

11.	Public Enterprises and Statutory Authorities, 1997–2002 .....	30
12.	Structure of the Financial System, 1997–2002 .....	31
13.	Monetary Survey, 1997/98–2002/03 .....	32
14.	Summary Accounts of the Monetary Authorities, 1997/98–2002/03 .....	33
15.	Balance Sheet of the Commercial Banks, 1997/98–2002/03 .....	34
16.	Credit to the Private Sector, 1997/98–2002/03 .....	35
17.	Interest Rates, 1997/98–2001/02 .....	36
18.	International Liquidity, 1997/98–2002/03 .....	37
19.	Balance of Payments, 1997/98–2002/03 .....	38
20.	Exports by Commodity, 1997/98–2002/03 .....	39
21.	Destination of Exports, 1997/98–2002/03 .....	40
22.	Origin of Imports, 1997/98–2002/03 .....	41
23.	Services and Income Account, 1997/98–2002/03 .....	42
24.	Composition of Outstanding External Debt, 1997/98–2001/02 .....	43
25.	Exchange Rates, 1997–2002 .....	44

## **L. SAMOA'S ECONOMIC REFORM PROGRAM<sup>1</sup>**

### **A. Introduction**

1. In 1996, Samoa launched a wide-ranging economic reform program that has transformed its economy into one of the best-managed in the Pacific islands. The Samoan Statement of Economic Strategy (SES) provides perhaps the most successful example of reform in the region, with the SES providing the overall macroeconomic framework for the development of separate strategies focusing on health, education, and rural development. Several major reforms of the civil service, financial sector, and tax and tariff systems have already been implemented. Since the strategy was launched, Samoa has achieved macroeconomic stabilization and enjoyed broad-based economic growth, resulting in improved social indicators. Large reductions in trade restrictions and financial liberalization have also enhanced the economy's competitiveness.

2. **The challenge going forward is for Samoa to build on this success by implementing the "second-generation" reforms needed to support private sector-led growth.** These reforms should focus in particular on further enhancing public sector efficiency (especially in state-owned enterprises), improving the quality of infrastructure, and increasing the availability of land for commercial development. This paper reviews Samoa's record of economic reform, its economic performance to date, and future areas of reform focus.

### **B. Economic Performance in the Pre-Reform Period<sup>2</sup>**

3. **The Samoan economy is narrowly based and highly vulnerable to weather-related and other external shocks.** Exports amounted to only \$14.3 million in 2001/02 (roughly 6 percent of GDP) and are heavily based on fish products, which account for roughly two-thirds of total exports. The remainder is primarily made up of coconut- and taro-based products. An automobile parts plant, which is the dedicated supplier of an automobile factory in Australia, is Samoa's only major manufacturing plant.<sup>3</sup> Thanks to a continuous flow of emigration (primarily to Australia and New Zealand) the population has remained stable at roughly 177,000. The economy is heavily dependent on private remittances to finance consumption, while investment needs are met primarily through official transfers.

---

<sup>1</sup> This paper was prepared by Andrea Richter Hume (ext. 34978).

<sup>2</sup> This section draws heavily on Chapter 8 ("Western Samoa") in Browne (1989).

<sup>3</sup> Net exports of the parts plant, which amounted to \$4 million in 2001/02, are included under "export processing" in the services account of the balance of payments.

Samoa's political system has been marked by great stability, with the Human Rights Protection Party leading the government continuously since 1982.<sup>4</sup>

4. **During the early 1970s, expansionary expenditure policies were implemented in an attempt to accelerate growth, resulting in severe balance of payments difficulties.**<sup>5</sup> Increased public expenditure led to large overall budget deficits and rapid credit expansion, and external pressures were compounded by the first round of oil price increases and the subsequent international recession. In the second half of the 1970s, a series of Fund-supported economic adjustment programs were adopted to correct domestic and external imbalances.<sup>6</sup> However, domestic financial policies did not support external adjustment, and the programs were largely unsuccessful.

5. **Other Pacific island economies performed relatively better during this period.** During the 1970s, most of the independent island countries enjoyed sound external positions reflecting buoyant export markets, plentiful concessional assistance, and cautious demand management policies. During 1980–82, adverse movements in the terms of trade caused a pronounced weakening in the external current accounts. However, in most countries the required degree of external adjustment was attained through the progressive tightening of fiscal, monetary, and wage policies.

6. **Samoa's economic performance improved somewhat beginning in the mid-1980s.** A successful adjustment program, supported by two Stand-by Arrangements with the Fund implemented during the 1983–85 period, which resulted in an impressive degree of fiscal adjustment. A strong recovery in international commodity prices assisted in strengthening the external position. These gains were consolidated over the following years, and the economy recorded modest growth.

7. **During the first half of the 1990s, however, the Samoan economy was again thrown off course by a series of supply-side shocks.** These included two major cyclones in 1990 and 1991, and the collapse of the production of taro, a leading export crop, due to taro leaf blight in 1993. Economic recession in Samoa's major trading partners also constrained prospects through effects on tourism, exports, and remittances. Government expenditure

---

<sup>4</sup> The Human Rights Protection Party was reelected to a five-year term in March 2001.

<sup>5</sup> In the decade following Samoa's independence in 1962, conservative financial policies had ensured the preservation of budget balance. However, efforts to expand investment and growth were constrained by shortages in foreign exchange.

<sup>6</sup> These included two stand-by arrangements (initiated in November 1975 and February 1978) as well as six compensatory financing and oil facility drawings.

associated with cyclone rehabilitation entailed a large increase in public investment and significant overall government budget deficits from 1992 to 1995.<sup>7</sup>

### **C. Samoa's Comprehensive Reform Program**

8. **Following the period of cyclone rehabilitation, the government developed a comprehensive economic reform program.** The first "Statement of Economic Strategy" (SES), released in 1996, emphasized the need to maintain macroeconomic stability, and called for private-sector led economic growth based on a new partnership between government and the private sector involving extensive consultation. The strategy also focused on enhancing the efficiency and accountability of the public sector, improving the performance of public enterprises through privatization and corporatization, human resource development, tax and tariff reforms, and financial market reforms. Since then, an updated SES has been released every two years, most recently in 2002.<sup>8</sup> The main areas that have been addressed by Samoa's reform program are discussed in greater detail below.

#### **Tax and tariff regime<sup>9</sup>**

9. **Reform of the taxation system has reduced Samoa's dependence on international trade taxes and enhanced the efficiency of the tax system.**<sup>10</sup> Tax reform was initiated in January 1994 with the introduction of a 10 percent value-added tax on goods and services (VAGST). This was followed by a series of tax and tariff reforms, which have reduced corporate and personal income tax rates, broadened the income tax base, lowered maximum tariffs and simplified the tariff structure, and streamlined the excise tax base.

10. **Trade liberalization is also being advanced through various international efforts.** Samoa is currently an observer member of the WTO, having applied for full membership in April 1998.<sup>11</sup> Samoa is one of the founding members of the Pacific Islands Countries Trade Agreement (PICTA), which aims to eliminate all intraregional tariffs by 2012.

---

<sup>7</sup> The government's financial position was burdened additionally by the assumption in 1994 of SAT 80 million in debt owed by Polynesian Airlines.

<sup>8</sup> The most recent SES, "Strategy for the Development of Samoa 2002-2004: Opportunities for All", has extended the program's target period to three years.

<sup>9</sup> Samoa's tax and tariff reform is discussed in Chapter II of this selected issues paper.

<sup>10</sup> In the early 1990s, import duties represented roughly 50 percent of government revenue.

<sup>11</sup> Samoa has submitted initial offers in goods and services to the WTO. The second meeting of the Working Party on Samoa's accession is expected during 2003.

## **Financial sector<sup>12</sup>**

11. **In 1998, the government launched a comprehensive reform of the financial sector aimed at establishing a market-based financial system.** The liberalization of the sector entailed the removal of all credit ceilings and interest rate controls, and the introduction of central bank securities auctions as the primary monetary policy instrument. The central bank has also adopted programs to strengthen its ability to manage liquidity.

12. **Reforms in the financial sector have included a strengthening of the supervision of financial institutions.** The 1996 Financial Institutions Act clarified that the Central Bank of Samoa is responsible for the prudential supervision of all commercial banks. The central bank has recently taken steps to strengthen its supervisory capacities, including the introduction of on-site inspection of banks and efforts to comply with the Basel Core Principles for Effective Banking Supervision. The amendment of the Financial Institutions Act in January 2001 provided the legal basis for bringing all nonbank financial institutions under the supervisory regime of the central bank. Strengthening the oversight of this sector remains an important objective. Because these institutions – especially the National Provident Fund and the Development Bank of Samoa – play a major role in Samoa’s financial markets, problems in these institutions would have major implications for confidence in, and stability of, the financial system at large.

13. **Several reforms have strengthened oversight of Samoa’s offshore financial sector.**<sup>13</sup> Following the amendment of the Offshore Banking Act in 1998, which tightened the sector’s regulatory regime, the number of offshore banks has declined from 25 to 8.<sup>14</sup> The new International Banking Bill, which will be presented to Parliament shortly, will strengthen the regulatory regime further by requiring offshore banks to establish a real physical presence in Samoa.

14. **Samoa has also made strides in developing an effective AML/CFT framework.**<sup>15</sup> Samoa’s primary anti-money laundering legislative regime was introduced in the Money Laundering Prevention Act (2000), while the Prevention and Suppression of Terrorism Act

---

<sup>12</sup> Financial liberalization in Samoa is the topic of Chapter III of this selected issues paper.

<sup>13</sup> In late 2002, the IMF’s Monetary and Financial Systems Department conducted an assessment of how Samoa’s offshore financial center observed international best practice with regards to the supervision and regulation of offshore financial services.

<sup>14</sup> The amendment increased the powers of the banking regulator to supervise the offshore banking sector and to adopt internationally accepted prudential supervision guidelines. It also introduced stricter controls on the ownership, management, and operations of offshore banks.

<sup>15</sup> “AML/CFT” refers to “anti-money laundering and combating the financing of terrorism”.

(2002) criminalizes the financing of terrorism and provides for the freezing and forfeiture of funds and proceeds used in the financing of terrorism. The AML/CFT framework is being further developed through strengthening the capabilities of the financial intelligence unit.

## **Public sector**

**15. Samoa's reform program has aimed to reduce the dominance of the public sector in the economy while improving efficiency and quality in the provision of public services.** Public sector reform has focused on several key goals: (i) narrowing the focus of the government to its core functions; (ii) right-sizing government; (iii) adopting performance-based budgeting; (iv) privatizing state-owned enterprises (SOEs) and corporatizing government departments; (v) making SOEs more accountable and financially responsible; and (vi) rationalizing the public sector investment program.

**16. Good progress has been made in reforming the civil service.** The government's Institutional Strengthening Program has focused on restructuring government departments and building up their capacity. As the first major initiative under the program, the government launched a major downsizing of the Ministry of Works in 2001, with employment reduced from 450 to 50. The Ministry's focus has been narrowed to overseeing the initiation of public works projects, with the implementation and management of the projects outsourced to the private sector. Thanks to an appropriate severance policy, the downsizing has been implemented without serious friction with employees.

**17. Management of Samoa's fiscal accounts has been strengthened.** Output budgeting was adopted on a trial basis in three departments in 1995–96 and applied to all departments the following year. Budgets now provide considerable detail on output and performance measures relating to timeliness, quantity, and quality. The Public Finance Management Act (2001) further legitimized the financial management reforms initiated in the mid-1990s.

**18. Progress has also been made in reforming the SOE sector.** The government has divested stakes in six enterprises since the mid-1990s, and corporatized the Post and Telecommunications Department in 1999.<sup>16</sup> The Public Bodies Act, passed in 2001, enhances oversight and improves the governance of SOEs. Key reforms introduced in the act include the requirement for each SOE to submit to Parliament an operational report, audited financial accounts, and related audit opinions; and the devolution of all decisions relating to the operation of the SOE to the Board level (and thus limiting the role of the government in these

---

<sup>16</sup> The enterprises divested comprise Bank of Western Samoa (1996–97), BOC-Samoa Industrial Gases (August 1999), MV Forum Shipping Line (wound up in 1999), Samoa Breweries (1999), Samoa Iron and steel Fabrication (November 1998), and Special Projects Development Corporation (wound up in 1999).

decisions). The legislation is expected to place SOEs on the same legal footing as private companies.

### **Trade and investment climate**

19. **Samoa has made less progress in addressing key constraints to business development.** The quality and reliability of basic utilities (electricity, water, and telecommunications, which are all wholly government-owned) remains poor, thus imposing a significant cost on business activity. The availability of land for commercial development purposes also remains low, primarily due to the communal ownership of land in Samoa.<sup>17</sup> The government is currently considering a more active role for itself as an intermediary in the land market, by taking on principal leases and subsequently subleasing land to commercial parties. Greater progress has been made in improving the transparency of Samoa's investment regime, and reducing barriers to entry for businesses. The Department of Trade, Commerce and Industry now promotes its services as a "one-stop shop" for investors, and recent reforms have significantly streamlined the process of obtaining and renewing a business license.

### **D. Results of the Reform Program**

20. **Samoa achieved macroeconomic stabilization and broad-based economic growth following the adoption of its economic reform program.** Over the 1997/98–2001/02 period, real GDP growth averaged 2.8 percent per year and with stable population, per capita income rose substantially. Inflation remained low, fiscal policy has been managed prudently, the external reserves position is stable, and public debt is on a declining trend.

21. **Reforms of Samoa's tax and tariff systems and of the financial sector have strengthened Samoa's macroeconomic framework and enhanced competitiveness.** The reduction of import duties and income taxes, which was achieved while maintaining a stable revenue base, has made conditions for private sector development more favorable. Financial liberalization has improved the efficiency of credit allocation, while reforms of the financial supervisory and regulatory framework have enhanced the ability of the authorities to safeguard the health of the financial sector.

22. **The public sector has been transformed, with a considerable streamlining of its operations expected to produce significant efficiency gains.** The ongoing process of redefining the role of the government should result in a better focus on the key services to be

---

<sup>17</sup> Customary land covers roughly 80 percent of Samoa. Although long-term leasing of customary land is permitted (its sale is prohibited), Samoan laws and institutions do not provide for clear enforcement of leasehold rights. Moreover, the lease is not considered to be sufficiently secured to be used as collateral in a financial transaction.

provided by it, leaving other services to the private sector. In addition, measures introduced to improve monitoring and accountability, especially in SOEs, are expected to enhance the efficiency and quality of public sector services.

23. **The success of Samoa's reform strategy has depended critically on political and institutional factors.** The strategy has enjoyed support at the highest political level, with one of the main architects of the reform program now holding the position of prime minister. Political stability has been another important factor, ensuring that the reform program was not held up unduly by elections or changes in government personnel. The program also has the backing of the public at large, thanks to a serious commitment by the government to a consultation process with civil society, which allows government to develop a reform strategy that is sensitive to Samoa's culture and socioeconomic conditions. Finally, the strategy also benefited from realistic expectations, which ensured that the reform program was designed within the Samoan government's capacity constraints.

#### **E. Remaining Reform Agenda**

24. **The key challenge now for Samoa is to focus on the reforms needed to improve conditions for private investment and export-led growth.** The recent slowing of the economy in 2001/02 suggests that for Samoa to extend its favorable performance record over the medium term, more will need to be done to diversify its productive base and enhance its competitiveness. It will also be essential for the Samoan government to resist the temptation to jump-start the economy through major public investment projects, which would likely endanger Samoa's hard-won macroeconomic stability. A few key areas for further reform are noted below.

25. **Government involvement in productive sectors of the economy should be reduced further.** The government fully owns nineteen companies and corporations, and holds minority interests in another five companies. This degree of government ownership should probably be reduced further in order to stimulate private sector development and productivity. Through technical assistance provided by the AsDB, the government is advancing its strategy with regards to selective privatization of SOEs and improving their reporting, control management, and oversight. Devising a strategy for Polynesian Airlines is particularly important in this regard, given its precarious financial condition and the already large resources that it has required from the public sector.<sup>18</sup>

26. **Samoa's infrastructure is in need of significant investment.** The current state of infrastructure (which remains entirely government-owned and -operated) results in high operating costs for businesses and limits opportunities to develop certain sectors, notably

---

<sup>18</sup> The government will be receiving assistance from the IFC in its assessment of the future options for Polynesian Airlines.