of 2.5 per cent in the VAGST and in excise taxes are expected to further improve tax collections during 2006/07 by 19 per cent. Grants in 2005/06 of ST\$71.8 million were a significant reduction from the 2004/05 level of ST\$241 million. Grants are projected to increase to ST\$98.5 million in 2006/07, reflecting better utilisation of the grant aid programs. It is projected that tax revenues and grants will be at least 37.7 per cent of GDP in 2006/07, which is a significant increase from 32 per cent in 2005/06. It is estimated that revenue collections for Samoa are above the average, as a percentage of GDP, for comparable island economies in the International Monetary Fund membership.

Total expenditure and net lending during the 2005/06 fiscal year amounted to ST\$391.7 million, comprising of current expenditure of ST\$281.9 million (72 per cent), ST\$86.1 million in development expenditure (22 per cent) and ST\$23.7 million in net lending (6 per cent). For 2006/07 total expenditure and net lending is estimated to have increased by 24.7 per cent to ST\$488.4

million. It is estimated that for 2007/08 the growth in total expenditure and net lending will decline by 4 per cent to ST\$508.7 million, reflecting mainly a slowing down in development expenditures following the heavy investments in infrastructure for the South Pacific Games during the 2006/07 period. Net lending to state-owned enterprises has been progressively declining from ST\$35.5 million in 2003/04, to an average of ST\$5.1 million in 2006/07 and 2008/09, reflecting improvements in the financial position of state-owned enterprises.

Financing of the government budget has had a significant temporary impact on the liquidity of the banking system and related interest rate levels during the 2005/06 and 2006/07 fiscal years. The rapid drawing down of the Government's position with the banking system to finance its budget deficits since 2003/04 had been arrested by early 2007, reflecting the results of the government's budget tightening and new revenue measures introduced in 2006.

For the 2007/08 fiscal year, the Government has set a target budget deficit of up to 1–2 per cent of GDP, ensuring that adequate resources are available for private sector development. A relatively conservative fiscal policy stance is called for in the medium term, given the projected increase in expenditure pressures arising from the high risk of cyclone damage and an aging and increasingly diabetes-prone population needing increased expenditures on health services and infrastructure. The track record of the Government in the fiscal policy area during 2006 has shown that when confronted with a financial threat it has been able to take timely measures, particularly in instituting new revenue measures. However, there has been a relatively liberal approach to expenditures, particularly in infrastructure developments and public service salary adjustments.

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Therefore, there is comparatively more scope to address expenditure policies in the medium term in order to maintain a manageable fiscal policy.

## Money and credit

Money supply (M2) at the end of December 2006 was ST\$550.56 million, reflecting an increase in quasi-money of ST\$57.6 million and a ST\$9.39 million increase in narrow money (M1), as compared to the M2 level of ST\$484 million at the end of December 2005. This growth in money supply of 14 per cent falls within the 10–16 per cent band recorded during the 2002–06 period; which is in contrast to the wide fluctuations between 3 per cent and 22 per cent in the growth rate of M2 during the 1993–2001 period.

Monetary conditions during 2006 were relatively tight and saw commercial bank liquidity dip in the second quarter to ST\$20.2 million, the lowest level registered since the introduction of the financial liberalisation program in January 1998. However, the liquidity situation eased towards the end of 2006 as the Government's financial position, *vis à vis* the monetary system, was in surplus for the last three quarters of 2006. The 2006 monetary developments highlighted the proactive stance taken by the Central Bank of Samoa when it reduced the statutory reserve deposit (SRD) ratio to 3.5 per cent in October 2006, to assist the commercial banks in the management of the tight liquidity situation. Interest rate levels edged up in 2006 in response to the tight liquidity situation, with deposit rates moving up to 5.41 per cent and lending rates to 12.07 per cent by the end of 2006. Due to the competitive nature of the commercial bank market, the interest rate spreads narrowed from 6.84 per cent to 6.66 per cent.

Despite the increase in interest rates, there was still strong demand for domestic

credit which increased by 32 per cent during 2006 to ST\$473.4 million at the end of December 2006. The increased demand for domestic credit was driven mainly by the 22 per cent increase in private sector credit to ST\$539.9 million.

The monetary policy statement for 2006/07, issued by the Central Bank of Samoa in September 2006, said that it was aiming at a relatively tight monetary policy stance in 2007. There is a policy target for the reduction of the annual growth rate in private sector credit from 22 per cent to 12 per cent for the 2007 period. The money supply (M2) growth rate is expected to be contained to 7 per cent in 2007, based on the 2007/08 budget deficit being maintained within manageable limits and net foreign assets increasing to ST\$195 million. The tight monetary policy stance is expected to be maintained at least up to 2008, given the fiscal pressures projected during 2007 from the increase in public service salaries and the volatile foreign reserves.

The conduct of monetary policy by the Central Bank of Samoa has become progressively more open and transparent with the publication of its annual monetary policy statements and publication of economic reports and statistics in their bulletins and through their website. The significant and direct impact of fiscal developments on the monetary situation during 2006 has shown the benefits of continuing the formal joint tracking and reviews of fiscal and monetary developments by the Central Bank of Samoa and the Ministry of Finance.

## Balance of payments and the exchange rate

The balance of payments structure is characterised by persistent trade deficits and the relatively high dependence on current account receipts from tourism and private

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remittance transfers, as well as the capital account grant aid receipts.

In 2006, imports increased to ST\$596 million against export receipts of ST\$28.8 million, resulting in a trade deficit of ST\$567.3 million. The 2006 trade deficit is equivalent to 45.3 per cent of GDP, reflecting a deteriorating trend when compared to the figure of 41.3 per cent in 2005 and 39 per cent in 2004.

The current account deficit of ST\$73 million in 2006 was an increase of ST\$9 million over the previous year despite the increases registered in net services and net transfers. The 2006 current account deficit was equivalent to 5.8 per cent of GDP; a slight decline from the level of 5.6 per cent in 2005 and 2004.

The net capital account fell by ST\$11.8 million in 2006 to ST\$86.2 million; reflecting a further reduction in grant aid disbursements from ST\$101.5 million in 2004 and ST\$98.1 million in 2005. Although an overall balance of payments surplus of ST\$13.1 million was recorded during 2006, there has been a weakening in the balance of payments position since 2004.

Samoa's net foreign assets stood at ST\$220.6 million at the end of December 2006, equivalent to four months of import cover—a decline in the import cover from

5.6 months in 2004 and 5.1 months in 2005. The rapid deterioration of net foreign assets from 5.1 months of import cover at the end of December 2005, to below three months in May 2006, highlights the fragility of the balance of payments structure. The Central Bank's monetary policy statement for the 2006/07 period issued in September 2006 set a target level of net foreign assets equivalent to four months of import cover. In the light of the mid 2006 experience, the target level for net foreign assets is likely to be revised to five months of import cover.

In setting its exchange rate, Samoa continues to use a trade-weighted basket of currencies of its six major trading partners, of which the NZ dollar and US dollar are the most important components. The weighting of the currencies takes into account not only relative trade flows but also the tourism and remittance flows. At the end of December 2006, the tala depreciated against all the currencies with the exception of the US dollar and yen over the comparable 2005 period. The Central Bank's September 2006 monetary policy statement for the 2006/07 period set an exchange rate policy that aims at not encouraging an appreciation of the real effective exchange rate of the tala as a basis for its package of monetary policy guidelines for the 2006/07 period.

Table 2 Samoa: balance of payments, 2004–2006 (ST\$ million)

	2004	2005	2006
Exports (fob)	33.13	32.50	28.75
Imports (cif)	441.89	507.71	596.02
Trade balance	-408.76	-475.21	-567.27
Net services	139.71	134.60	206.67
Net transfers	210.48	276.62	287.54
Current account balance	-58.57	-63.99	-73.06
Capital account (net)	101.47	98.01	86.19
Overall balance	42.90	34.02	13.13

Source: Samoa, Ministry of Finance, Economic Planning and Policy Division, 2006. *Quarterly Economic Review*, October–December, Government of Samoa, Apia.

## External debt

Official external government debt outstanding was recorded at ST\$448.4 million, or 25.8 per cent of GDP, at the end of December 2006, a decline of ST\$13.1 million from the end of December 2005. When related to GDP, outstanding external debt has undergone significant reductions as compared to 1992 when the level of external debt was above 100 per cent of GDP. It is estimated that 99 per cent of the outstanding multilateral loans are predominantly on concessionary terms due to the least developed country status of Samoa. The debt service obligations as a percentage of total foreign exchange earnings are estimated at only 2 per cent as a result of the large portion of the debt being on concessionary terms.

The expected hardening of the terms of development debt arising from Samoa's imminent graduation from least developed country status is expected to lead to the development of an orderly strategy to enter and establish its credit standing in private capital markets in the medium term.

## Prospects and risks

There is general optimism about the short-term economic and financial prospects of the Samoan economy. Economic growth is expected to be sustained at around 3 per cent per annum over the next three years, driven mainly by continuing rapid growth in the tourism, commerce, and financial services sectors. On the inflation front, it is estimated that increases in prices will average around 3 per cent per annum during 2007/08 subject to no major cost escalations in the prices of the main import items. The budget expenditure pressures in recent years arising from the need to construct a range of sports facilities and supporting infrastructure by

2007 are expected to ease off from 2008/09, thus help in keeping the Government budget deficit within the policy target of less than one per cent of GDP. Although the balance of payments structure is fragile, it is forecast that there will be balance of payments surpluses generated in the next three years from the expected strong earnings from tourism and remittances.

In the medium term, the following strengths and opportunities have been identified that when effectively exploited could propel Samoa to the status of a relatively strong middle income country within five years.

- Samoa's credibility in international financial and political circles as a reliable, predictable and competent Pacific island country built up since gaining independence in 1962.
- Samoa's relatively stable and flexible social and political systems, which have allowed effective management of communities and, in turn, underpin the stable and peaceful transition of national political power.
- Samoa's credible profile as relatively successful economic reforms managers, as demonstrated by the recent track record of rapid economic growth leading to its imminent graduation from least developing country status.
- Proven long-term access to overseas private remittances and a pool of highly skilled labour from the overseas Samoan communities.
- Samoa's external debt has declined significantly from around 100 per cent of GDP in 1992 to 25.8 per cent in 2006. This improvement has enhanced Samoa's capacity to contract external debt in the future if all the other economic and financial country credit risks are contained.

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- Faster, lower cost, and reliable domestic and international links to the major global markets made possible by major innovations with airline links and telecommunications.
  - Building on the relatively strong international profile of the Samoa International Finance Authority for expanding and deepening financial services for international investors.
  - The wide range of sports facilities, built for hosting of at least 20 sporting competitions in the 2007 South Pacific Games, provide a strong basis for hosting regional and international sporting tournaments. The facilities could also provide opportunities for local communities to promote preventative health programs.
  - Samoan athletes have proven that they are internationally competitive and can earn relatively lucrative overseas incomes in a range of sports.
  - The opening up of trade in goods in the Pacific region under the Pacific Island Countries Trade Agreement (PICTA) provides opportunities for Samoan businesses to target markets in the other Pacific island countries.
- While there are a number of positive developments and general optimism about the economic and financial prospects for Samoa, there are risks and threats that have to be closely monitored, analysed and managed. The main short-term risks have been identified in the following areas.
- The cost of increased salaries and wages of the Government arising from the recent three year salary and wage adjustments, needs to be contained and at least matched by productivity increases in the public services.
  - Unemployment shocks from the scaling down of the operations of Yazaki EDS and the fish canneries in American Samoa. If these risks materialise, they could lead to job losses of around 1,000 in 2007 and 2,000 in 2008.
  - The management and maintenance costs of the sports facilities and supporting infrastructure used for the 2007 South Pacific Games are likely to impose immediate pressures on the expenditures of Government as from 2008/09. Based on a capital investment of at least ST\$200 million in sports facilities and supporting infrastructure, it is estimated that the management and maintenance costs could be at least ST\$6 million annually.
  - Reduced access to concessionary development funding as a consequence of Samoa effectively graduating from least developed country status in 2010. Although there is a transitional phase for graduation from 2007, it is a significant benefit that will be lost when Samoa is completely shut out from access to concessionary funding. Based on the current outstanding external debt of ST\$448.4 million, every additional increase of 1 per cent in interest rates would lead to an additional interest cost of approximately ST\$4.48 million.
  - Lack of timely access to customary owned lands for siting of tourism infrastructure to sustain its development programs. Related to this is the likely lack of clear understanding by the public of the proposed land registration and leasing reforms being promoted by the government for customary owned lands.
  - Good economic growth over the past five years has strained the capacity of ports, roads, power, water and waste treatment support infrastructure. Lack of timely planning to enhance the capacity of support infrastructure to keep up with

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the demand could significantly hamper the pace of economic development in the immediate future.

The following risks will need to be managed if economic development is to be sustained over the longer term.

- Relatively high vulnerability to natural disasters and global economic and financial shocks, which could rapidly plunge the Samoan economy into crisis if there are no measures in place to cushion and spread the impact of such risks. In addition to the cyclones of the 1990s, the recent rapid escalation of imported fuel prices has highlighted Samoa's vulnerability to global economic and financial shocks.
- The aging and diabetes-prone population, which is expected to impose budgetary expenditure pressures on the health sector and adversely affect labour productivity. The risk of the population becoming more prone to diabetes was highlighted recently by the Samoan National Kidney Foundation pointing out that one out of eight adults now faces the risk of having diabetes and kidney complications.
- Unemployment among the youth is projected to worsen unless there is economic growth capable of generating at least 1,500 new jobs every year.
- Stagnation of the agricultural sector could undermine national food security and lead to increased dependence on food imports.
- Income distribution disparities are expected to worsen as a result of the good economic growth unless there are targeted measures to channel support to the pockets of hardship in the rural communities.

The main challenge for Samoa is to seek how best to leverage its strengths and manage the risks identified above. The preparations by the Government during 2007 of the 2008–2010 Statement for the Development of Samoa will provide the opportunity for wide ranging national consultations and finalisation of appropriate development strategies for the next three years. It is hoped that this economic update will assist in this exercise.

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