



Western Samoa

Awelcome improvement in the state of the Western Samoan economy became apparent in 1995. Economic growth was strongly positive, sufficient to recover much of the ground lost in 1994 when GDP declined sharply as a result of serious damage to the country's main agricultural export crop. The overall balance of payments showed a surplus, aided by some recovery of exports and tourism growth, while international reserves increased after several years of decline. Inflation was reduced substantially from the high level experienced in 1994. Through tight control on public expenditure, a fiscal surplus was achieved which enabled the Government to cope with a large external debt repayment.

Maintaining macroeconomic balance may not be easy in the near term as pressures mount for increased public expenditure. A cautious fiscal policy should be aided by improvements in the scope and effectiveness of monetary policy instruments. In the longer term, strengthening and widening of the productive base and diversification of exports are needed to reduce both the vulnerability of the economy to external shocks and natural disasters and the extent of its reliance on external grants. Fiscal reforms are needed to improve the efficiency of government management and public expenditure and more deliberate efforts are needed to enable the private sector to play a greater role in the development effort.

Recent Trends and Prospects

Over the years, the growth rate of the Western Samoan economy has displayed considerable

volatility, largely because of the country's weak productive base and vulnerability to natural disasters. GDP growth was 6 percent in 1993 as the country recovered from successive hurricanes; in 1994, GDP declined by nearly 8 percent, largely as a result of the destruction of its main export crop, taro, by leaf blight disease. The economy recovered again in 1995 with GDP growth reaching 6.7 percent (Figure 2.34). Taro production began to recover, the output of a number of minor agricultural crops improved, and there was increased contribution from coconut products. Output of automotive wiring harnesses for export also increased following the extension of the Yazaki Samoa plant. The contribution of the services sector to growth in 1995 was boosted by a further increase in tourism activity.

The fiscal operations of the Government in 1995 were greatly influenced by the need to meet the large debt obligations of Polynesian Airlines (PA). Substantial cuts in both current and development expenditures were required for this reason as well as because of shortfalls in revenue from customs duties as imports declined. Domestic revenue declined to 39 percent of GDP from 43 percent in 1994, but total revenue rose to nearly 60 percent of GDP in 1995 from over 53 percent in the previous year because external grants virtually doubled to 20 percent of GDP. Total expenditure (current and capital) was cut back by 10 percentage points to 51 percent of GDP. Net lending, however, was over five times greater at 17 percent of GDP in 1995 by comparison with what it was in 1994 and virtually all of that increase of some 14 percent

of GDP was accounted for by the repayment of PA debt. The overall balance, after allowing for external grants, was a deficit of some 10 percent of GDP in 1995 compared with nearly 12 percent a year earlier. In contrast with experience in 1994 when the entire deficit was financed from external concessional loans, such sources provided less than half of the deficit financing in 1995; and borrowing from domestic sources amounted to over 6 percent of GDP. Money supply (M2) increased by nearly 14 percent in 1994 and by 22 percent in 1995. Private sector credit growth after declining by 4.6 percent in 1994 picked up following some relaxation of monetary policy in early 1995. The rate of inflation moderated substantially in 1995 to an estimated 1 percent after reaching over 18 percent in 1994. Improvement in domestic food supplies, especially taro, was the main reason for this. The initial effects on prices of the introduction of the value-added goods and services tax (VAGST) in early 1994 were not present in 1995.

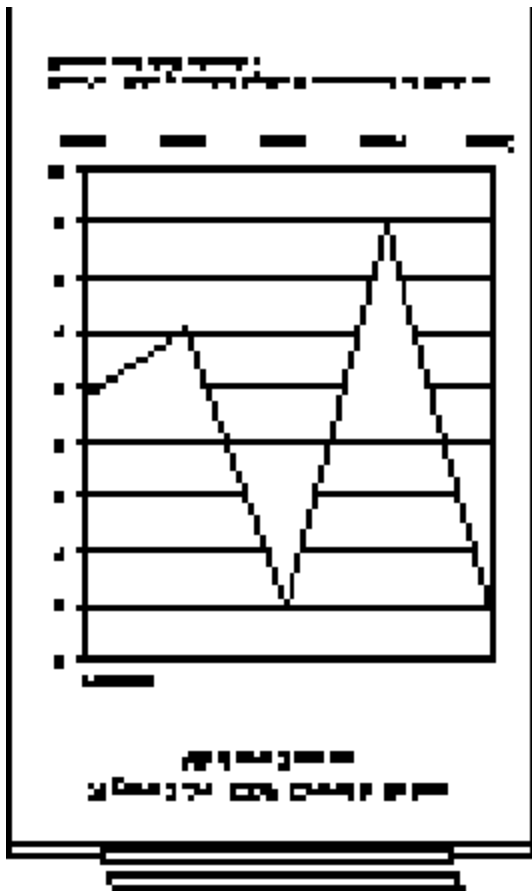
Western Samoa's external position continued to improve in 1995 despite the need for further repayments of PA debt. Although export receipts, mainly from coconut products, more than doubled, they were still equivalent to only 8 percent of import payments. Net services income rose by 2.8 percent, mainly as a result of increased tourism and higher net foreign exchange earnings of the Yazaki Samoa automotive wiring plant. (The gross value of exports and imports by this enterprise are not recorded in the trade statistics.) Private and official transfers also improved. Import payments, which had fallen substantially in 1994 following the completion of some major projects, were only \$5 million greater than in 1994, an increase that was considerably less than the rise in external income. The current account balance improved accordingly from a surplus of 2.7 percent of GDP in 1994 to a surplus of 5.7 percent in 1995. The capital account also showed modest improvement. External borrowing was about half of what it was in 1994; however, debt repayment was also down. The overall balance of payments thus showed a surplus equivalent to 1.8 percent of GDP, in contrast to deficits in each of the preceding four years. External reserves increased modestly after having declined persistently since 1990. At

the end of 1995, they were equivalent to over five-and-a-half months of imports.

The outlook for the Western Samoan economy in the near term is more sanguine than appeared justifiable in early 1995. Action taken to deal with the consequences of the failure of the taro crop and the strains imposed by PA debt repayment on the fiscal and external balances restored a degree of macroeconomic balance. This has enabled the authorities to turn their attention to more general issues relevant to the achievement of sustainable growth over the longer term.

Economic growth is expected to be about 3 percent in 1996. Continued recovery in coconut production will obviate the need to import coconuts for the production of coconut oil and cream; and further increases in the output of other agricultural products such as fruit flowers and root crops both for domestic consumption and exports are also expected. Manufacturing production, aside from agro-processing, will increase as a result of the further expansion of the Yazaki Samoa enterprise and the establishment of several garment factories. The contribution of tourism to GDP is also expected to improve, with new hotels due for completion during the next two years.

The Government's fiscal position in 1996 will be less constrained than in 1995. Expenditures from net lending to public enterprises and settlement of PA debt are projected to fall from nearly 25 percent of total expenditure in 1995 to 4.6 percent in 1996. This means that, although in GDP terms total expenditure will decline to 62 percent of GDP from 69 percent in 1995, both current and development expenditure could be increased in 1996 from the severely compressed levels of 1995. Together, they will rise to more than 59 percent of GDP in 1996 from 51 percent in 1995. Development expenditure will increase more strongly than current expenditure with emphasis being given to grant-financed projects in tourism development, education, and rural infrastructure. Total revenue is budgeted at 58 percent of GDP, virtually the same as in 1995. Domestic revenue will be down; however, increased external grants are expected to make up the fall. Overall, the outturn is expected to be a deficit of just under 4 percent of GDP compared with over 10 percent in 1995. More than half of this will be met from external



financing. The call on domestic financing would thus drop from over 6 percent of GDP in 1995 to 1.5 percent in 1996. To achieve this result will nevertheless require firm resistance to demands for wage increases, or for privatization receipts to be used for current expenditure. Monetary growth is expected to be reasonably restrained in 1996 with a modest expansion in credit to the private sector of about 10 percent. The rate of inflation is expected to be slightly higher than in 1995, at 2 percent.

Western Samoa's external account position is expected to show some improvement in 1996 with the current account surplus increasing to 6 percent of GDP. However, this will be due largely to an increase of about 50 percent in official grants to finance the sharp increase in development spending

(and hence in imports) provided for in the 1996 budget. Export earnings will rise only marginally but imports will increase by nearly 16 percent, thereby enlarging the trade deficit. The capital account deficit will be only a third of that in 1995 because PA debt repayments will be much smaller. The overall balance is expected to show an increased surplus of around 5 percent of GDP, enabling reserves to be built up to over seven months of imports.

Policy and Development Issues

The Government's success in dealing with the fiscal difficulties occasioned by PA debt has provided a framework of macroeconomic stability that is essential if progress is to be made with the structural reforms that are needed not only for improved macroeconomic management but also for the achievement of modest but sustained economic growth over the longer term. Fiscal policy needs to remain tight. Planned reductions in corporate taxes and in indirect taxation will need to be accompanied by measures to reduce public expenditure. However, that reduction should be achieved not by economizing on items such as education, health, and public infrastructure, which are important for the growth process, but by divesting those functions that are more appropriate for the private sector and by improving the efficiency of those that are retained. The proposed extension of program budgeting to all departments and the privatization and commercialization of government enterprises so that they no longer require government budgetary support need to be pushed ahead with some speed. In monetary management, the authorities' plans to move away from direct control to a more market-oriented system are to be commended. However, it is important that all financial institutions, including the National Provident Fund which is active in consumer lending, should come within the scope of the Central Bank's monetary control.