tourism and fishing. The supply of electricity is both highly irregular and of varying quality (i.e. voltage fluctuations), requiring most businesses to have their own generators. The poor quality of water necessitates the fishing industry to maintain its own water purification plant to ensure that the catch is processed correctly, and dock facilities remain inadequate, thus limiting the development of the industry. The cost of telecommunications also remains extremely high.

27. **The private sector environment would also benefit from further improvements.** Regulatory and administrative obligations for businesses are still considerable, with changes in policy and regulations not communicated very effectively to the business community. The land tenure system remains a major obstacle to the development of commercial agriculture and tourism. Therefore, government efforts to expand its role as an intermediary in the leasing of land are particularly important if Samoa's competitiveness is to be enhanced.

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II. TAX AND TARIFF REFORM[1]

A. Introduction

1. **Samoa has undertaken wide-ranging tax and tariff reforms that have improved the efficiency of the taxation system while maintaining a solid tax revenue base.** These reforms have included a substantial reduction in tariff rates, the introduction of a value-added tax on goods and services (VAGST), and the streamlining of the tax structure.

2. **Prior to the reforms attempts to protect domestic industries via extensive tax and tariff incentives had resulted in a highly distorted (and opaque) taxation system.** Most consumption goods were levied at maximum rates of 50–60 percent and the duty schedule was divided into more than six categories. Investment incentives were available for a wide range of business activities, mostly in the export and tourism sectors. These incentives were provided in the form of income tax holidays and concessions, as well as exemptions from customs and excise duties.

3. **The tax structure was also highly inefficient from the revenue collection standpoint.** Administration costs were high because of the complex tax structure and the high tax rates gave firms strong incentives to evade taxes, for example through underreporting income or smuggling in the case of import duties. (Many retail and wholesale activities were effectively shifted offshore in response to the high tax rates, especially to American Samoa.)

B. Pattern of Reform

4. **The main thrust of the tax and tariff reforms has been to improve the efficiency and equity of the tax system.** The bulk of the reforms have taken place since 1998, although there were a number of important reforms in the first half of the 1990s, including most notably the introduction of a value-added goods and services tax (VAGST) of 10 percent in 1994. The income tax system was also simplified by raising the minimum income level for submitting a tax return. The more recent reforms have focused primarily on reducing (and rationalizing) external tariffs, streamlining excise taxes, and broadening the tax base through the abolition of investment incentives and eliminating income tax exemptions (Box 1).

5. **As a result of the reforms, Samoa now has a relatively robust and efficient tax structure:**

- **The VAGST has a single rate** (12.5 percent) applied to a wide range of goods and services. Exemptions are limited to basic food items, water, electricity, transport, and medical and educational services. Revenue from the VAGST now accounts for around 20 percent of tax revenue.

[1] This paper was prepared by Ayako Fujita (ext. 37368).

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- ***Excise taxes*** are now limited to alcohol, soft drinks, tobacco, petroleum, and automobiles. They account for approximately 20 percent of tax revenue.

Box 1. Tariff and Tax Changes, 1998–2003

***1998–1999* Budget**

Substantial reduction in the maximum tariff rate (from 60 to 20 percent).

Phasing out of business incentive schemes and abolition of tax concessions for new enterprises.

Increase in the tax-free threshold of the income tax from SAT 6,000 to SAT 8,000 and an increase in the threshold at which the marginal 20 percent rate becomes effective.

Removal of most excise taxes, excluding those on alcohol, soft drinks, tobacco, petroleum products, and automobiles with an engine capacity of more than 2,000 cc.

Exemption from the VAGST for small business with annual turnover of less than SAT 52,100.

Increase in a range of fees and charges such as motor vehicle registration and wharf charges.

Removal of the 1 percent foreign exchange levy.

1999–2000 Budget

Further cuts in tariff rates, particularly on business inputs such as raw materials, capital goods, and building materials, and simplification of the duty schedule from five to four general rates (0, 5, 10, and 20 percent).

Abolition of investment incentive concessions on import duty.

Further increase in the personal income tax threshold from SAT 8,000 to SAT 10,000, and an increase in the threshold at which the marginal 20 percent rate becomes effective.

Reduction in the top rate of the personal income tax and the company tax rate from 35 to 29 percent.

No extension of new tax holidays.

Increase in stamp duty charges, fees for government guaranteed loans, and taxes on petrol, diesel, and kerosene to offset part of cost of reforms.

2002–2003 Budget

Increase in the rate of VAGST from 10 to 12.5 percent.

Reduction of the 10 percent tariff rate to 8 percent (to 5 percent for fishing boat and gear).

Extension of the income tax to the commercial fishing sector.

Increase of excise taxes on a range of products including soft drinks and alcoholic beverages (by 10 percent), petroleum products and tobacco products (by 15 percent), and increase in motor registration and license fees (by 10 percent).

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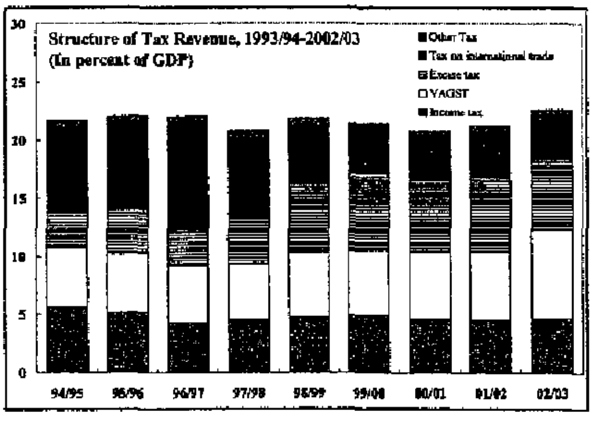
- The top rate of ***income tax*** has been reduced to 29 percent rate. Corporations are taxed at the same rate. Income taxes account for approximately 15 percent of tax revenue.

- The maximum ***import tariff*** has been reduced to 20 percent and the tariff schedule has been simplified to four rates (0, 8, 15 and 20 percent). Most goods are taxed at the 8 percent rate. Import duties now only account for 12 percent of tax revenue.

6. **Despite the significant reduction in tariff rates, total tax revenue has remained relatively stable as a share of GDP** (Figure). Revenue from import duties has fallen from around 8 percent of GDP prior to the recent reforms to roughly 4 percent. This decline in revenue has, however, been offset by higher revenue from consumption-based taxes (VAGST and excises), which has risen from 9 percent to 13 percent. Excise revenues, in particular, have risen sharply, boosted by the removal in 1998/99 of excise tax exemptions that had been granted as incentives to specific industries and tighter administration of excises. (The key change was the institution of a minimum valuation on cars to reduce evasion.) Revenue from the income tax has remained fairly stable, with the higher revenues from the elimination of exemptions compensating for the reduction in income tax rates.



7. **Compared to other countries in the region, Samoa's dependence on import duties is now relatively low** (Table 1). Income tax revenues in Samoa are broadly in line with other countries in region, except for PNG which has a large mining industry as an income tax source. Samoa collects a relatively high share of revenue from taxes on goods and services, especially excises (reflecting mainly the collection of excise tax on vehicles).

Table 1. Structure of Tax Revenue

(In percent of GDP, unless otherwise indicated)

	Samoa 1/ (2001/02)	Fiji (2001)	Kiribati 1/ (2001)	Tonga 1/ (2000/01)	Vanuatu (2001)	PNG (2001)
Income Tax	4	7	5	4	-	15
Tax on goods and services	12	8	-	3	10	3
VAT or other sales tax	6	7	-	2	7	2
Excise duties	6	2	-	-	-	-
Other	-	-	-	1	3	1
Tax on international trade	4	4	11	13	7	3
Other tax	1	-	-	-	1	-
Total tax revenue	21	19	16	20	18	21
Total revenue & grants (million of U.S. dollars)	77	400	46	40	48	762

Sources: Pacific Island Economic Report (World Bank), IMF Staff Reports.

1/ Fiscal year beginning from July to June.

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8. **Samoa is one of five countries in the region that have introduced a VAT.**[2] The efficiency of Samoa's VAGST compares well with that of other countries in the region. This reflects largely the limited range of exemptions, as well as the high import content of consumption. Efforts have also been made to set the threshold for the tax at an economically efficient level (businesses with an annual turnover below SAT 52,000 are exempt from the VAGST).

Table 2. VAT Efficiency Ratio

	Samoa		PICs			Average ratio	
	2000/01	2002/03	Fiji 1/ (2001)	Vanuatu (2001)	PNG (2001)	Asia and Pacific	Small islands
VAT revenue/GDP (1)	5.9	7.6	6.6	7.4	2.0	-	-
Standard VAT rate (2)	10.0	12.5	10.0	12.5	10.0	-	-
VAT efficiency ratio (1)/(2)	0.59	0.61	0.66	0.59	0.20	0.35	0.48

1/ The VAT rate applied in Fiji has been increased from 10.0 percent to 12.5 percent since the 2003 budget.

9. **The tax reforms have been well-received by Samoa's business community.** The tariff reduction has contributed to improving resource allocation through reducing the cost of investment inputs and increasing competitive pressure in import-substituting sectors. The broader community has also supported the reforms, as the increase in the tax-free income threshold and the continuation of VAGST exemptions has allowed the impact of the reform on lower-income groups to be minimized.

C. Remaining Issues and Challenges

10. **The principal challenge for Samoa will be adjusting to a potential decline in external grants that may accompany Samoa's graduation from the ranks of lower income countries.** Although Samoa has managed to increase the relative importance of its tax revenue in recent years, grants remain a large share of total government income compared to other Pacific island countries. As these grants decline (as a share of GDP), the government will need to decide whether to compensate for lower grants by raising taxes or by reducing expenditure. The relatively high share of tax revenue in GDP, suggests that the burden should fall primarily on expenditure consolidation.

11. **Some further strengthening of the domestic tax base will be needed, however, as further tariff reductions are to be expected.** In particular, Samoa's membership in PICTA (Pacific Island Countries Trade Agreement) requires a phase-out of all tariffs levied on intra-regional trade by 2012. Samoa is also in the process of joining the WTO. Although Samoa will have the option to gradually adjust to binding rates offered to developing countries, further reduction in tariff rates for WTO member countries are likely to be required eventually.

[2] Fiji, Papua New Guinea, Vanuatu, and the Cook Islands have also introduced a VAT.

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