

BACKGROUND

Samoa's population of 171,000 lives on the two main islands of Upolu and Savaii, which make up most of the total land area of 2,800 square kilometers. Emigration to New Zealand, Australia, and the United States kept the population growth at around 0.5 percent per year during the 1990s. The country ranks fifth amongst PDMCs on the Human Development Index scale. GDP per capita in 1999 was US\$1,555; life expectancy is 68 years; the infant mortality rate is 19 per 1,000; and the adult literacy rate is 99 percent. Because many of those who hold higher educational degrees emigrate, there is a shortage of professionals with managerial and financial skills.

Samoa is a parliamentary democracy and was the first South Pacific country to gain full independence in 1962. The constitution provides for a Head of State elected by the legislative assembly for a five-year period. All legislation must have the assent of the Head of State, who appoints one member of the legislative assembly as prime minister. This is usually the member who enjoys the support and confidence of the majority of members of the assembly. The prime minister appoints the cabinet.

Until 1990, the majority of members of the legislative assembly were elected by the *matai* (family chiefs), which was seen as a way of combining a parliamentary form of government with Samoan tradition. Following a 1990 plebiscite, universal suffrage was adopted, giving everyone over the age of 21 the

right to vote. Elections are held every three years. Local government is still traditional and is based on the *matai* system.

Most of the land is held under customary title in the collective ownership of Samoan people, cannot be alienated by sale or mortgage, and is difficult to lease to non-Samoans. Customary land is controlled by *matai*, which means a person is unlikely to be able to operate a business on customary land without the consent of his or her chief. Much of the land in the capital, Apia, however, is freehold land. In addition, the Government has extensive rural freehold land that it may offer for sale or lease. It may also allow foreign investors to lease land from villagers, though this is rare in practice.

Traditional culture in Samoa can constrain business development. The *matai* system can prevent a family member from starting a business by refusing access to land or money. In the past, business people have had comparatively low status. Samoans share wealth with members of the family, the community, and the church, which can prevent the accumulation of capital needed to start a business and reduce the incentive to build wealth. On the other hand, success in business can also provide the means to give generously.

THE MACROECONOMIC ENVIRONMENT¹⁹

Samoa achieved modest economic growth of around 2 percent per year in the 1980s, in part reflecting the impact of economic reforms begun in 1985. Economic activity in the next decade was severely disrupted, first by cyclones in February 1990 and December 1991, then by the impact of taro leaf blight disease in 1993–1994. There was also a financial crisis in the publicly owned Polynesian Airlines in 1994/95 that required the Government budget to assume sizable external debt. There was a marked recovery in 1995 and 1996 as a result of infrastructure rehabilitation; but growth slowed in 1997, due to the closure of a coconut oil mill and reduced exports by the Yazaki company of

¹⁹ This section draws on ADB 2000.

automotive wiring harnesses to Australian car manufacturers (following the Asian financial crisis). However, the fishing sector was growing strongly, and in 1998 was supported by growth in transport and communications and finance and business services. The aggregate growth rate rose to 3.4 percent. In 1999, growth accelerated to 5.3 percent, led by the fishing, construction, and commerce sectors, and by expansion in public administration and tourism (Table 5.1). Continued expansion of fishing and strong growth in the industry sector led a further growth acceleration in 2000, with real GDP increasing by 7.0 percent.

Inflation declined substantially in the 1990s, peaking at nearly 7 percent in 1997 and then dropping to almost zero in 1999 and 2000. The latter decline reflects tariff cuts in 1998 and 1999, and more modest currency depreciation. The Samoan currency, the tala (SAT\$), is pegged to a trade-weighted basket of currencies of major trading partners, the most important being the New Zealand and US dollars. The nominal effective exchange rate has depreciated through the 1980s and 1990s, but in the latter decade the real effective rate has appreciated slightly.

Remittances continued to be a major source of external income in the 1990s, but fell in relative importance because of the improved domestic growth performance. Aid flows averaged over 10 percent of GDP, while tourism receipts increased from 5 percent of GDP in the 1980s to 10–15 percent in the late 1990s. Growth of formal-sector employment has been weak despite the strong growth in output. The primary reason is a decline in the number of jobs at the Yazaki factory. Minimum adult wages are low by Pacific standards, declined substantially in real terms in the 1990s, and are not a constraint in areas of comparative advantage. Around 60 percent of the workforce is employed in agriculture and fisheries, although often part-time.

In the early 1990s, macroeconomic policy was preoccupied with responding to the cyclones and subsequent rehabilitation. Substantial budget deficits were incurred, and monetary policy was tight. In 1996, the Government developed a comprehensive economic reform program that emphasized macroeconomic stability, improved public sector efficiency, private sector development, and better health and education standards. Tax and tariff reforms have been implemented to achieve an open trade policy and an efficient taxation system, with a value-added

tax being adopted well in advance of the major tariff cuts. A financial liberalization program was also begun in late 1997, supported by an Asian Development Bank (ADB) program loan and technical assistance. Credit and interest rate controls were removed, auctions of central bank securities became the primary monetary policy instrument, and a process of strengthening the capacity of the central bank was begun.

In regard to foreign exchange transactions, the Export Financing Facility, which provided local currency funds for agricultural exporters at subsidized rates, was discontinued; commercial banks were permitted to offer forward cover exchange risk contracts; the foreign exchange levy of 1 percent was removed; the ceiling on commercial banks' foreign exchange holdings was replaced by prudential regulation; and the Foreign Exchange Control Regulations were revised to allow private sector parties to operate as foreign exchange dealers upon the approval of the central bank.

The overall budget balance moved into surplus in 1996 and remained in surplus for the rest of the 1990s; and the rise in Government deposits with the central bank allowed for strong growth in private sector credit without dangerously rapid growth in broad money. As noted above, the inflation rate fell (Table 5.1).

Privatization and corporatization of State-owned enterprises (SOEs) was also part of the ADB-supported financial sector reform program. Progress has been slower than originally envisaged, because of the difficulty of adopting a standardized approach to all SOEs, but some full privatizations have taken place, and some of the larger enterprises have been corporatized. There has also been divestment of a number of minority shareholdings.

The Government's current *Statement of Economic Strategy* (Government of Samoa 2000) places special emphasis on growth in agriculture, fisheries, and tourism, and on a revitalization of the village economy as an essential means of ensuring growth with equity. The Government is committed to maintaining a stable macroeconomic environment, continuing its public sector reforms (including a greater performance orientation in the civil service), and promoting private sector development. As to the latter, much remains to be done to address problems of insecure land tenure and regulatory and

administrative impediments to private investment. Regulation and taxation of the fisheries sector are also issues.

Table 5.1
Macroeconomic Indicators for Samoa, 1994–1999

	1994	1995	1996	1997	1998	1999
Output and inflation						
			(in percent)			
Real GDP growth	-0.1	6.4	7.3	1.0	3.4	5.3
Change in CPI (period average)	12.1	-2.9	5.4	6.8	2.2	0.6
Money and Credit			(% change over beginning stock of broad money)			
Net foreign assets	-12.4	5.9	8.0	14.7	12.0	2.6
Total domestic credit	20.0	15.1	4.0	-0.5	-1.5	12.8
Private sector credit	-4.7	15.9	12.7	11.7	13.0	12.4
			(annual percent change)			
Broad money	13.0	21.8	5.1	13.3	4.9	9.1
Central Government 1/			(percent of GDP)			
Revenue (excluding grants)	30.6	32.6	31.4	28.0	27.6	27.9
Expenditure & net lending	49.6	52.3	45.5	37.6	37.8	39.6
Current expenditure	26.6	25.7	26.8	25.2	24.7	24.7
o/w Wages and Salaries	9.8	9.4	8.8	10.2	9.7	9.2
External grants	11.3	16.9	15.0	10.8	11.2	10.2
Overall balance (incl.grants)	-7.7	-2.8	0.9	1.1	1.1	-1.5
Overall Balance (excl.grants)	-19.0	-19.7	-14.1	-9.7	-10.1	-11.7
Balance of Payments (US\$ mn)						
Exports (annual percent change)	-45.3	151.4	14.8	45.5	3.4	5.3
Imports (annual percent change)	-22.0	15.1	7.4	1.2	3.4	14.0
Private remittances	33.1	35.3	36.8	42.1	39.3	38.7
Official transfers	23.7	25.0	22.4	26.1	27.9	26.2
Current Account						
(incl.official trsfers)	3.9	8.6	11.1	18.3	22.1	18.3
(In percent of GDP)	2.0	4.5	5.1	8.4	10.3	8.0
Current Account						
(excl.official trsfers)	-19.8	-16.4	-11.3	-7.8	-5.8	-7.9
(In percent of GDP)	-10.3	-8.7	-5.2	-3.6	-2.7	-3.4
Overall Balance	-5.1	1.0	6.9	9.4	6.3	5.6
Gross Reserves	47.0	47.7	56.9	60.3	63.1	
(in months of imports of goods and services)	5.4	4.9	5.3	6.0	6.0	
External public debt (US\$ mn)	178.5	173.8	169.4	154.9	154.7	162.4
(In percent of GDP)	93.3	92.5	78.7	72.0	74.0	73.4

Sources: CBS 1999b.

THE STRUCTURE OF THE FINANCIAL SECTOR AND INSTITUTIONS

The financial system of Samoa comprises the Central Bank of Samoa (CBS), three private commercial banks (two foreign and one domestic), and seven nonbank financial institutions (NBFIs) (Table 5.2). Under the Financial Institutions Act of 1996, CBS performs a normal prudential regulation role, is responsible for conducting monetary and exchange rate policy, and manages part of the country's foreign exchange reserves (the other part being managed by the Ministry of Finance). Improvements are taking place in CBS's management information and accounting systems, and budgetary reporting is being strengthened to support key responsibilities and provide greater transparency.

The financial sector reform program initiated in late 1997 provided for an extension of central bank prudential supervision to the major NBFIs: the National Provident Fund (NPF) and the Development Bank of Samoa (DBS). Formalization of an in-principle agreement required amendments to the Financial Institutions Act, which were passed in January 2001, and will be followed by appropriate amendments to the acts under which NPF and DBS operate. An International Companies Office operates an offshore financial center, which is currently responsible to the governor of CBS and is staffed with CBS personnel. A bill has been prepared to set up the Offshore Finance Center as a statutory corporation separate from CBS.

The assets of the commercial banks constituted 42 per cent of total financial sector assets in mid-1999 (Table 5.2). The three banks are the ANZ Bank (Samoa) Ltd (ANZ); Pacific Commercial Bank Ltd (PCB), which is jointly owned by the Westpac Banking Corporation (Westpac) and the Bank of Hawaii; and the National Bank of Samoa (NBS), which is locally owned by private Samoan investors and the International Finance Corporation. Their shares in total assets of commercial banks were 62.8 percent, 28.7 percent, and 8.5 percent, respectively.

ANZ opened in 1959 and became a wholly-owned subsidiary of the ANZ Banking Group Ltd after the Government relinquished its 25-percent shareholding in 1995. PCB commenced operations in 1987 as an entirely private bank, with Westpac and the Bank of Hawaii each holding a 43-percent

Table 5.2
Total Assets/Liabilities of Major Financial Institutions, 1994–1999

	1994	1995	1996	1997	1998	1999 ^a
	(in percentage of Total Assets/Liabilities)					
Treasury	0.5	0.5	0.4	0.4	0.4	0.3
Central Bank of Samoa	21.1	20.9	21.2	20.7	18.8	16.7
Commercial Banks	36.5	37.4	38.8	40.8	40.4	42.4
ANZ Bank Ltd	27.1	25.6	26.5	28.5	26.5	26.7
Pacific Commercial Bank Ltd	9.3	10.8	10.3	9.7	10.4	12.2
National Bank of Samoa ^b	0.0	0.9	2.0	2.6	3.5	3.6
Non-Bank Financial Institutions	41.9	41.0	39.6	38.1	40.4	40.5
National Provident Fund	21.5	21.4	21.3	21.6	23.2	23.5
Development Bank of Samoa	10.5	10.0	9.3	7.8	8.1	8.2
National Pacific Insurance Ltd	3.1	3.1	2.6	2.4	2.8	2.6
Samoa Life Assurance Corp.	3.1	3.3	3.2	3.1	3.2	3.2
Public Trust Office	1.4	1.4	1.3	1.3	1.2	1.2
Housing Corporation of Samoa	1.8	1.9	1.9	1.9	1.9	1.8

a. As at June 1999.

b. National Bank of Samoa came into operation in December 1995.

Source: CBS 1999a.

equity stake and private domestic interests holding the remaining 14 percent. NBS opened for business in December 1995, when the Government disposed of its entire shareholding in the former Post Office Savings Bank to local interests. The two foreign banks are mostly involved in trade financing, term financing, and letters of credit.

ANZ's market share has fallen from 74 percent in 1994 to 63 percent in 1999. It has a full branch in Apia, four bank-staffed agencies, one airport foreign exchange agency, and two mobile vans. PCB has a head office, one bank-staffed agency, and two airport foreign exchange agencies. NBS has a head office, five bank-staffed agencies, and one airport foreign exchange agency. As in most other PDMCs, the urban areas are much better served by banking facilities than the rural areas: most banking outlets are in urban areas, and there are two ATMs in Apia. There was one branch or agency for every 10,500 people in 1999.

NBFIs account for 41 percent of the total financial system. The State-owned NBFIs are the NPF, DBS, Housing Corporation

of Samoa, Samoa Life Assurance Corporation, and the Public Trust Office. They accounted for 94 percent of total NBFIs in mid-1999. NPF, the largest NBFIs, holds 23.5 percent of the total assets of the financial system, almost as much as ANZ: NPF is a compulsory retirement scheme covering all paid employees in Samoa. DBS accounts for 8.2 percent of the total assets of the financial system; it does not take deposits and is funded solely by Government equity and lines of credit provided by international development agencies. The major insurance providers are the Samoa Life Assurance and National Pacific Insurance Limited, in which the Government has a 30-percent equity stake. The Housing Corporation of Samoa provides some housing finance but is a small player in the financial system, with less than a 2-percent share.

Money transfers are also available through two major providers (Xpresstrac and Western Union) and four foreign exchange dealers approved by CBS in October 1999. Credit unions are an established part of the financial system; and small amounts of credit are provided by solicitors and moneylenders, as well as through families and relatives.

PERFORMANCE OF COMMERCIAL BANKS

The market for deposits is dominated by the commercial banks. The deposit structure is relatively short-term: in 1999, around 27 percent of funds were held in deposits of less than three months; almost 48 percent of funds were in deposits with maturities of between three and 12 months; 25 percent were held in deposits with maturities of 12 to 24 months; and few or no funds were held in maturities beyond 24 months.

Commercial banks accounted for 51 percent of credit to the private sector in June 1999, compared with 49 percent provided by NBFIs (Table 5.3). The commercial banks' share has increased since the financial sector was liberalized. Banks have minimal claims on the Government and SOEs. Commercial bank lending is focused on building and construction and the purchase of land, together with manufacturing and trade. Very little bank lending goes to the agriculture sector, which relies on DBS and NPF (Table 5.4).

Table 5.3**Total Domestic Lending, 1994–1999**

	1994	1995	1996	1997	1998	1999 ^a
	(in millions of Tala)					
Central Bank of Samoa	1.1	1.3	1.5	1.4	1.6	1.5
Commercial Banks	82.7	104.6	122.0	141.2	167.1	188.3
Nonbank Financial Institutions	145.7	149.9	157.0	161.0	175.8	182.6
Total	229.5	255.8	280.5	303.6	344.5	372.4

a. To June 1999.

Source: CBS 1999a.

Table 5.4**Loans to the Private Sector by Type of Institution
(percent of total loans)**

	1996		1997		1998	
	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks
Agriculture, Forestry & Fishing	1.2	13.8	1.1	14.2	1.1	14.6
Manufacturing	22.5	5.4	16.0	5.4	17.0	4.8
Building, Construction, Installation & Purchase Land	38.2	42.6	40.4	44.0	40.2	47.7
Trade	16.2	13.3	13.4	11.8	9.4	10.6
Transportation, Storage & Communication	4.3	3.6	3.3	4.3	5.0	3.1
Professional & Business Services	7.1	5.3	13.0	4.9	11.1	4.7
Other Activities	10.4	16.5	12.8	15.2	16.3	14.8

Source: Central Bank of Samoa 1999a.

FINANCIAL DEEPENING AND INTERMEDIATION

Financial deepening began occurring after the financial sector reforms. The ratio of broad money to GDP has increased over the period 1994 to 1999 (Table 5.5). However, this measurement does not adequately capture financial deepening, because of the high level of Government deposits in the banking system. A better measurement is private sector credit as a percentage of GDP, which increased from 16.3 percent in 1994

to 26.1 percent in 1999. Credit to the private sector increased by an average 30 percent per year between 1995 and 1999. This was an encouraging development during a period when the inflation rate dropped significantly.

Another measure of financial deepening is the ratio of narrow money to broad money. This ratio declined in the late 1990s, indicating increased use of the formal financial system through the holding of fixed-term deposits. The ratio of time and demand deposits to GDP has also increased much more rapidly than currency to GDP, demonstrating that demand and time deposits are replacing money in circulation.

Excess liquidity has declined with financial sector reforms. The gap between broad money in percent of GDP and private credit in percent of GDP provides a rough indication of the excess liquidity in the system. This measurement has fallen from 13 percent in 1994 to just under 7 percent in 1998 and an estimated 5 percent in 1999.

Prior to January 1998, maximum rates on loans and overdrafts were set at 12 percent and minimum savings rates at 3 percent. The minimum rate on 1-month to 2-year term deposits ranged from 4.5 to 7.5 percent. Since deregulation of interest rates, nominal deposit rates have remained unchanged. Base lending rates initially were set between 11.75 and 12 percent, with risk margins of up to 2 percent. The base lending rates subsequently fell to between 10.5 and 11.5 percent in late 1999, while the risk margins increased slightly. The average margin between nominal lending and deposit rates has decreased if base rates alone are considered (Table 5.6); but allowing for risk margins, the spread has increased from around 7 percent to 7.6 percent (ADB 2000). The increase reflects more effective pricing for risk and greater access to credit for some private sector projects, and should not be assumed to be the result of diminished competition in the financial sector.

Real interest rates fluctuated considerably before deregulation, as Table 5.6 shows, with occasional large negative rates for deposits. Since deregulation, rates have been positive. This increases the incentive to save.

Table 5.5
Financial Intermediation Statistics, 1994–1999

	1994	1995	1996	1997	1998	1999 ^a
	(in millions of Tala)					
Money Supply (M2)	138.1	168.2	176.8	200.2	210.2	214.8
Narrow Money (M1)	47.20	60.94	61.14	69.02	66.53	68.07
Currency outside banks	16.82	21.60	20.96	24.88	24.82	19.41
Demand Deposits	30.38	39.34	40.18	44.14	41.71	48.66
Quasi Money	90.88	107.30	115.69	131.17	143.67	146.70
Savings Deposits	18.64	26.02	29.80	28.73	30.38	33.01
Time Deposits	72.24	81.28	85.89	102.44	113.29	113.69
	(in percent)					
Growth of Demand Deposits		29.5	2.1	9.9	-5.5	16.7
Growth of Time Deposits		12.5	5.7	19.3	10.6	0.4
Growth in Private Sector Credit	-2.2	30.4	18.2	17.5	18.8	37.3
	(in percent of GDP)					
Currency in percent of GDP	3.6	4.5	4.0	4.1	3.9	2.8
Narrow Money in percent of GDP	10.0	12.8	11.6	11.4	10.3	9.9
Broad Money in percent of GDP	29.3	35.3	33.4	33.1	32.6	31.3
	(in percent)					
Private Sector Credit (percent of GDP)	16.3	21.0	22.4	23.0	25.7	26.1
Private Sector Credit (% of total credit)	191.3	160.5	178.8	212.8	264.6	210.2
Currency (per cent of broad money)	12.2	12.8	11.9	12.4	11.8	9.0
Narrow Money (percent of broad money)	34.2	36.2	34.6	34.5	31.7	31.7
Quasi Money (percent of broad money)	65.8	63.8	65.4	65.5	68.3	68.3
Demand Deposits (% of narrow money)	64.4	64.6	65.7	64.0	62.7	71.5
Total Domestic Credit/ Banking Assets	38.6	56.0	53.7	49.3	48.5	72.6

a. To June 1999.

Source: CBS 1999b.

Table 5.6
Nominal and Real Returns on Savings and Lending

	Average Deposit Rates	Average Lending Rates	Inflation Rate	Real Average Deposit Rates	Real Average Lending Rates	Nominal Interest Spread
1994	5.5	12.0	12.1	-5.9	-0.1	6.5
1995	5.5	12.0	-2.9	8.7	6.3	6.5
1996	5.5	12.0	5.4	0.1	6.3	6.5
1997	5.5	12.0	6.9	-1.3	4.8	6.5
1998	5.5	11.25-11.5	2.2	3.2	8.9-9.1	5.75-6.0
1999	5.5	10.75-11.5	0.7	4.8	10.0-10.7	5.25-6.0

Source: ADB 2000.

COMPETITION

The oligopolistic nature of the banking sector is an inevitable outcome of small market size and by definition means that there is limited price competition and a tendency for high interest spreads to persist. However, entry of new banks into the market has been facilitated by Samoa's licensing and supervision policies; and as noted, one new bank entered the market in 1995 (although the bank's market share remains small). Under the liberalized financial system, four foreign exchange bureaus have started operating, and there are indications that these bureaus are competing quite well with the commercial banks.

Moreover, NBFIs were never subject to official credit controls, accounted for around 56 percent of credit to the private sector in 1996, and continue to offer some competition, even though their share of the market declined to half in 1999. NPF in particular lends for private sector development in commercial, industrial and agricultural projects, and offers small loans to members (up to 45 percent of their NPF balance).

Although auctioning of central bank bills is occurring, they generally have not been issued to the public, and have not provided alternative savings instruments for the public. There are around 20 credit unions in Samoa, and these provide facilities for village people to save and borrow.

NONBANK FINANCIAL INSTITUTIONS

National Provident Fund

NPF was established under the National Provident Fund Act of 1972. It administers social security contributions for all wage and salary earners of both the Government and the private sector, except for persons less than 15 years of age, nonresident companies, and the self-employed. NPF has around 25,000 active members out of a potential workforce of 50,000–60,000. Members and their employers each contribute 5 percent of the employee's gross monthly salary. At age 55, members can take either a lump sum or a pension, most opting for the lump sum. In addition to administering the main fund, NPF also administers the Senior Benefits Scheme on behalf of the Government. The SBS is the vehicle utilized by Government to pay pensions to senior citizens who have retired and are receiving a benefit. These benefits can be an NPF pension or some other social security benefit.

There are no specific guidelines on investment in the NPF Act, which places NPF in the position of a trustee. The board interprets this as meaning that it should be ultra-cautious in its investments. Its major investment areas are lending on property (residential and commercial); members' loans (for housing, school fees); and freehold properties. However, in December 1998, a number of amendments to the NPF Act were passed by Parliament. One specified that members' interests were to be paramount in the administration of the fund. Another allowed NPF to invest up to 10 percent of its funds overseas and to invest for terms longer than 12 months without prior approval of the Minister of Finance. A third amendment allowed members to withdraw their account balance at retirement in one lump sum from age 55, as well as allowing withdrawal prior to this age under certain circumstances.

Less than 5 percent of NPF's investments are in equity. There are investments in two companies recommended by the South Pacific Project Facility (SPPF). No foreign investments had been made at the time of writing. At present, if NPF takes an equity investment, it is essentially locked in because of the absence of a national or regional stock exchange.

Under the financial sector reform program, NPF has undertaken a major reorganization and associated capacity building. It has also moved to implement a market-based interest rate policy for loans to its members. Prior to the financial sector reforms, NPF charged 9 percent for all loans, regardless of risk. It has now adopted a base rate of 10.5 percent, with risk-weighted margins normally up to 2.5 percent. The average interest rate for NPF loans is between 12 and 13 percent per year, which is comparable with rates being charged by the commercial banks. NPF has also established board-approved credit policy guidelines that include clear loan classification and credit rating policies based on risk assessment, established benchmarks for various types of lending, loan provisioning policies, appropriate asset/liability matching policies and monitoring and reporting systems, defined account reviews and follow-up measures, improved rehabilitation and recovery policies, and defined policies for loan rescheduling.

Development Bank of Samoa

DBS was established in 1974. The Minister of Finance appoints the DBS Board, which meets 12 times a year. There are 10 positions, with an effective membership of seven. The Secretary of Finance, as the senior financial representative of the Government, chairs the Board. The Directors of Agriculture and Fisheries; Trade, Industry and Commerce; and the DBS general manager are members. The other members represent the private sector. The DBS Act prohibits staff or directors of other banks from being board members.

DBS has relied almost entirely on soft loans from ADB and the European Investment Bank (EIB) and funding from the Government for its capital and finance. The bank has the option of borrowing from the domestic market (particularly NPF). Lending growth has been constrained by insufficient liquidity in the past, and although additional credit lines were provided by EIB in 2000, there is a need to develop alternative sources of funding if portfolio growth of around 5 percent per year is to be achieved. The Development Bank of Western Samoa Act 1974 (with amendments in 1984 and 1986), Clause 8(g), provides for DBS to accept money on deposit at rates of interest to be decided

by the bank. However, clause 5 entitled "Functions of the Bank" refers only to lending and provision of financial, technical, and advisory assistance to enterprises. For DBS to raise funds through deposit taking or issuance of its own securities, further amendments to the Act would be needed. In addition, the cost of funds raised in these ways would be higher, so that operational efficiency would have to increase.

Like NPF, and in the context of a strategic plan approved by the board in late 1998, DBS has streamlined loan processing and recovery procedures, adopted a policy of full market-based interest rates, and established improved credit policy guidelines. It has eliminated concessional 8-percent lending rates for agriculture, and put in place a base rate of 10.5 percent with a risk margin of up to 3 percent. Average rates are in the same range as the commercial banks' rates. Small loans are charged a flat minimum rate of 10 percent to ensure coverage of their relatively high appraisal and administrative costs.

As a result of these policy changes and associated institutional strengthening, and of Samoa's stronger growth performance, DBS's financial performance has improved. The gross loan portfolio stood at SAT\$53 million in June 2000. Very few loans exceeded SAT\$1 million, with the average size being just SAT\$10,000. Approximately 80 percent of its new loan approvals by number and 50 percent by value go to the agriculture sector. These facts underline the crucial role that DBS plays in providing credit to small-scale business in rural areas.

LEGAL AND REGULATORY ENVIRONMENT AND SUPERVISION

CBS is responsible for external and domestic monetary stability, regulation and issuing of money, and the regulation and supervision of the financial sector, as set out in the Central Bank of Samoa Act 1984 and the Financial Institutions Act 1996.

Monitoring and supervision take place in the Financial Institutions Department of CBS, which has issued policies for all of the key areas of banking supervision and has been strengthening its prudential framework. The prudential guidelines issued in March 1996 are consistent with the Financial Institutions Act and with standards adopted worldwide in

accordance with the Basle core principles. CBS is strengthening monitoring of bank compliance with these guidelines, with technical assistance from ADB. The capital adequacy ratio (CAR) as a minimum percentage of risk-weighted assets and other exposures has been set at no less than 15 percent. Tier 1 capital can be no less than 7.5 percent while Tier II capital cannot exceed 100 percent of Tier 1 capital. The Basle concordat sets a minimum CAR of 8 percent.

Commercial banks are subject to a system of detailed regular reporting, with reports analyzed in relation to prudential standards as detailed above. The two domestic banks that are foreign-owned exceed the minimum, while the locally-owned NBS has a capital ratio of about the minimum. The Net Open Position guidelines for banks are now fully implemented, with prudential procedures and data monitored on a weekly basis. The prudential statement on increasing general provisions from 1 to 2 percent is proceeding. Banks are also permitted to lend an equivalent of no more than 25 percent of capital to any one borrower.

Until 1999, NBFIs were not subject to prudential guidelines. During 1999, CBS and DBS agreed that the latter would come under CBS prudential supervision, which has since also been extended to NPF. As noted earlier, implementation of the agreement required an amendment to the Financial Institutions Act, and will require complementary amendments to the individual acts under which DBS and NPF operate. This widening of CBS supervision will better protect the stability of the financial system.

CBS is being reorganized so that departmental responsibilities are better aligned with the requirements of managing a liberalized financial system. Procedures in CBS are being strengthened, including supervisory procedures, and further strengthening of prudential matters including liquidity requirements are being considered by the Financial Institutions Department. The capacity of CBS to conduct banking supervision is being enhanced with technical assistance. Nevertheless, the Financial Institutions Department is small and the average length of experience of its staff is short; there is a need for ongoing staff training.

DEVELOPMENT OF MONEY AND BOND MARKETS

The movement away from direct controls on interest rates and credit towards an indirect system of monetary management was completed with the removal of ceilings on the growth of commercial bank lending in January 1998 and the phasing out of the Liquid Asset Ratio in September 1999.

The auction of CBS bills started on 6 January 1998. The face value of the 91-day and 182-day bills issued in 1998 was SAT\$99.6 million and those issued up to October 1999 was SAT\$85 million. On average, auctions have been held in three weeks out of four, depending on the liquidity situation at the time. The issue is made on a tender basis and CBS is free to accept none, any, or all of the tenders. The interest rate is slightly below the rate offered by the commercial banks on term deposits. Bills are issued in bearer form, but the banks are required to advise CBS if they trade. Securities can be freely traded at negotiated prices, and can be discounted at CBS at any time after issue, but are subject to a rediscount penalty of 100 basis points above yield. To date, there has been very little secondary trading—one or two trades per year. None of the commercial banks in Samoa issues bonds or bills.

The Government does not issue either short- or long-term paper and currently has no intention to do so, because it can borrow more cheaply abroad than at home. Neither does the Government guarantee any domestic bonds, although it does guarantee overseas bonds issued to multilateral organizations by SOEs, such as the power company and the central bank.

The Statutory Reserve Deposit (SRD) has now been established as an instrument in its own right, and CBS bills are not now eligible assets for SRD. SRD was redefined as a direct proportion of bank deposits and has been set at 5 percent since February 1998.

Samoa has laid the foundation for promoting money markets that will in time lead to the development of interbank activity in money market instruments and CBS securities. As a result of the removal of the direct controls, CBS is making greater use of the issue of central bank securities as the monetary policy instrument to meet the inflation target of 3 percent per year. However, it will take time before CBS securities are actively

traded in sufficient amounts to influence financial sector liquidity substantially.²⁰ To date, CBS has been effective in using the instruments that are being developed to mop up liquidity, but there has only been a tiny amount of interbank activity in money markets. Now that the liquid asset reserve has been phased out, the Exchange Settlement accounts with CBS indicate that there is much less excess liquidity in the system, and it is expected that a short-term interbank borrowing market will begin to develop. It is also expected that the interbank money market will continue to grow and that eventually a yield curve will emerge.

Part of ADB's Financial Sector Program Loan was allocated to covering the cost to CBS of issuing CBS securities. This coverage was due to end in December 2000, so that the issue of how these costs would be covered after December 2000 needed to be resolved. As of mid-2001, an in-principle agreement had been reached that provided for the Treasury to finance the interest costs of CBS securities for a two-year period, pending a later strengthening of CBS's balance sheet through a transfer of Treasury foreign exchange reserves to CBS.

DEVELOPMENT OF DEBT AND CAPITAL MARKETS

The original Companies Act was based on the 1955 New Zealand Act and needed replacing by a clear and relatively simple act. A new Companies Act was drafted and approved by the Cabinet in June 2001; it is expected to be passed into law later in the year. The existing act requires the annual filing of accounts, which are open for inspection by the public. In the past, the commercial banks have had difficulty in getting quality financial information from companies on a timely basis. However, the recent change that permits the banks to price for risk is beginning to improve the situation, and there is a marked growth in professionalism by those companies that want to reduce their interest costs. There are three full-time accounting firms and an

²⁰ CBS has retained the legislative ability under the CBS Act to reimpose credit ceilings, should this be necessary in the interest of monetary stability.

accounting society that has adopted international accounting standards.

There is no securities regulation in Samoa. None of the banks provides investment advice, nor does any of them offer investment products, such as mutual funds.

The offshore market is regulated by: (i) the International Companies Act 1987; (ii) the Offshore Banking Act 1987; (iii) the International Trusts Act 1987; (iv) the Insurance Act 1987; and (v) the Trustee Companies Act 1987. There are currently six domestic companies licensed under the Trustee Act, 6,000 international companies, 12 offshore banks, and eight insurance companies operating in the market. The trustee companies undertake due diligence on the international companies. The International Companies Office, which under the 1987 act implements this legislation, is therefore primarily concerned with regulating the trustee companies themselves, the banks, and the insurance companies. Samoa has not yet developed a mutual fund industry. Until it does, development of an offshore stock exchange will be inhibited: mutual funds (unit trusts) are the majority listings in such markets as Cayman, Bermuda, and Luxembourg.

Samoan companies obtain investment funds from family and friends, the commercial banks, DBS, and NPF, and only to a limited extent from the general public buying securities made available through a public offering. There is no domestic stock exchange and only around nine public companies. Generally, the potential for listing is limited. Most businesses in Samoa are small (turnover of less than SAT\$500,000) or medium (turnover of less than SAT\$2 million). Only very few companies would have a turnover of more than SAT\$5 million. Many of the larger companies in Samoa are run as sole traders or private companies. To all but a relatively small number of companies, disclosure of company information would be a problem. As for the rare exceptions, the companies have shareholders who are not part of the family, and they prepare formal accounts and hold annual general meetings.

There is some trading in the shares of Pacific Commercial Bank. Holders of the shares tend to approach the bank to find buyers. The system is entirely informal and not at all transparent. Demand for the shares is strong, particularly from

bank employees. One third of the shares issued by the National Insurance Company are held by the general public. There is no secondary market, and if an investor wishes to sell them, they generally approach the company secretary for help in finding a buyer.

When a shareholder in one of the public companies wishes to sell to the majority shareholders, the company may facilitate a valuation. Otherwise the shareholders have no idea what the shares are worth. NPF has equity stakes in two domestic private companies and would like to acquire more. However, the lack of a secondary market for the shares means that the investments are held at par value and only the dividend is taken into the accounts. This may well be distorting the finances of the companies concerned, in that they are paying dividends when it would be more appropriate to invest the profits in further expansion. Such a move will only be possible if the holders of shares can reflect the increased value of the company in their books by revaluing the shares at market price.

The NBS is currently a private company and as such is limited to 25 owners (although some of these are trusts that act for more than one principal). It is possible that the bank will go public in the medium term and would welcome a regional stock exchange. DBS is undertaking some equity investments and will want an exit strategy after about five years. Management's view is that some companies might welcome listing on a regional exchange, whereas others will be very wary, because of public disclosure and external participation. The Companies Act requires a 75-percent majority for special resolutions and the principals like to ensure that they can control this number of shares.

A number of SOEs have been corporatized and privatized. The *Statement of Economic Strategy 1998/1999* (Government of Samoa 1998) confirmed the corporatization of the Posts and Telecommunications Department and the privatization of nine SOEs. Three enterprises had been privatized by the end of 2000, including the relatively large Samoa Breweries and Rothmans; and a Public Bodies (Performance and Accountability) Bill has been prepared to provide the legislative framework for ensuring a more commercial orientation and greater accountability of SOEs. However, the Government's plans do not yet envision privatization in terms of the issue of shares to the general public.

In most industries, except fisheries, the Government is encouraging foreign investment. The Cabinet has decided that Samoans must be majority shareholders in companies that participate in the fishing industry, but in other industries, wholly and partially foreign-owned businesses are welcome. The Government is in the process of passing new foreign investment legislation, which has been drafted in consultation with the private sector to ensure that approval times and conflicts of interest between ministries are minimized.

MICROFINANCE

There is a growing, unmet demand for microfinance services, especially by low-income households in rural areas that have limited access to formal financial services. Reasons for this growth include the erosion of traditional safety nets as the transition to a modern market economy is made, rising unemployment, and the growth in informal sector activity.

Although it is believed that one never goes without in Samoa because of the *fa'asamoa*, which is a kind of a safety net that protects and provides for all members of an extended network of family and friends, there is evidence that the net does not catch everyone. Increased crime rates, the rising incidence of family disputes and marriage breakups, and the emergence of relative poverty all testify to the decreasing relevance of the "subsistence affluence" model (UNDP1998). The most readily visible evidence is the occasional beggars roaming the streets of Apia.

Unemployment is on the rise, as private sector employment growth fails to keep pace with the number of new entrants into the workforce each year. People in informal employment increased from 27,400 in 1986 to 29,000 in 1991, while those in formal employment rose from 45,500 to 47,900. Estimates are that the urban informal market has grown by around 10 percent annually, and involves 500 to 600 households (UNDP 1998). Women, in particular, are more actively involved in informal sector activities in order to augment the family income. It is estimated that 90 percent of traders at the food, handicrafts, and flea markets are women. Sellers of handicrafts and fine mats at the Apia market indicated that this was their sole source of

income and that the cash earned would pay for school fees and essential family items.

The supply of microfinance services comes from the informal financial system; a semiformal sector that includes credit unions, nongovernment organizations (NGOs), and finance companies extending small-scale loans; and the formal sector.

Formal Sector

In the formal sector, NBS provides microcredit; but it does not have a presence in villages and only a small number of people have the savings track record needed to qualify for a loan. DBS also provides small loans, but these are subject to standard lending policies, making access difficult for low-income people. DBS will, however, administer a microfinance facility that is included in an ADB-supported small business enterprise project.

Informal Sector

There are indications of substantial financial transactions (credit and savings) flowing in the informal financial system in Samoa. However, the savings and loans are mainly used for meeting traditional and family obligations and are rarely utilized for productive purposes or enterprises.

Semiformal Sector

NGOs. In the semiformal sector, only one NGO, the Women in Business Foundation, is involved in microfinance, but on a very limited scale. The project aims to improve the livelihood of disadvantaged women and their families through provision of small loans for income-generating activities at full-cost interest rates; provision of appropriate business skills and savings mobilization training; and business consultancies, regular monitoring and other related services for the clients. The project relies on donor funding. Another NGO, the Small Business Enterprise Centre, provides credit guarantees, but usually for small-scale business enterprises with loans up to SAT\$20,000. Other NGOs have signified interest in microfinance, but there is no legal framework that allows them to engage in it.

Credit Unions. Credit unions are the longstanding providers of microfinance services. The credit union movement began with the issuance of the Credit Union Ordinance 1960, but after an initial surge, it went into decline. The movement was revitalized in the 1980s with support from DBS, which provided an office and one of its senior officers to manage the apex organization, the Samoa Credit Union League (SCUL). The objectives of credit unions are: (i) to promote thrift among their members; (ii) to receive savings of their members either as payment on shares or as deposits; and (iii) to make loans to members exclusively for provident and productive purposes. Credit unions are not allowed to lend money or accept savings/deposits from any person who is not a member of the credit union. At present, there are 20 active credit unions in Samoa, of which 12 are community-based and eight are urban or employee-based. There are 55 dormant credit unions. Credit unions usually make relatively small loans, more for personal than productive purposes.

SCUL has been a past recipient of concessional external loans for on-lending to affiliated credit unions, strictly for productive purposes. The project was regarded as successful. For example, a SAT\$500,000 loan from the International Fund for Agricultural Development's (IFAD's) Pilot Credit Fund was held in the Treasury account at CBS for on-lending to commercial banks, DBS, and the credit union movement through SCUL at 6 percent on a refinance basis. SCUL was granted a total of SAT\$152,000 to cover the period October 1996 to October 1998. It on-lent to credit unions at 9 percent and the credit unions in turn on-lent to members at 12 percent. The maximum loan amount was SAT\$3,500 and loans were largely unsecured. All loans were fully repaid on time. The projects funded were profitable and included a banana plantation, poultry, fishing nets, copra drying, and handicrafts. Success was attributed to peer pressure within the credit unions and to close monitoring and motivation by the SCUL Board of Directors and the technical credit adviser. DBS was granted a total loan of SAT\$383,000, but experienced a low repayment rate due to poor project selection, misuse of funds, and poor management.

As of January 2000, credit unions had disbursed SAT\$3.7 million in loans. They also had mobilized a significant amount of savings from members. In most cases, operating costs of credit

unions are low because their office holders are volunteers, so that some of them appear profitable, as evidenced by the income earned: a total of SAT\$280,796 as of January 2000. The SCUL has a permanent office but only one full-time paid staff member, the general manager, who is assisted by the Board of Directors of SCUL. Technical assistance is provided by the Hans Seidel Foundation and Credit Union Association Australia, and through linkage with a network of credit union leagues in the Pacific region. SCUL needs financial as well as technical staff to be able to efficiently monitor, supervise, and provide technical assistance to credit unions, especially in rural areas.

Finance companies are allowed to engage in lending upon securing a business license. As described by Skully (1997): "There are perhaps half a dozen such companies operating in Apia. These firms might more appropriately be called "moneylenders" in developed-country terms. They depend mainly on their owners or related parties for funding, rather than on raising deposits from the public or issuing capital market instruments. At least some of these lenders are operated from the premises of, or are affiliated to, local law firms. These lenders specialize in very small short-term, usually unsecured lending utilized for paying school fees and custom-related expenses" (Skully 1997).

Microfinance can contribute to the development of the informal sector by providing a convenient, affordable, and safe means of saving for those who cannot access formal banking services, and by providing credit for the establishment and expansion of microenterprises. A great deal of social preparation is needed to inculcate good savings habits and credit discipline. There is also a need to create an environment that enables and encourages participation of more potential microfinance providers, especially NGOs, that have a wide grassroots outreach. Institutional strengthening and capacity building will be needed to ensure sustainability of service provision.

LAND OWNERSHIP STRUCTURES

Approximately 80 percent of the land in Samoa is held by indigenous people in accordance with traditional principles of land tenure, which normally allows for holdings by groups,

usually based on kinship. About 14 percent, previously called Crown land and now called public land, is owned by the Government. About 6 percent, previously called European land and now called freehold land, is owned by individual persons and bodies. After New Zealand took over the administration of Western Samoa in 1919, it required that all Crown land, European land, and European interests in native land be recorded in a Land Register. All instruments of title affecting such lands were also to be recorded in the Land Register. There was no provision in the Land Registration Order that the Government guarantee the land or the instrument of title so registered. This same system of land registration has been continued to the present day under the Land Registration Act 1992/1993.

Public Land

After independence in 1962, legislation was enacted to replace the provisions of the Samoa Act 1921 (NZ), and to authorize the State of Western Samoa to acquire customary or freehold land compulsorily for public purposes, subject to payment of compensation. Freehold land may also be purchased by the Land Board on behalf of the Government. Public land may be leased by the Land Board for periods not exceeding 20 years. Leasehold interests in public land cannot be transferred, subleased, mortgaged, or otherwise disposed of without the prior consent of the Land Board. The Land Board is not permitted to consent to a mortgage of leased land, except for the erection of a dwelling on the land, or to increase the production of the land; it is required to take steps to ensure that the mortgage money is applied only for such purposes.

If a mortgagor of a lease of public land defaults, the mortgage may be enforced by sale of the leasehold interest by public auction or public tender. There is no express power for entry into possession, or for foreclosure in the Land Ordinance 1959. The Property Law Act 1952 (NZ), which applies to Samoa, provides no express power to the mortgagee of entry into possession if the mortgagor is in default, and expressly prohibits foreclosure.

Freehold Land

New Zealand, as administrator of Western Samoa after 1919, recognized existing titles that had been sold by Samoans to any person or body other than under Samoan title, and determined that they were to be deemed as grants of freehold by the Crown and to be called European land, now freehold land. Additional freehold land was made available from the New Zealand Reparation Estates, later the Western Samoan Trust Estates Corporation lands, especially around Apia.

Because of uncertainties about entitlements to freehold land, a Land Titles Investigation Commission was established by the Land Titles Investigation Act 1966. This Commission was authorized to inquire into claims by any person to individual ownership of property except land undoubtedly held for an estate in fee simple. In 1972, legislation was enacted to control the alienation of freehold land to persons who were not resident citizens or to overseas corporations (defined to include companies in which more than 25 percent of the voting shares were in the hands of noncitizens). Sales of freehold land or leases for more than 20 years, and options for the purchase or acquisition of such interests in freehold land, require the consent of the Head of State, if the purchaser or lessee is not a resident citizen or is an overseas corporation. The Alienation of Freehold Act 1972 also appears to apply to mortgages, because in Samoa a mortgage takes effect as a conveyance or a transfer of land, by virtue of the Property Law Act 1952 (NZ). Consequently, mortgages of freeholds to a person who is not a resident citizen, or to an overseas corporation, are prohibited unless they have the prior consent of the Head of State.

Customary Land

Traditional customs of land tenure usually provide that land is to be held by a *matai* on behalf of a family group, called *ainga*; where several different family groups live in a village, some land may be held by the council of *matai* on behalf of all members of the village.

When New Zealand assumed control of Western Samoa in 1919, it legislated to prohibit all alienations of customary land,

whether by sale, lease, license, mortgage, or otherwise, except to the Crown. It also prohibited customary land from being taken in execution for the payment of debts of a Samoan, on his death or upon insolvency. The Constitution of independent Samoa went further and prohibited all alienation of customary land, whether by sale, mortgage or otherwise, except that Parliament could authorize the granting of a lease or license of customary land, or the taking of customary land for public purposes.

Since 1962, under Article 102 of the Constitution, no one is permitted to purchase customary land, not even the State, although legislation permits the granting of leases of or licenses to customary land, and authorizes its compulsory acquisition. Legislation has, in fact, been enacted for both these purposes. The Alienation of Customary Land Act 1965 allows the Minister of Lands to grant a lease of or license to customary land for a term of 30 years for a hotel or industrial purpose, and for a term of 20 years for any other approved purpose. There is a proviso that customary land cannot be leased to a Samoan for agricultural or pastoral purposes unless he is a *matai*. Rents payable under such leases are to be paid to the Director of Lands in trust for the owners of the leased land, subject to deduction for fees and a 5-percent commission. The act does not, however, provide for customary land, or leases of customary land, to be mortgaged. The Taking of Land Act 1964 authorizes the State to acquire compulsorily both customary and freehold land, but subject to the payment of compensation.

Leases of customary land must be registered under the Land Registration Act 1992/1993. All instruments of title affecting such leasehold interests must also be registered. The Government provides no guarantee as to the validity of the leasehold interest, or to the validity of the instrument of title.

Disputes

Disputes relating to public land or to freehold land are dealt with by the Supreme Court under its ordinary jurisdiction as provided by the Judicature Act 1961. The Supreme Court comprises the Chief Justice, appointed by the Head of State on the advice of the Prime Minister, and a unspecified number of Judges, appointed by the Head of State on the advice of the

Judicial Services Commission. The Constitution stipulates that only persons who have been in practice at least eight years in Samoa or some other approved country are qualified to be appointed Judges of the Supreme Court.

Appeals against decisions of the Supreme Court on matters relating to public land or freehold land are to be adjudicated by the Court of Appeal. The members of the Court of Appeal are the Chief Justice and other Judges of the Supreme Court, and such other persons, qualified to be Judges of the Supreme Court, who are appointed by the Head of State on the advice of the Judicial Services Commission. In practice, judges of other Pacific island countries and of Australia and New Zealand are usually appointed as members of the Court of Appeal.

Disputes relating to customary land are dealt with by the Land and Titles Court, which sits for two or three days a week most of the year. The Court consists of a President (who is required to be the Chief Justice or a judge of the Supreme Court), two or more Samoan judges appointed by the Head of State on the advice of the Judicial Services Commission, and not more than two assessors selected by the President of the Court from a panel appointed by the Head of State on the advice of the Judicial Services Commission. Deputy Presidents are appointed by the Head of State on the advice of the Judicial Services Commission from among the Samoan judges, and a Deputy President may preside in place of the President. Lawyers are not permitted to appear in proceedings of the Land and Titles Court, and many of the fees are stipulated in the First Schedule to the Land Titles Act 1981. However, there are other costs of proceedings before the Court that are not controlled, especially the costs of transporting and accommodating witnesses.

The Land and Titles Court has jurisdiction to adjudicate all matters relating to Samoan names and titles, claims, and disputes between Samoans relating to customary land, and rights of succession to property held in accordance with the customs and usages of Samoans. Final decisions of the court are to be given by a majority of all its members. Appeal may be taken with the leave of the president of the court to a reconstituted sitting of the Court, at which the Chief Justice or a judge of the Supreme Court shall preside, together with two Samoan judges appointed by the President. Decisions of the reconstituted Land and Titles

Court are final. The Supreme Court has also held that it has no power to exercise its normal inherent powers of judicial review over decisions of the Land and Titles Court.

If there is uncertainty as to whether or not land is freehold land, this is to be resolved by the Land Titles Investigation Commission, established under the Land Titles Investigation Act 1966. The Commission comprises the Chief Justice, who is chairman, the Director of Lands, and three other members appointed by the Head of State acting on the advice of the Cabinet. One of the latter group must be a senior Samoan judge of the Land and Titles Court. The Land and Titles Court may determine that any land is customary land, if all persons who have an interest in such land have consented, or if a claim that it is freehold land has been disallowed by the Land Titles Investigation Commission.

KEY CONSTRAINTS ON FINANCIAL SECTOR DEVELOPMENT

Small size of economy and distance from markets

The rate and pattern of economic growth are the major determinants of financial sector development. Economic growth has accelerated in recent years, and the economy is benefiting from the impact of economic reforms; but there are still impediments to private sector development. The small size of the domestic market and high transportation costs to distant markets are givens. Other impediments can be removed through appropriate policy action. They include insecure property rights, extensive involvement of the public sector in economic activity, and inadequacies in business regulations (ADB 2000).

Difficulties in Finding Land for Development and in Use of Customary Land as Collateral

Although much of the land in Apia is freehold and the Government has extensive rural freehold land that it may offer for sale or lease, 80 percent of the land is customary land and therefore inalienable. Banks cannot accept traditionally held land as collateral for loans. The *Statement of Economic Strategy 2000–*

2001 (Government of Samoa 2000) states that the Government will design and implement a strategy to improve the availability of land and the use of customary land as collateral. This will be a complex and lengthy exercise, but it is nonetheless essential.

Slow Progress in Public Sector Reform

Progress in implementation of the public sector reform program has been slower than originally expected. Further reform is needed to improve the enabling environment for the private sector. In particular, better performance is required of public utilities. Electricity supply is irregular and relatively costly; pricing policy discriminates against business. Water supply is unreliable, of variable quality, and, in the view of some enterprises, too costly. There are also concerns about cost, service availability, and quality in the telecommunications sector.

Discrimination in Transaction Costs Against Rural Businesses

The transaction costs of doing business have been lowered through a streamlining of the business licensing process. Since 1998, licensing has been handled by the Commissioner of Inland Revenue instead of by numerous Government departments. However, the new arrangements continue to discriminate against rural businesses, no matter how small and remote, since they all must apply and pay the annual fee. A threshold level could be set to remove this discrimination. Transaction costs could be reduced, through simplification and strengthening in the areas of import/export documentation, quarantine requirements, exit permits for residents, work permits for expatriates, and stamp duty. The lack of a small claims court also increases transaction costs (ADB 2000).

Need for Reforms in Legal Framework for Private Sector

The legal framework for private sector activity is generally regarded as satisfactory, but there are some areas requiring reform. These include the streamlining and updating of company and insolvency law; the streamlining of stamp duty law; the

streamlining of dispute resolution arrangements; reform of procedural aspects of land laws; reform of the law regarding security of property; modification of the Fair Trading Act to limit price control provisions; and the removal of barriers to competition. An appropriate regulatory framework for the fisheries sector is also needed. Foreign investment policy has become more open, but there is still room for more effective facilitation of investor inquiries.

Shortages of Workers with Managerial and Financial Skills

While the overall educational standard in Samoa is relatively good and is not considered to be a significant constraint to business development, the Government acknowledges the need to improve the quality of primary education, in order to ensure that students are functionally literate and numerate. In addition, a shortage of professionals with managerial and financial skills has been exacerbated by the emigration of some tertiary graduates. On the other hand, overseas communities of Samoans are proving to be a source of skills and capital for the business sector: many have returned to establish successful businesses, especially in the service sector.

Within the constraint imposed by smallness, considerable progress has been made in the creation of a liberalized, more competitive financial sector. Outstanding reform issues include the effective extension of CBS prudential supervision to DBS and NPF; and a resolution on meeting the future costs of issuing CBS securities. Another issue is the full operationalization of CBS's liquidity management framework as the basis for determining the size of the auctions of CBS bills. At present, this is constrained by Treasury's difficulties in providing weekly forecasts of Government receipts and payments. Full liberalization of foreign exchange controls, which apply to capital account transactions, will be implemented gradually over the long term. For microfinance, the lack of an enabling legal framework constrains development.

RECOMMENDATIONS

Implement the *Economic Strategy 2000–2001*, while maintaining macroeconomic stability and speeding public enterprise reform.

The *Statement of Economic Strategy 2000–2001* (Government of Samoa 2000) reaffirms the Government's commitment to achieving higher growth rates through eight key strategic outcomes, which include maintaining a stable macroeconomic framework, reforming the public sector to improve efficiency, and continuing financial sector liberalization. The Government must continue to maintain a stable macroeconomic environment through the continuation of the firm fiscal and monetary positions that it has held over the past few years. It must also accelerate the public enterprise reform process, and act determinedly to reduce the transaction costs of doing business, by addressing the issues summarized in the preceding section. This will include reduction and perhaps elimination of price controls.

Devise ways to work around land tenure problems.

The details of a comprehensive reform strategy for the land tenure system must be worked out over the medium term. In the meantime, business and financial institutions must operate within the existing system. Strategy design must encompass

- (I) regularizing present informal occupations of public lands;
- (II) acquisition of additional customary land around Apia to be leased for residential purposes;
- (III) town and country planning legislation to regulate urban development; the granting of longer-term leases of public land that could be mortgaged; and
- (IV) legislation to enable rural dwellers to mortgage or charge crops, trees, and livestock.

Consideration should also be given to ensuring that the Land and Titles Court sits continuously, by appointing two persons with the qualifications of a judge as President and Deputy

President in place of the Chief Justice and Judge of the Supreme Court. Other measures could include increasing the number of Samoan judges and assessors, to ensure that two divisions of the Land and Titles Court could be continuously in session; and establishment of a permanent Appellate Division of the Land and Titles Court, consisting of the Chief Justice or Judge of the Supreme Court and two or four senior Samoan judges.

Encourage a secondary market in securities, and build capacity for supervision.

In the financial sector, CBS should issue different maturities of CBS bills and encourage secondary market activity, which will eventually lead to a yield curve for Samoa. This could be done by ensuring that efficient interbank markets develop and by adopting a primary dealer system to facilitate market making. The Financial Institutions Department of CBS should continue its capacity-building efforts through appropriate recruitment and short- and long-term in-house and overseas training of banking supervisors, in order to strengthen on-site and off-site supervision capacity. It is also recommended that Samoa continue to strengthen the process of regional cooperation and consultation in regulatory and supervisory matters, as begun through the Pacific Islands Prudential Regulation and Supervision Initiative.

The required amendments to the DBS and NPF acts should be made in order to complete arrangements for CBS prudential supervision of these organizations.

Establish a venture capital fund.

It is recommended that consideration be given to the establishment of a new venture capital fund. This recommendation has been supported by DBS and by the Department of Trade, Commerce and Industry, which has reported an unmet demand from local entrepreneurs.

Adopt and enforce clear guidelines, regulations, and supervisory standards for the private sector.

It is recommended that the new Companies Act ensure that public companies file audited returns. In view of the small size of the private sector and the need to encourage its growth, the

act should make turnover and/or importance to the economy an additional criterion for a company (or group of associated companies) to file audited accounts. Adoption of clear international accounting and auditing standards, together with disclosure standards, should be grounded within an updated commercial law. Samoa also needs a modern bankruptcy law and collection procedures. Collateral should be clearly defined and recognized by commercial law. Effective enforcement procedures and accessible, up-to-date registration and information systems on property, credit, and security should also be in place. Strengthening the judicial system would ensure that supervisory decisions are not unduly delayed and should enhance the ability of banks to enforce the contractual obligations of their customers.

Join the regional stock exchange, if and when one develops.

Participation in a regional stock exchange should be pursued, provided

- (i) the Government has the opportunity of reviewing and approving the regulation of the participating exchanges before permitting the service to be marketed in Samoa;
- (ii) the system is branded, so that Samoan companies and investors see some local content;
- (iii) there is a domestic company to manage the contracting process, acting as the local information point and managing the publicity campaign; and
- (iv) a local public awareness, information, and marketing campaign is conducted, to encourage companies to list and investors to participate.

Encourage the growth and spread of microfinance.

Microfinance development should be encouraged through implementation of the following measures:

- (i) an education program to help inculcate credit discipline and a savings habit;

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- (ii) encouragement of existing women's village committees to register as credit unions, so that appropriate training can be provided by SCUL;
 - (iii) creation of a conducive policy and regulatory environment;
 - (iv) institutional capacity building for existing microfinance schemes and the Small Business Enterprise Centre, through provision of financial assistance and technical assistance and training; and
 - (v) consideration of a loan to DBS for wholesale lending to microfinance schemes, which should include components on social preparation/mobilization, savings mobilization, credit, and microenterprise support services.

