ADB

Private Sector Assessment

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Samoa: Consolidating Reform for Faster Economic Growth

Asian Development Bank

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ABBREVIATIONS

ADB	–	Asian Development Bank
ADSL	–	asymmetrical digital subscriber line
ASC	–	Agricultural Stores Corporation
BOT	–	build-operate-transfer
bps	–	bits per second
CSO	–	community service obligation
DBO	–	design-build-own
EEZ	–	exclusive economic zone
EPC	–	Electric Power Corporation
FIAS	–	Foreign Investment Advisory Service
FY	–	fiscal year
GDP	–	gross domestic product
GSM	–	global system for mobile communications
IMF	–	International Monetary Fund
ISP	–	Internet service provider
KwH	–	kilowatt hours
LHD	–	left hand drive
MW	–	megawatt
MWTI	–	Ministry of Works, Transport and Infrastructure
PPP	–	public-private partnership
RHD	–	right hand drive
SAA	–	Samoa Airport Authority
SBC	–	Samoa Broadcasting Corporation
SBEC	–	Small Business Enterprise Centre
SOE	–	state-owned enterprise
SOEMD	–	State-Owned Enterprise Monitoring Division
SPA	–	Samoa Ports Authority
SPBD	–	South Pacific Business Development Foundation
SLC	–	Samoa Land Corporation
SSC	–	Samoa Shipping Corporation
SSS	–	Samoa Shipping Services
STA	–	Samoa Tourist Authority
STEC	–	Samoa Trust Estates Corporation
SWA	–	Samoa Water Authority
TA	–	technical assistance
TDMA	–	time division multiple access
UNCITRAL	–	United Nations Commission on International Trade Law
UNDP	–	United Nations Development Programme
VAGST	–	value-added and goods and services tax

NOTE

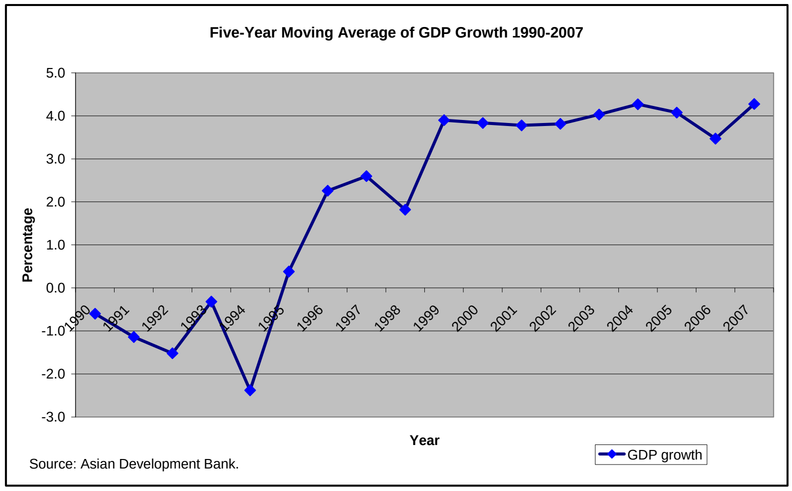
The fiscal year (FY) of the Government and its agencies ends on 31 May. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2000 ends on 31 May 2000.

SAMOA PRIVATE SECTOR ASSESSMENT: A SUMMARY OF BINDING CONSTRAINTS AND POLICY ISSUES

Samoa has already implemented substantial reforms.

Over the past 10 years, policies have:

- Rationalized the trade regime,
- Achieved fiscal stability,
- Reduced inflation, and
- Begun to reduce the role of government.



Reform has been rewarded. The result has been sharply improved economic growth.

Further reform is underway.

- State-owned enterprises (SOEs) have been corporatized, with standards of operation and accountability established.
- Some Ministries have begun contracting out services with notable success, particularly the Ministry of Works, Transport and Infrastructure. Productivity has improved nearly more than 400% as a result.
- The international routes of Polynesian Air have been sold to Polynesian Blue. Fares have declined by nearly 50%, and tourist arrivals have increased substantially.
- A new mobile network operator, Digicel, has been licensed in Samoa. The cost of calls has declined, and service availability has expanded.
- Legal reform has begun, but it is still incomplete.

Most of the necessary macroeconomic reforms have now been completed. The binding constraints are now primarily microeconomic in nature and should be the primary focus of policy.

Major Constraints and Policy Priorities

1. The state still plays too large a role in the economy and raises the costs of doing business.

- The state accounts for over 40% of the country's gross domestic product. It still owns a significant number of enterprises, some of which are protected by monopoly privileges.
- The poor quality of infrastructure raises the costs of doing business, damaging competitiveness.
- Many SOEs are inefficient, costly, and often provide poor service quality, resulting in high costs for business.
- In particular, unreliable and high cost electricity supplied by Electric Power Corporation (EPC), the state-owned power company, is a major problem for businesses, many of which need their own generators because of frequent power outages. Private providers may only operate in emergencies. Given the substantial private generation capacity available, allowing private generation without restriction is an urgent priority.

- Most provisions of the Public Bodies Act designed to improve corporate governance have yet to be implemented.
- The nature and costs of SOEs' community service obligations (CSOs) are not fully known.

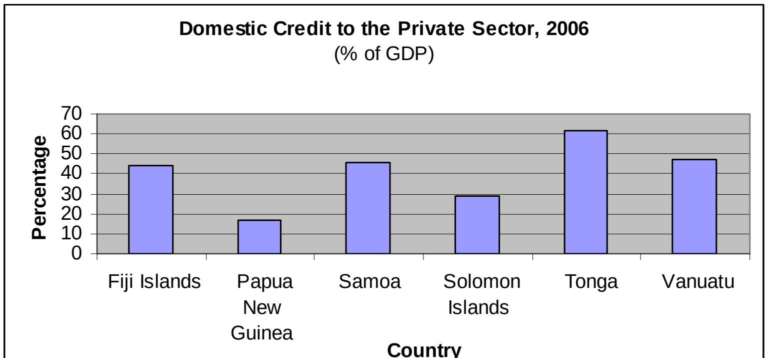
This requires actions to:
- Accelerate implementation of the Government's SOE Ownership and Divestiture Policy, which advocates reducing the role of SOEs in the economy by expanding private sector participation.
- Develop a new Electricity Act, allowing expanded private sector participation in the electricity sector, while expanding the capacity and governance of EPC through technical assistance.
- Implement the Public Administration Reform Plan, supporting further contracting out by ministries and SOEs.
- Calculate the costs of CSOs and explicitly include them in SOE budgets. Explore alternative means of fulfilling CSOs through competitive bidding for output-based subsidies.

2. Property rights, the foundation of development and prosperity, are not well defined because of weaknesses in the land leasing framework. This affects large areas of the economy, particularly financing, agriculture, and tourism.

This requires actions to:
- Advance the timetable to make the land leasing framework more predictable and to reduce the time and costs of obtaining leases.
- Eliminate the bias against Samoan nationals leasing land for agriculture.
- Develop and implement a formal policy for making the substantial land holdings of the state available to private investors.

3. The financial market is "thin" and the cost of finance in Samoa is high. Weak property rights, the lack of a collateral framework, difficulty in collecting debts, and poor credit history on borrowers hampers financial market deepening.

This requires actions to:
- Finalize the Personal Property Securities Act as well as design and establish the personal property securities registry to improve the collateral framework, including debt collection.
- Extend the availability of credit information by promoting the establishment of a full-fledged credit bureau.
- Enter into agreements with credit bureaus in other Pacific countries, including those in Australia and New Zealand, to extend the availability of credit information region wide.



Source: World Bank 2008.

4. Commercial law reform is incomplete, sustaining high transactions costs for doing business.

This requires actions to:
- Proceed as quickly as possible with the work that has commenced on setting up the new companies registry, possibly in conjunction with the new personal property securities registry.
- Draft a new Bankruptcy Act and a new Arbitration Act, as well as conduct a more general review of the commercial legal framework.
- Modernize the court system.

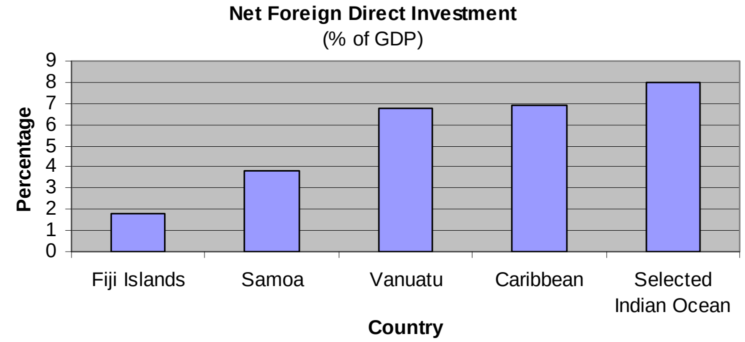
5. Samoa has a comparative advantage in niche product agriculture, but existing policies are not conducive to realizing its potential.

This requires actions to:

- Close down supply-oriented agricultural extension services and increase the number of organic farms.
- Develop a private sector focused plan for agricultural development.
- Improve knowledge and facilities for export market health standards.
- Work with mobile network operators to provide market price information for agriculture and fishing.

6. Opaque and ad hoc processes result in Samoa doing poorly in attracting foreign direct investment.

This requires actions to:



Source: IMF 2007.

- Simplify procedures for foreign investors.
- Introduce a new Arbitration Act, which includes the low cost enforceability of foreign arbitral awards.
- Reduce barriers to employing skilled foreign workers, who bring vital knowledge to the economy.
- Make land leases easily available to foreign investors.
- Eliminate investment incentives and compete for foreign direct investment by making Samoa a low cost country in which to do business.

7. There is limited formal discourse between the Government and the private sector.

This requires actions to:

- Establish a formal body for consultation, with members of the private sector nominated by their representative organizations, possibly through the Chamber of Commerce as the new umbrella organization.
- Plan a National Economic Summit that will place private sector development as the centerpiece of the next Economic Development Strategy.

I. INTRODUCTION

1. Samoa has been a leader in policy reform in the Pacific region. In 1996, the Samoan Statement of Economic Strategy articulated a framework for reform in the areas of the macroeconomy, trade, health, education, and rural development, which is generally viewed as a model for the region. In many of these areas, progress has been made in transforming economic policy away from the promotion of inward-looking, state-dominated, import-substituting activities, toward freeing up trade, reducing the role of the state, and reforming institutions. This has manifested in the highest sustained growth in the region and a sharp improvement in Samoa's human development indicators. Key issues examined in this report are the extent to which reform has led to accelerated growth and which reforms remain to be implemented to raise long-term growth potential.

2. Based on our examination of the data and recent developments in Samoa, as well as interviews with senior government officials and business leaders in the country, the evidence suggests that reforms, so far, have led not only to an improvement in macroeconomic and social indicators, but also in the private sector response, which has resulted in an improved growth performance, even though many business environment related reforms are relatively recent. Experience in other countries shows that investors tend to assess the permanence of change before reacting. And while there have been significant improvements in policies that make Samoa a better place in which to do business, much remains to be done.

3. The following discussion examines the issues surrounding reform in Samoa and the response from the private sector. It looks at how far change has occurred that promotes private sector development, analyzing the extent to which there has been an improvement in the business environment and how the private sector has responded. Although employment has much improved, jobs remain scarce and relatively low paid, and many of Samoa's brightest youth continue to emigrate. While this does result in strong remittance flows, it also shows that the economy is failing to provide opportunities for many well-educated Samoans.

4. In many areas, Samoa appears not to be exploiting fully its comparative advantage. This report identifies areas of the economy that appear to be held back by substantial barriers to development. Development of the agricultural sector, which has the unique natural advantages of climate and soil fertility, appears to be limited by policies that have the unintended effect of distorting incentives and reducing productivity. In addition, tourism policy is not concentrating resources where it could be most effective, and there is no long-term articulation of what type of tourism Samoa would like to attract.

5. The point of departure for this report is that growth can only be achieved through private sector development—that reform is a long-term process that requires patience, hard work, and commitment, and that private sector response takes time because investors are cautious over the permanence of positive change.

6. Our approach to promoting private sector development in Samoa suggests that implementation be neutral with respect to sectors, activities, and investors. We caution against attempts to attract foreign investment through the provision of incentives, and note how such policies have been unsuccessful elsewhere. We also urge the rationalization of the trade regime to remove biases against agriculture through tariff cuts on agricultural inputs, followed by more general tariff reduction.

7. Our overall policy message is that Samoa's path to prosperity lies in its becoming a beacon in the Pacific for ease of doing business that attracts both domestic and foreign investment. This can be achieved while maintaining traditional Samoan values, but will require much discussion, debate, articulation, and pursuit of national goals. Furthermore, the conclusion that the state in Samoa is still hindering the growth of the economy is inescapable. While great strides have been made in reform, there are still major

impediments to private sector development and growth brought about by state ownership of resources and inefficient provision of services. Meanwhile, some of the essential public goods and institutions necessary to provide the foundation for innovation, investment, and entrepreneurship remain inadequate. Leading ministers and government officials are strongly committed to reform. Unfortunately, this commitment is not always shared by those in the middle ranks of public service or even by some senior officials. These issues are explored more fully in the succeeding chapters.

8. In formulating policies for growth and investment through private sector development, it is worthwhile to keep in mind the economic consequences of Samoa's physical and geographical realities. Samoa is remote and transport costs are high because of distance to markets and small cargo volumes. These make economies of scale difficult to achieve. Moreover, these high costs often create a monopoly position which freight carriers and airlines may try to exploit, thereby increasing costs even further. High transport costs are equivalent to a tax on exports and imports, and are an obstacle that must be overcome if Samoa is to compete effectively on the world stage.

9. Samoa is small,[1] with domestic markets that do not allow the local capture of scale economies. Nevertheless, small scale is not the same as market failure, and does not justify state intervention—which, in turn, leads to even higher costs and state failure. The implications of the small size of the economy suggest that Samoa should take every opportunity to integrate its markets with the rest of the world. Samoa needs low trade barriers and a low cost business environment.

10. Samoa is also susceptible to natural disasters, including periodic droughts and especially cyclones, from which the agriculture sector in particular, has suffered greatly and which, together with pests, have had a strong adverse impact on production and destroyed significant investments in coconut trees.

11. Agricultural production has also been negatively affected by low or negative rates of return on state-owned estates. Given the potential importance of agriculture to Samoa, it is important that this land be farmed privately, either through sale or through long-term lease arrangements.

12. Small states, including Samoa, have limited institutional capacity because there are significant economies in operating public services, policy formation, regulatory activities, justice, and foreign affairs that small economies cannot capture due to their size. Thus, the per capita cost of the state apparatus is higher for small island economies, implying that taxes must be a higher proportion of income than in countries where such economies are captured. Further, the quality of civil servants (and indeed of the working population as a whole) is undermined by the "brain drain" of skilled workers seeking better opportunities abroad. Samoa currently has as many citizens living abroad as in country, which represents a substantial loss in human capital that is only partly compensated by the repatriation of remittances. One result of emigration and size is that the relatively small number of highly competent public sector officials that remain are overtaxed by the demands of their jobs. The shortage of well qualified public sector officials also argues for farming out as many activities to the private sector as possible.

13. In Samoa, private sector firms are small because they cannot realize economies of scale, may not be attractive business partners, cannot spend on market intelligence, and cannot invest in new skills and technologies. These factors limit the absorptive capacity of small island economies like Samoa for both aid and investment. Because of the country's size and isolation, its private sector may lack the skills to generate innovative projects and proposals, or even manage aid projects funded by development partners. This places a high premium on the introduction of foreign innovations (i.e., technology, methods, systems, and

[1] It has a land area of 2,935 square kilometers and a population of only less than 200,000.

skills) that foreign investors and skilled foreign workers can bring. Policies should, therefore, be directed toward attracting these.

14. The following chapters analyze the key private sector development issues in Samoa. They are based on interviews with members of both the private and public sectors, and rely on microeconomic analysis of the incentives faced by the business community, investors, and entrepreneurs in Samoa. This analysis embodies an approach that rejects the notion of “the private sector” as another sector of the economy along with agriculture and tourism, for example. Rather, it considers private sector development as encompassing all the productive sectors of the economy—from agriculture to tourism, to services, and even the segment of the public sector that produces goods and services for sale. The key message of this report is that a private sector development strategy impacts all sectors of the economy—including agriculture—and requires significant action on the part of government. A private sector development strategy deals with a whole range of issues that includes infrastructure, privatization, public-private partnerships, legal reform, trade policy, and property rights. Thus, private sector development does not refer to a particular sector of the economy, but is rather a theme for reform that promotes the development of the economy.

II. BACKGROUND

A. Structure of the Economy

15. Samoa has a population of approximately 180,000, where the majority live on Upolu (known as the Main Island), while the rest live mostly on the larger and more agrarian island of Savai'i.[2] Over the past 10 years, Savai'i has been depopulating as residents move to Apia or emigrate to find better employment opportunities abroad. Despite one of the highest fertility rates in the world (averaging 4.4 children per woman in 2000–2005), Samoa's high emigration rate limits its population growth.

16. Samoa's per capita gross domestic product (GDP) was aproximately US$2,184 in 2005 (UNDP 2007). On a purchasing power parity basis, Samoa's per capita GDP was US$6,170, placing it among middle income countries. In 2007, the United Nations Development Programme (UNDP) Human Development Indicators ranked Samoa 77th in the world, showing an improvement over the past 20 years. Life expectancy at birth and infant mortality rates were important factors in the relatively low ranking of the country, where visible poverty is scarce. Aid at US$238 per person in 2005, represents slightly above 10% of per capita income.

Table 1: A Breakdown of Samoa's Economic Sectors
(Millions Tala, Constant 2002 Prices)

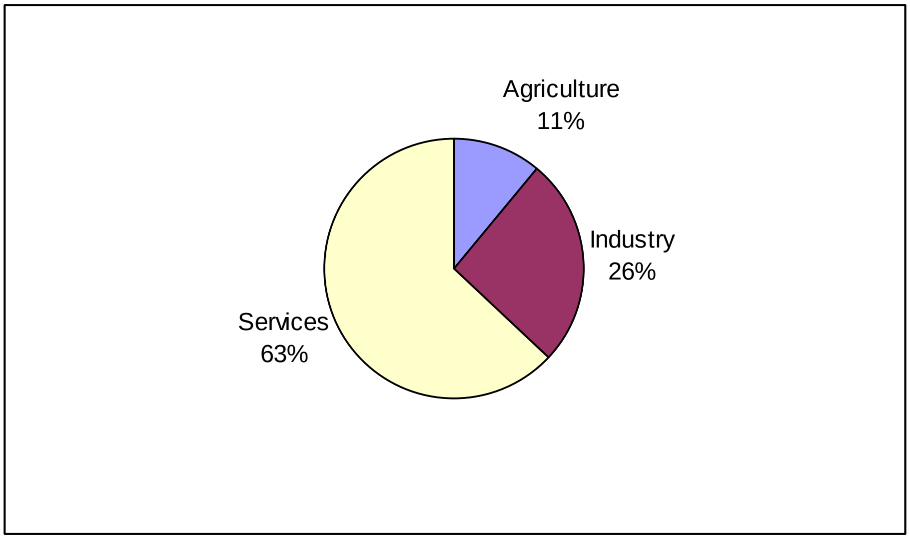
Industry/Sector	2004	2005	2006	2006 (% of Total)	2006/2005 (% Change)
Agriculture	63.3	73.13	68.28	6.7	-6.6
Fishing	52.78	48.5	48.33	4.8	-0.4
Manufacturing (Food and Beverages)	30.42	33.3	31.21	3.1	-6.3
Manufacturing (Other)	106.61	100	89.32	8.8	-10.7
Construction	74.28	84.45	87.71	8.6	3.9
Electricity and Water	43.09	44.46	46.49	4.6	4.6
Commerce	182.13	192.04	200.92	19.8	4.6
Tourism (Hotels and Restaurants)	24.15	26.49	34.1	3.4	28.7
Transport and Communications	120.84	126.9	132.06	13.0	4.1
Public Administration	78.89	90.45	100.52	9.9	11.1
Finance and Business Services	90.45	94.35	99.29	9.8	5.2
Less: Enterprise Share of FISIM	-11.59	-12.04	-12.27	-1.2	1.9
Ownership of Dwellings	34.55	35.25	35.96	3.5	2.0
Personal and Other Services	53.04	53.43	53.49	5.3	0.1

FISIM = financial intermediation services indirectly measured.
Source: Government of Samoa Ministry of Finance 2008.

17. The economy is dominated by tourism, agriculture and fishing, commerce, and the public sector. Table 1 provides a sectoral breakdown. The most striking aspect of recent developments is the very rapid growth of tourism as the hotels and restaurant sector grew by more than 28% in 2006, the latest year for which data are available. Even though the data show that this sector accounts for only 3.4% of GDP, the actual share of tourism in the economy is much larger because tourist expenditures are recorded in other sectors, such as transport and communications. The actual share of tourism in the economy is more likely to be close to 20%. Agriculture and fishing amount to some 11% of GDP, with slightly less than half of this accounted for by fishing, although fish account for the large majority of exports from this sector.

[2] Samoa consists of 10 islands.

Figure 1: Structure of the Samoan Economy



Source: Asian Development Bank 2007.

18. Nearly half of Samoa's exports go to American Samoa (mostly to the tuna cannery). Some 23% of exports go to the United States, 15% to Australia and New Zealand, and about 11% to Europe. By contrast, over 50% of imports come from Australia and New Zealand, and some 22% come from Asia. North America supplies some 13% of imports.

Table 2: Gross Domestic Product and Growth Rates
(Millions, Tala)

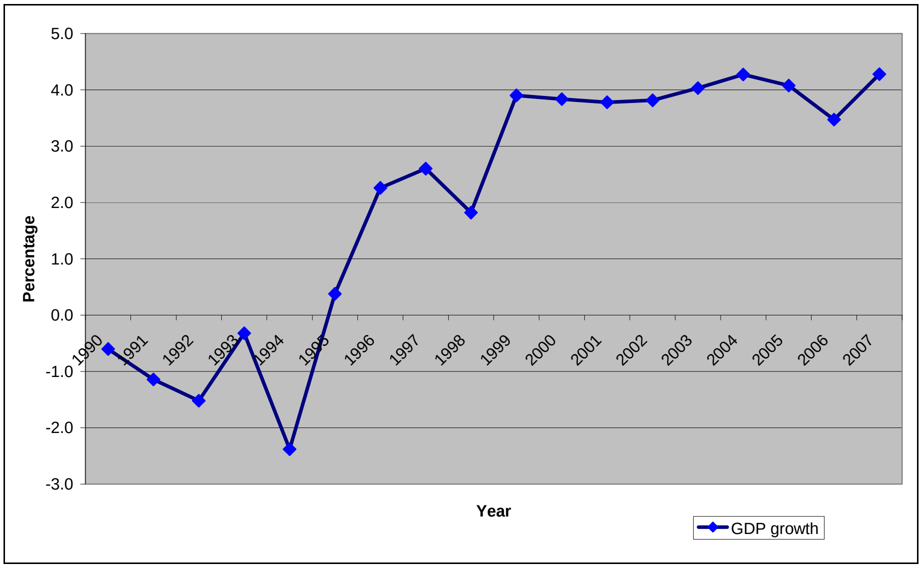
Year	2002	2003	2004	2005	2006
Current Prices	885	949.2	1,049.4	1,151.2	1,249.1
2002 Prices	885	912.6	942.9	990.7	1,015.4
Real Annual Growth (%)	1.8	3.1	3.3	5.1	2.5

n.a. = not available.
Source: Government of Samoa Ministry of Finance 2007b and 2008.

B. Growth Performance

19. Growth performance over the past years, has been solid, with real GDP rising by more than 5% in 2005, after having grown by 3.1% in 2003 and 3.3% in 2004. Although growth in 2002–2005 was lower than in 1996–2001 (which averaged more than 4% annually in real terms), the economy appears to be set for more rapid expansion, with a sharp increase in the growth of the tourism industry, fueled at least partly by the building boom that resulted from preparations for the 2007 South Pacific Games.

Figure 2: Samoa Growth Trends



Source: Asian Development Bank.

20. Figure 2 is a five-year moving average of Samoa's growth performance over the past 20 years.[3] It shows clearly that Samoa has already been rewarded for the reforms that it has undertaken so far. The trend rate of growth has risen sharply. In the period from 1986 to the mid-1990s, there was zero or even negative growth. Since the mid-1990s, the trend has risen substantially to around 4% per year. Reform has been successful. The challenge now is to raise the potential growth rate further through more far reaching reforms.

21. GDP data in Samoa are based on calculating value-added on final outputs. A problem of estimating GDP from only the output side is that the breakdown between investment and consumption is not available. This makes it impossible to ascertain whether the economy is going through a consumption boom, or measure the extent to which investment is responding to an improved private sector environment.[4]

C. Prices

22. Inflation rates have been unstable. In 2004, as a result of Cyclone Heta's impact on agriculture, the general price level rose by 14%, with a concomitant rise in food prices. As agricultural performance recovered, food prices fell, with the general price level increasing only by less than 2%. In 2006, higher oil prices plus the rapid expansion of the construction and tourism sectors have placed upward pressure on prices. Demand pressures, higher inflation rates in major trading partners, stronger currency in Australia and New Zealand, and higher commodity prices have contributed to the acceleration of inflation to about 6% in 2008 (Central Bank of Samoa 2008a).

D. Public Sector Finances

23. Samoa's public finances reflect sound fiscal management that keeps the budget deficit within prudent bounds. The most recent budget, for fiscal year (FY) 2008 anticipates a

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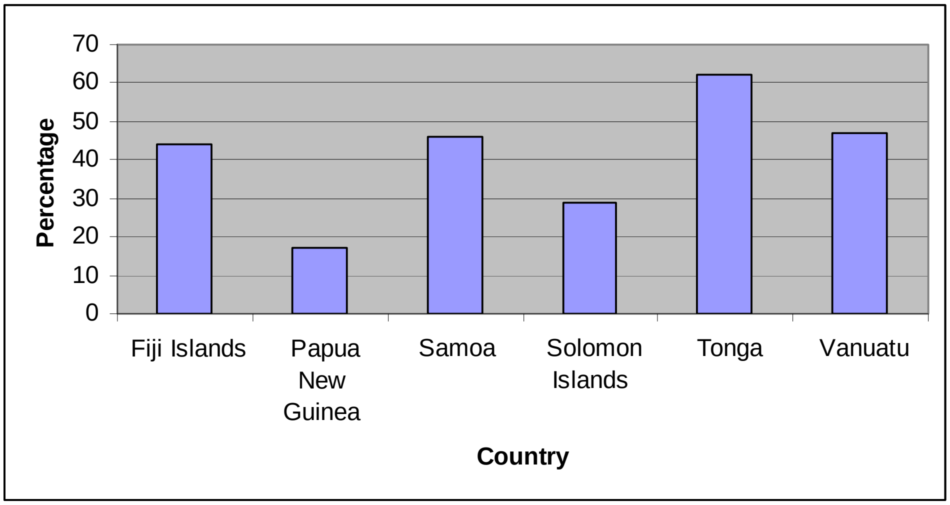
[3] A five-year moving average is used to smooth out statistical anomalies and to abstract from the growth fluctuations that are often experienced by small open economies.

[4] This methodology can be fraught with inaccuracies for several reasons. First, estimating final value-added is difficult because it is hard to uncover what has been left out. The usual way of doing this is by surveys, which pose problems in themselves. Second, it is often difficult to know what an input is and what an output is. Third, when the composition of output changes, especially during periods of rapid growth, some outputs are missed.

deficit equivalent to 1.1% of GDP. In FY2006, however, revenues exceeded projections by nearly 10%, as most major revenue sources performed better than expected as a result of improved compliance and the continued growth of the economy. Expenditures were also higher than budgeted, but exceeded projections by a much lower amount. As a result, the budget deficit for FY2006 was 0.4% of GDP.

Figure 3: Domestic Credit to the Private Sector, 2006
(%of GDP)



Source: World Bank 2008.

E. The Financial Sector

24. Bank lending to the private sector has risen sharply over the past 2 years, from the equivalent of 35% of GDP in 2004 to about 42% of GDP in 2006. But despite this significant increase, the ratio of private sector lending to GDP by the banking system remains below the average for middle income countries which is about 60%.

25. The key elements of the financial system are:

(i) Two foreign-owned banks and two locally-owned banks;

(ii) The Development Bank of Samoa, a state-owned bank with the goal of promoting development;

(iii) The National Provident Fund, which lends primarily to individual Samoans using their contributions as security, but also lends to businesses;

(iv) Two microfinance initiatives, the South Pacific Business Development Foundation (SPBD) and the microfinance facility under the Small Business Development Project of the Asian Development Bank (ADB); and

(v) One small business finance scheme which operates through guarantees.

26. The commercial banks dominate private sector lending in Samoa. Their business is focused primarily in urban areas, and the majority of lending is for loans secured by property. Currently, loans secured by chattel mortgages, while increasing, are still relatively uncommon.

27. In 2006 and the first quarter of 2007, Samoa experienced a major credit crunch. The combined normal reserves for lending amounted to approximately US$85 million, but by early 2007, reserves were at less than 20% of this—an unprecedentedly low level. The banking system's decline in liquidity is the result of a number of factors. In particular, two

transactions drained banking sector liquidity. First, the Government paid a large penalty, in excess of US$20 million, for the early termination of an aircraft lease. It withdrew deposits from the commercial banks to make the payment, resulting in a significant drop in liquid reserves. Second, the Government brought onshore a NZ$25 million loan to fund the purchase of spare parts by Polynesian Airlines. One of the banks funded this loan, sharply reducing its reserves.

28. Further reduction in liquidity has resulted from the banks substantially increasing their private sector lending, especially to the construction industry. This was partly a result of preparations for the 2007 South Pacific Games, but also due to an expansion in the tourism industry and government infrastructure spending (e.g., the new Development Bank building). There has been a slight improvement in liquidity by mid-2007.

F. Balance of Payments

29. The trade deficit expanded sharply over the past 2 years and continued to rise in 2006 as the building boom accelerated and consumption further increased. However, increased private remittances and revenue from telecommunications have offset the increased merchandise trade deficit and lowered tourism earnings for the third quarter of FY2008, resulting in an overall surplus for the fourth consecutive month. This has increased foreign exchange reserves to the equivalent of 5.0 months of imports in the end of March 2008, as against 4.0 months of imports at the end of March 2007.

G. Remittances and Emigration

30. Remittances form a major component of transfers in the balance of payments current account. Samoans living abroad, primarily in New Zealand, send home the equivalent of nearly 20% of GDP, which is among the highest in the world. The fact that so many young Samoans are driven to emigrate illustrates that opportunities and salaries are higher elsewhere, and reflects the environment for doing business in Samoa. In addition, emigrants are usually economically active, so the positive impact of remittance inflows should offset the reduction in domestic output they could generate.

31. Nevertheless, remittances do add to the overall income in Samoa, but perhaps not to as large an extent as it may seem. For example, a recent investigation by Fajanzylber and Lopez (2007) finds that the impact of remittances on Caribbean and Latin American economies, is modest at best. On a positive note, remittances increase consumption in Samoa, which helps reduce poverty and hardship. It is, however, important to note that this will not raise the growth rate of the economy.

32. To the extent that inflows are saved, they also add to the liquidity of the financial system, making more funds available for investment. However, Fajanzylber and Lopez find that for the countries most like Samoa (i.e., the small Caribbean economies), the impact on financial sector development is negative. If remittances are invested, the long-term growth rate should rise.

33. There are, however, a number of possible negative effects from remittances and emigration. The most important of these are:

(i) Upward pressure on the exchange rate, making Samoan goods and services less competitive in trade.

(ii) Negative incentive effects (i.e., recipients of remittances having a reduced need to work).

34. In some ways, the movement of workers between Samoa and other countries, particularly New Zealand, constitute an opportunity. If Samoans acquire skills that they can bring home, the country's growth potential would rise. If, by improving the business

environment, opportunities in Samoa can be increased, some migrants could well return, bringing with them the knowledge they have gained overseas. And this will positively benefit productivity and the growth of the economy.

35. Furthermore, the positive impact of remittances on the Samoan economy will be enhanced by reforms such as those recommended in this report. The incentive to invest remittances is greater, the better the environment for doing business. And good policy environments reduce the incentives for consumption as well as raise the incentives for investment, which has a long-term positive impact on the rate of growth.[5] Nevertheless, "remittances are neither manna from heaven, nor a substitute for sound development policies" (Fajnzylber and Lopez 2007). Their potential can be maximized by continuing along the reform path on which Samoa has already embarked.

[5] See Burnside and Dollar 2000 and Burnside and Dollar 2004.

III. BINDING CONSTRAINTS TO GROWTH AND POLICY INITIATIVES

A. Background

36. The environment for doing business in Samoa has improved consistently over the past decade. Beginning with the reforms of the mid-1990s that removed many of the distortions in the economy, the Government has proved that it is genuinely committed to transforming Samoa into a country that provides prosperity and opportunities to its citizens. Samoa has made great strides in the direction of reform. From the mid-1990s, macroeconomic policy has been stabilized, price distortions have been reduced, the trade regime has been rationalized, and tariffs have been brought down substantially. Consequently, the economy has responded with growth rates that are the highest in the Pacific region. Yet some observers feel disappointed that expansion has not been more rapid, and that the private sector has yet to play its part in generating faster growth.

37. The private sector's response to the reforms of the past decade is difficult to ascertain. However, some indicators of progress in improving the business environment are strongly positive:

(i) Financial market reforms have had a positive impact on the availability of funding for investment. Competition in the financial sector has increased, placing downward pressure on interest rate spreads and bringing a wider range of financial services.

(ii) The entry of Polynesian Blue Airlines has been a resounding success to date, as reflected in the current rise in tourist arrivals, resulting from improved services and lower fares.

(iii) In the area of telecommunications, the advent of Digicel has already led to sharply lower call charges and wider coverage which, in the medium term, could significantly transform the Samoan economy.

(iv) There is a greater degree of public-private dialogue, which is leading to more coherence in the reform process.

38. On the other hand, negative factors remain:

(i) The consistency and reliability of economic policies is an issue that continues to have a negative impact on investment—especially while entrepreneurs wait to observe developments. At present, Samoa remains a relatively high cost environment for doing business.

(ii) None of the Pacific countries rank highly in the World Bank Doing Business surveys. In some areas, Samoa performs well relative to other countries in the region, while in others, such as business registration, it ranks poorly. What the indicators show, however, is that Samoa has been, by far, the leading reformer in the region, and has been rewarded accordingly with substantially higher growth rates than its neighboring countries. Recently, there have been few additional reforms in Samoa. However, other Pacific countries have accelerated their reform programs, most notably, Tonga. The reform gap between Samoa and other Pacific countries is narrowing.

39. Although Samoa's economic performance has not been spectacular, its growth rates since the implementation of reforms have approximately doubled over the past 10 years. Nevertheless, the full potential of private sector development to contribute to higher growth rates and further reductions in poverty has still not been realized. Further reform could substantially increase the growth rate of the Samoan economy. This will require further strengthening of the institutional foundations of private sector development, and a reduction in the costs of doing business in Samoa.

B. Binding Constraints Issues

40. In its 2007 Article IV Consultation with the Government of Samoa, the International Monetary Fund (IMF) undertook an analysis of the binding constraints to growth as developed by Ricardo Hausmann, Dani Rodrik, and Andres Velasco.[6] The core of this analytic framework revolves around identifying whether the reasons for low private sector activity are the result of high financing costs or low rates of return on investment. The IMF report uses a decision tree to identify the key binding constraints to private sector development, and concludes that both low rates of return on investment and high financing costs are major factors in reducing the potential growth rate in Samoa.

41. The decision tree analysis identifies costly infrastructure, uncertainties arising from the land leasing framework, and excessive regulation as the key reasons for low rates of return on economic activity. The IMF report concludes that the factors underlying the high cost of finance are the inability to use land leases as collateral, the lack of credit information, other collateral issues, and low levels of foreign direct investment (FDI).

42. The following is a detailed examination of the constraints to raising the economic growth rate in Samoa. While it does not use the same classification of issues as the IMF report, its conclusions are similar.[7] This report goes beyond the IMF analysis and examines the binding constraints in detail. It is striking how these have changed over the past decade. In the mid-1990s, inflation at times exceeded 20%, the trade regime was distorted, and the fiscal deficit was large. Major progress has been made in eliminating most macroeconomic constraints that the binding constraints to growth are now primarily microeconomic in nature. However, the role of the state in the economy continues to be a major impediment to private sector development as it raises the costs of doing business and crowds out private sector activity. Other major binding constraints are weak property rights for both fixed and movable property, “thin” financial markets, problems with the commercial legal framework, barriers to developing the agricultural sector, an opaque and difficult foreign investment regime, with barriers to reform being compounded by the lack of formal discourse between the public and private sectors.

43. The following sections outline key issues and policy recommendations to improve the business environment and raise the country’s long-term growth potential. The most important include: infrastructure, state-owned enterprise (SOE) reform, corporate governance, financial sector reform, the legal framework for commercial activity, and policies affecting agriculture and tourism.

44. A theme of this report is that while the building blocks necessary for a business-friendly environment are being put in place, much remains to be done before Samoa can be described as a low cost location for doing business. Furthermore, the recent instability in other Pacific countries exposes the whole region to being categorized as unstable and risky. While this is patently unfair to Samoa, which has been a paragon of democracy and political stability, the perceptions of far-off investors are colored by developments in other countries in the region, and this is a reality which Samoa will have to manage. It makes the provision of a low cost business-friendly environment particularly important for future economic growth.

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[6] See Hausmann et al 2006.

[7] As Leipziger and Zagha (2006) point out, the identification of binding constraints to growth is a "disciplined art" more than a science. “The growth diagnostics framework brings numerous insights to the analysis of growth in developing countries and helps us test the strength of empirical evidence supporting specific policy and institutional reforms. That said, it remains a challenging and difficult approach. Behind the intuitive, methodic, and judicious use of price and other signals in the economy lies the enormously hard task of organizing and interpreting such signals.”

C. Costs of Doing Business: The Doing Business Indicators

45. Samoa is a costly place for doing business. It ranks relatively poorly in the World Bank's 2008 and 2007 *Doing Business* report at 61 and 60 respectively, a significant decline from its 2006 ranking of 39 despite the continued pace of reform.[8]

Table 3: World Bank Doing Business Indicators for Samoa

Ease of	Rank	
	2008	**2007**
Doing Business	61	60
Starting a Business	104	94
Dealing with Licenses	41	40
Employing Workers	15	14
Registering Property	58	60
Getting Credit	135	132
Protecting Investors	19	19
Paying Taxes	53	47
Trading Across Boarders	108	101
Enforcing Contracts	80	77
Closing a Business	129	129

Source: World Bank 2007 and 2008.

46. The growth potential of the Samoan economy has undoubtedly risen as a result of the earlier reforms. But while Samoa has been the fastest growing economy in the region, its growth rate has still been well below what it could be. Further reform could significantly raise the potential growth rate. The following sections discuss the priority areas for reform, in order of importance, in terms of binding constraints to growth.

D. The Role of the State in the Economy

47. The public sector still accounts for a large portion of overall expenditure in Samoa, with government spending equivalent to approximately 40% of GDP. For a country of Samoa's size and per capita income, this is a significant portion of total output. By comparison, when per capita GDP in Australia was equivalent to that of Samoa, government expenditure as a percentage of GDP was less than half of what it currently is in Samoa. Furthermore, in some sectors, particularly power generation, legally implemented monopolies raise costs and reduce productivity.

48. At present, the Government supplies most infrastructure services, has an extensive role in agriculture, and runs a number of businesses. Compared with the past, however, there has been a strong downward trend in the involvement of the state in the economy. Furthermore, if the Government's intentions with respect to future policy are carried out, the size of public sector expenditure should continue to decline, and competition should gradually be introduced as service provision is contracted out to the private sector. Loss making government enterprises have accounted for considerable spending in the past, with Polynesian Air being the most notable example. Following the sale of its international routes to Polynesian Blue and the intention to rationalize the operations of other SOEs, the drain on the budget will decline, providing both the opportunity to reduce taxes and increase expenditure on social services. To date, income and company tax rates have been equalized at 27%.

[8] There are several possible reasons for the deterioration in the Doing Business rankings in spite of reform: that other countries have reformed faster than Samoa over the past year; that the Doing Business indicators do not measure areas where Samoa has reformed; or that the Doing Business indicators do not accurately reflect conditions in Samoa. In discussion, Samoan officials rejected the results of the 2007 Doing Business rankings.

49. With the passage of the Public Bodies Accountability Act in 2001 and cabinet approval of the Policy Paper on SOE Ownership, Performance, and Divestment (SOE Policy) in 2003, the Government of Samoa established the principles by which it would place its SOEs on a commercial footing and divest all non-strategic SOEs.[9] This progressive new SOE law follows the first period of SOE reform from 1987 to 1996 when 21 SOEs were either divested or liquidated. In the absence of a formal legal and policy framework, these divestitures were conducted on an ad-hoc basis with mixed results. The new framework provides a sound basis for the restructuring of SOEs, the strengthening of their corporate governance practices, and the creation of a privatization pipeline to transfer non-strategic SOEs to the private sector. Despite the successful divestiture of three minority holdings and 45% of Polynesian Airlines in 2004–2005,[10] implementation of the new SOE framework has been proven difficult for a number of reasons outlined below.

50. SOE divestiture takes time even in the most buoyant markets. In Samoa, where the domestic market remains small, it could be more challenging still. While the smaller, more profitable SOEs should find ready buyers, others will require some pre-privatization restructuring and/or carving out of viable business lines for sale. Assessing the divestiture prospects of each SOE in the state portfolio would be an important step in preparing a more comprehensive SOE reform strategy going forward. Corporate governance reforms already underway and supported by technical assistance (TA) from ADB,[11] will be essential for improving the management and oversight of SOEs that will remain in state hands for the foreseeable future.

1. Infrastructure

51. Infrastructure plays a key role in generating economic growth and providing a solid foundation for private sector development. Reliable electricity frees local businesses from having to invest in costly back-up facilities. Widely available and affordable telephone services connect the Pacific islands to remote areas within their own countries and to distant markets throughout the world. Well functioning telecommunications are critical to bringing not only the benefits of technology to the countries in the region, but also the enormous power of the Internet to poorer communities. Transport services connect the Pacific countries to markets abroad and bring in tourists that are eager to experience their pristine beaches and distinctive culture.

52. Because of the public good nature of certain types, or even portions of infrastructure, in even the most market-oriented economies, these are still provided through the public sector. Nevertheless, there are many alternative ways to provide infrastructure services, and the most efficient means usually involve major private sector involvement. In most countries where infrastructure functions effectively, the Government finances facilities that are built by the private sector.

53. Samoa has been the Pacific's leader in infrastructure reform, particularly in the areas of telecommunications and transport. The recent arrival of the mobile telephone service provider, Digicel, is having a dramatic impact on the cost of telecommunications. And the sale of the international routes of Polynesian Air has lowered the cost of air travel to Samoa overnight, bringing an increased number of tourists to the country and benefiting Samoans visiting their relatives abroad. Furthermore, SOE corporate governance policies are helping to make public enterprises more efficient.

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[9] Strategic SOEs are the Samoa Airport Authority, Electric Power Corporation, Samoa Ports Authority, Samoa Water Authority, and the Samoa Shipping Corporation. All others are to be divested.

[10] The Polynesian Airlines transaction has relieved a significant burden on government finances as the airline had been absorbing the equivalent of 1% of GDP per year in subsidies and transfers.

[11] Strengthening State-Owned Enterprise Corporate Governance (TA No. 4513–SAM), approved in 2004.

54. At the same time, however, much remains to be done. A significant portion of the economy remains in state hands, and in several key sectors, considerable inefficiencies raise costs for the private sector without any corresponding benefits. Nevertheless, the Government has expressed its determination to continue to improve infrastructure services and corporate governance in the public sector.

55. Although government intends for major SOEs[12] (with the exception of mobile telephone services and Internet provision) to remain 100% government-owned, policy will gear toward allowing private sector participation in partnership with these SOEs. Given the existing legal framework and small size of the infrastructure markets in Samoa, private sector participation can take two basic forms:

(i) The contracting out of non-core functions to the private sector; and

(ii) Public-private partnerships (PPPs) for the execution of core functions, including joint ventures, management contracts, asset leases, and build-operate-transfer (BOT) arrangements for additional service capacity (e.g., in power generation and water and wastewater treatment).

56. Despite improvements, the high cost and poor quality of infrastructure provided either directly by the state or by SOEs have been obstacles to the growth and development of the private sector in Samoa. Electricity costs are among the highest in the Pacific,[13] reflecting the rising cost of fuel inputs, the inefficient tariff structure, and shortfalls in management of the state-owned monopoly. And although treated water charges are comparatively low, service remains erratic. These high costs depress the competitiveness of export industries, while the capacity constraints of state-owned utility companies inhibit investment growth in productive sectors. The success in bringing down telecommunications costs shows the expected benefits of private sector involvement and the budgetary advantages of private provision of services in wide areas of the economy.

57. Table 4 summarizes the current and potential future modes of private sector participation in infrastructure.

Table 4: Private Sector Participation in Sectors of Infrastructure

Sector	Current Modes of Private Sector Participation	Potential Future Modes of Private Sector Participation
Power	• Private provision of selected Electric Power Corporation maintenance and disconnection services	• Unrestricted self generation • Provision of existing private generation capacity to the Electric Power Corporation • Build-operate-transfer scheme for new generation facilities • Private provision of metering and billing services
Water	• Village schemes providing water to 15% of the population • Private construction of a new pressure sewer system for Apia	• Design-build-operate scheme for proposed wastewater treatment plant in Apia (ADB loan)
Airports	• Private provision of light maintenance and retail concessions	• Private provision of ground handling, heavy maintenance, and airport management

[12] Samoa Water Authority, Electric Power Corporation, Samoa Ports Authority, Samoa Airport Authority, and Samoa Shipping Corporation. The soon to be formed Samoa Land Transport Authority is also expected to have “strategic” status, while SamoaTel is open to privatization.

[13] Electricity is currently billed at US$0.25/KwH, significantly higher than the US$0.16/KwH in the Fiji Islands, yet lower than in Tonga and Vanuatu.

Ports	• Private provision of stevedoring, cargo handling, and heavy maintenance services	• Private provision of port management • Build-operate-transfer scheme for future ports
Roads	• Private provision of engineering, construction, and maintenance services	• Not applicable
Transport	• Private provision of international passenger ferries and airline services	• Private provision of domestic sea and air transport services (on a subsidized basis) • Management contract for Samoa Shipping Corporation

2. Telecommunications

58. The telecommunications sector has undergone significant restructuring over 2006 with the entry of a new mobile telephone service operator, Digicel,[14] and the establishment of an independent regulator. Competition increased further in January 2007 when the state-owned fixed line operator, SamoaTel, entered the mobile market, and international gateway access was liberalized. In preparation for the anticipated loss of an estimated 30% of its international revenue, SamoaTel rebalanced both local and international tariffs, resulting in a 50% decrease in international call rates as of July 2006. International mobile phone rates have also fallen by more than 50% since Digicel entered the market and introduced GSM[15] technology as the successor to the TDMA[16] technology of the incumbent, Samoa Telekom Cellular.

59. Total telephone penetration is about 30% of the population (i.e., there are currently 20,000 fixed line and 90,000 mobile subscribers). Fixed line telecom density has increased from 6.8% of the population in 2003 to 11.2% in 2006. Mobile density has increased from 3.9% in 2003 to 19.4% in 2006. Estimates of how many more subscribers the market can absorb vary between 25,000 to 70,000, and will depend on the success of the marketing strategies of the two operators[17] going forward.

60. There are currently three internet service providers (ISPs), and the regulator has received applications for five more, although this is difficult to reconcile with the potential profitability of the investment, as currently the number of computers being used is relatively low. The ISPs access wholesale international data rates through SamoaTel and are free to set up their own national networks. Currently, there are no plans to allow ISPs to access their own international service.

61. In 2007, SamoaTel introduced higher speed Internet service through ASDL2[18] technology to its fixed line subscribers, mainly in the Apia area. While the broadband service has higher transmission speeds compared to dialup service, satellite Internet technology is expensive, has severe bandwidth limitations, and inherent latency problems which limit broadband speeds and voice over IP applications.

62. While the opening up of the telecommunications market to competition has provided immediate cost savings to consumers, it has also created regulatory challenges. Chief among them are the development of an equitable interconnection regime, the regularization of the licensing procedures, the management of international gateway access, and the

[14] Digicel also purchased the existing infrastructure and customer base of the incumbent monopoly mobile telephone service provider, Samoa Telekom Cellular.
[15] global system for mobile communications.
[16] time division multiple access.
[17] SamoaTel and Digicel.
[18] asymmetrical digital subscriber line.

establishment of a compensation regime for SamoaTel's universal service obligation. These are currently being addressed by the Office of the Regulator. Looking forward, the sector reform agenda will also include an assessment of options for the privatization of SamoaTel.[19] This analysis will involve a review of the options for spinning off or contracting out the postal activity which SamoaTel still retains.

3. Power

63. Electricity generation, transmission, and distribution is provided by the state-owned Electric Power Corporation (EPC). EPC's 35 megawatt (MW) generation capacity is provided by eight hydropower plants in Upolu (12.2 MW) and diesel generators in both Upolu and Savai'i (22.8 MW). This capacity is insufficient to meet peak demand requirements on an N-2 basis, and blackouts are reportedly frequent.[20] Spot load growth is expected to drive demand going forward, most notably with the possible addition of several new hotels in 2007–2009, and the spike in use related to the 2007 South Pacific Games.[21] Compounded demand growth for 2007–2009 on Upolu and Savai'i is projected to be around 4.2% and 2.2% respectively, placing further demands on generating capacity.

64. The Electric Power Corporation Act of 1980 implicitly assumes that EPC represents the electricity sector. Private power generation is allowed under license,[22] but such licenses are being issued for standby gensets only to meet emergency demand requirements. It is estimated that up to 9 MW of additional generation capacity is available within the existing gensets of captive users,[23] and that some of these are large enough to generate and resell power to other consumers. Given the growing demand for power, unleashing the generation capacity already available within the private sector (by allowing self generation and resale) will be an important step in meeting this demand and preparing the market for greater private sector participation.[24]

65. To this end, the Government has agreed to develop a new regulatory framework to govern all stakeholders, including the private sector. Thus, the Act will be revised to govern EPC, and the new regulatory framework will govern the sector. In the near term, existing captive power capacity will become available to use or resell as needed.[25] In the medium and long term, the Government and EPC will be looking to actively encourage independent power producers.[26]

66. Concurrent to these reforms, a significant strengthening of EPC's operational systems, corporate governance practices (i.e., independence), and value-added and goods and services tax (VAGST) status is in order. Weak management information systems hinder effective decision-making, and political interference has lead to poor revenue collection and eroded the company's cash flow, leaving it unable to meet its debt service obligations and restraining needed capital investments. Moreover, while the company pays VAGST on all inputs, it does not receive full reimbursement for the VAGST paid from the Government, nor

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[19] TA is being provided by the World Bank's ongoing Telecommunications and Postal Sector Reform Project.
[20] The hotel industry is particularly critical of the power supply, indicating that the quality is erratic and reduces the competitiveness of the industry.
[21] Three planned hotels may require an increase in capacity of 1.100 MW (plus losses). The South Pacific Games facilities will increase demand by some 1.500 MW (plus losses), but will be transient in nature.
[22] Part IV, Section 24 of the Electric Power Corporation Act specifies that power generation requires a license from the Licensing Committee.
[23] It is estimated that approximately 4 MW of this could be made available to the grid with investments in transmission lines.
[24] It should be noted that EPC has its own plan for adding 4 MW of capacity to Upolu in 2007–2008 with a A$6 million investment in a coconut-based fuel plant.
[25] While licensed, private genset owners will be free to self-generate and sell power to third parties. However, the cost of installing new transmission connections may make the sale of power unattractive.
[26] The introduction of a fully competitive generation market, where existing and new power producers compete to supply power to EPC for distribution through the grid, is not under consideration at the moment due to the small size and limited regulatory capacity of the market.

can it pass on the VAGST cost to its customers, further eroding its financial position. Lastly, the company has been proven unable to accurately cost and extract compensation from the Government for its community service obligations (CSOs), which it estimated at over ST16 million in FY2006.[27]

67. While some CSOs carried out by EPC have some or all of their costs reimbursed (e.g., capital expenditures categorized as CSOs), others do not. There is a need for a clearer definition of what CSOs EPC are to carry out, how they will be measured and costed, and how they will be reimbursed. In the long term, those non-commercial CSOs that can be carved out of EPC should be contracted out to the most efficient service provider.

68. Samoa has among the highest electricity tariffs in the Pacific,[28] yet EPC revenues remain insufficient to cover costs.[29] A new 15% tariff increase was made effective in early 2007, representing the second 15% tariff increase since 2001—a period during which the cost of fuel, expressed in local currency, increased more than twofold.[30] Reducing the cost of supply will require a longer term fuel diversification strategy and significant operational efficiency improvements.

69. From the user's perspective, harnessing the existing private diesel generation capacity should provide immediate benefits, relieving demand on the grid at peak times. It would also unleash underutilized value in the existing gensets. Over the long term, the formal contracting of independent power producers should help reduce costs, especially as additional renewable energy capacity is added to reduce dependence on diesel. Future hydropower projects could represent opportunities for private investment on a design-build-operate (DBO) or design-build-operate-transfer basis. It should be noted, however, that given the role of EPC as the sole power purchaser in the market, potential suppliers may view EPC's weak financial position as creating payment risk that would need to be covered through higher pricing and/or a government guarantee.

70. Ongoing TA from ADB[31] is being provided to EPC to support capacity building, reform regulatory arrangements, and facilitate greater private sector participation in the electricity market. Key outputs of the TA include:

(i) Improved governance, management, planning, budgeting, and procurement systems at EPC; and

(ii) A tariff regime and regulatory framework[32] for the electricity market that allows private power generation.

71. Together with the corporate governance reforms supported through ADB TA,[33] these efforts, which will require a more commercial orientation from board members, should both significantly improve EPC's operating efficiencies and prepare the necessary groundwork for expanded private sector participation in the power sector.

[27] Total CSO payment to EPC was ST10.7 million in FY2006.
[28] Weighted average cost is currently just under US$0.28/KwH.
[29] Operational inefficiencies, system losses, and the rising cost of diesel fuel continue to erode the company's profitability.
[30] In 2005–2006, the cost of fuel represented 77% of the total generation cost and 53% of EPC's overall costs.
[31] Preparing the Power Sector Expansion Program (TA No. 4791–SAM), approved in 2006.
[32] Regulation will be needed to ensure that appropriate levels of cost recovery are being applied to the distribution network and the retail business. Such regulation may be possible by extending the responsibilities of the existing telecommunications regulator or by extending the energy planning and SOE monitoring activities currently undertaken from within the Ministry of Finance.
[33] Strengthening State-Owned Enterprise Corporate Governance (TA No. 4513–SAM), approved in 2004.

4. Water and Wastewater

72. The state-owned Samoa Water Authority (SWA) supplies water to 85% of the population[34] with a combination of raw and treated water, while 24 village-operated schemes service the remaining 15%. The SWA operates four water treatment plants in Upolu and one in Savai'i, which are sufficient to meet the growing demand of the population for at least the next 5 years. Inadequate maintenance and metering systems have resulted in very high non-revenue water losses of 40%. With poor payment recovery systems and the additional burden of CSOs, SWA revenues cover only 60–65% of its operating costs on average. SWA remains in a very weak financial position, with 2007 losses of ST4.6 million on revenues of ST11.3 million. Accumulated losses exceed ST23 million or close to 25% of total assets, while net trade receivables totaled ST2.6 million or 177 days of credit sales in FY2006. SWA continues to request CSO payments averaging ST5–7 million per year to cover its operating deficit, yet is not able to more precisely define the costs of its CSOs. Government payments for CSOs have been averaging 50% of the request. Commercial water tariffs remain well below cost recovery, and at ST0.53/cubic meter are among the lowest in the region. Tariffs for commercial users have not been been increased since 2002. While the company's financial position remains precarious, improvements are to be expected from reducing non-revenue water and improving collections—initiatives that are currently underway.[35] Beyond these measures, efforts must also be made to effectively define and cost CSOs so that they can be contracted through output-based subsidy agreements.

73. Sewage is managed through individual septic systems and industrial wastewater by the producers of the wastewater. Private sector participation in the sector today is focused on the operation of village schemes, the installation of pipes, construction of reservoirs, and septic pumping. There is scope for more private sector participation in a number of areas, namely:

(i) Support to SWA to detect and repair leaks;

(ii) Operation and maintenance of pipe systems;

(iii) Village system repairs; and

(iv) DBO for a new wastewater treatment plant in Apia.

74. Through the ADB-financed Sanitation and Drainage Project,[36] Samoa's first sewage treatment plant will be built in Apia on a DBO scheme with a proposed 5 year operational contract. Costs of the project are estimated at US$2.26 million, and tendering has recently been completed with an award notification issued in May 2008.[37] Additional private sector participation will also be possible in the disposal of sludge from the facility.

5. Transportation

a. Ports

75. The commercial port system in Samoa is owned and operated by the Samoa Ports Authority (SPA), a 100% state-owned enterprise formed under the Samoa Ports Authority Act of 1998. SPA is structured as a landlord port, and operates four commercial ports, although the Apia port is by far the largest and the only port with container handling facilities. SPA is one of six SOEs considered strategic by the Government and is, therefore, not

[34] 18,000 households.

[35] Unaccounted-for water was reduced from 72% in 2001 to 44% in 2002 and 40% in 2005. Billing collection rates have also improved from 52% in 2001 to 80% in 2002. An ongoing program to further improve pipe leakage detection and repair is supported by the €19 million Water Sector Support Program funded by the European Union.

[36] Sanitation and Drainage Project (Loan No. 2026–SAM), approved in 2003.

[37] Tendering was conducted in the first quarter of 2007, but offers received were judged non-compliant, so a second tender was undertaken which is now complete.

positioned for privatization. However, commercial functions within the port are open to private contractors.[38] Private companies currently provide a number of landside services, such as stevedoring, container handling, and major maintenance, while SPA provides the waterside services of pilotage and dredging as well as overall security.

Box 1: Crowding Out of Private Sector Investment

The recent investment by the Samoa Ports Authority (SPA) in the development of a purely commercial yacht marina is a clear example of the crowding out of private investment opportunities by public enterprises. The construction of this yacht marina, which was completed in late 2007 is being financed by SPA at a cost of ST$3.7 million. Such an investment is beyond the core roles of SPA, and it is not strategic. Interest in such a facility could have been advertized locally and internationally to call for expressions of interest in either a public-private partnership or a stand-alone private investment. Such investments should be undertaken by the private sector, which would provide the risk capital and, subsequently, the commercial management of the facility.

76. Despite the company's low capital costs, due largely to the Government's transfer of major assets as equity injections, SPA has provided very low returns on investment (0.6% and 0.2% in 2006 and 2007, respectively).[39] This is far below the returns on equity of major commercial ports in the region, including the Ports of Auckland which returned 20–26% per year from 2003–2006. According to SPA management, future investments will need to be supported with commercial bank financing. This could put a significant strain on the company. While no large investments will be necessary within the next 3–4 years, if container throughput continues to increase at its current rate of 10–12% per year, port capacity will be exceeded by 2009.[40] The Apia port cannot be extended at its current location, so an alternative site will be required. It is unclear if a new port project could attract private investment on a BOT or joint venture basis, given the low level of revenues currently generated by the port. Container fees are ST230–350 per container, at par with those of regional ports. Users consider the port as quite efficient, with faster turnaround times than others in the region.[41]

77. The low profitability of SPA suggests opportunities for efficiency improvements that could possibly be introduced through a performance-based management contract. This option should be explored as part of a general review of PPP opportunities in the infrastructure sector. Beyond this, there appear to be few additional opportunities for private sector participation in the port sector, except possibly in the development of new port facilities in Upolu and Savai'i. The current legal framework would allow for such investment, but it is unclear whether market conditions would make these investments financially viable. A more thorough assessment of port infrastructure demand should be conducted jointly by the Ministry of Works, Transport and Infrastructure (MWTI), SPA, and port users to identify future bottlenecks, and determine the most cost effective solutions for increasing existing capacity.

b. Airports

78. The commercial airport system in Samoa is owned and operated by the Samoa Airport Authority (SAA), a 100% state-owned enterprise formed under the Samoa Airport Act of 1984. SAA is structured as a landlord airport operator and manages three airports,[42] although the Upolu airport is by far the largest and the only one with sufficient traffic to potentially be profitable. The remaining two airports in Savai'i see very little traffic and are

[38] The 2003 SOE Policy does not exclude this possibility. However, contracting private management of the port has yet to be considered by the Government.
[39] The 2004 Apia wharf extension, financed through a grant of ST65 million from the Japan International Cooperation Agency, is a recent example.
[40] Annual container throughput capacity is 35,000 units, while current throughput is 10,000–12,000 units.
[41] While port users are generally happy with the level of service provided by SPA, they expressed concern about the recent leasing of SPA land behind the port for hotel development, as this project will require the container handling companies to reduce noise levels at the port.
[42] One in Upolu and two in Savai'i.

operated at a net loss of ST0.2 million per year, which is not reimbursed by the Government as a CSO. While SAA is considered strategic by the Government and is, therefore, not positioned for privatization, commercial functions within the airport are open to outsourcing. This has been done on a limited scale thus far (e.g., retail space operation and ground handling).[43] Opportunities for further outsourcing exist in maintenance services, workshop operations, security and rescue—services which SAA's 200 staff currently provide. Ground handling is currently provided by Polynesian Airlines on an exclusive basis, with no concession fees remitted to SAA. According to SAA, revenues from ground handling could be as high as ST4 million per year.

79. SAA operates at a net loss, generating ST2.0 million in losses on ST9.2 million in revenue in FY2006, and an estimated ST0.8 million in losses on ST9.4 million in revenue in FY2007. On average, 40% of revenue is generated by airport taxes, 30% by landing fees, and 30% by rental income on commercial space. Management indicates that its earnings before interest, taxes, depreciation, and amortization is positive, but high depreciation and financing costs result in net losses. However, an increase of 15–20% in passenger traffic would allow the company to cover its high level of fixed costs and break even on a net basis. While an increase in passenger volume could be accommodated with very little increase in variable costs, there are undoubtedly efficiency gains that could also allow the company to reduce its net deficit. Increased outsourcing of non-core airport services should be explored, including the competitive tendering of a ground handling contract that generates a concession fee to SAA.

c. Roads

80. The road network in Samoa is the responsibility of the MWTI, which manages and maintains the 880 kilometers of roads, over 90% of which are paved. The condition of the road network is considered adequate by the business sector, although the future development of agribusinesses may require the building of more roads to and from the more remote plantations. The MTWI has been at the forefront of the Government's efforts to restructure public administration and cooperate with the private sector where possible. In 2003, the MWTI implemented a program designed to encourage employees to create private enterprises that provide services to the public sector. A total of 180 employees from MWTI participated in the program, creating construction, design, and engineering firms, all of which are still thriving today despite the expiry of their three-year exclusive contracts with MWTI. The Ministry estimates that as a result of the program, it is now able to achieve more than 400% the productivity and output with the same budget. The MWTI now focuses essentially on policy matters, having outsourced virtually all of its commercial functions.

d. Move to Right Hand Drive

81. In mid-2007, the Government announced its intention to change the side of the road upon which vehicles travel from the right side of the road to the left, or as the debate in Samoa has come to describe the move, from left hand drive (LHD) vehicles to right hand drive (RHD). The rationale for the move to RHD appears to be based on the notion that imported vehicles from Australia, Japan, and New Zealand (where the cars are RHD) will be cheaper than cars sourced from America. The other justification is that it will be easier for family members resident in Australia and New Zealand to send cars to family members still residing in Samoa. This may be the case, but again, no empirical evidence has been submitted to support either justification.

82. In April, the Government passed the law mandating the move to RHD. Anecdotal evidence suggests that private sector investment has slowed significantly as a result of the uncertainty. Cars are a major source of security for bank lending on personal loans, and

[43] As is the case with the Samoa Ports Authority, private management of the airport(s) could be considered under the framework of the current SOE Ownership and Divestiture Policy.

banks reacted to the announcement of the move to RHD by reducing the security value of the existing car stock by 30% to 50%. The security gap had to be filled by the use of personal guarantees to support personal debt. In a country where levels of personal debt are already high, the use of personal guarantees will increase the overall leverage of the population, which among other factors, will mean that the average Samoan is less able to adsorb the effects of adverse economic shocks.

83. Only time will tell whether the move to RHD is positive or negative for the Samoan economy. However, with the passage of the empowering Act, the fact that there is certainty that this will now happen, means that investment and purchase decisions deferred during the debate period, would now take place.

e. Transportation Services

84. Transportation services in Samoa are provided by a combination of public and private service providers that operate largely on a competitive basis.

Table 5: Transportation Service Providers

Transport Service	State-Owned Enterprise	Private Companies
Domestic passenger ferry	Samoa Shipping Corporation	No [a]
International passenger ferry	Samoa Shipping Corporation	Yes
Domestic airline	Polynesian Airlines	No
International airline	Polynesian Blue (minority)	Yes
Bus and taxi	–	Yes
Trucking	–	Yes

[a] Although domestic passenger ferry services are open to private providers, none are operating these routes due to their low profitability at the current set fare level.

85. Polynesian Airlines, whose long haul routes were sold to form Polynesian Blue, operates with competition on its remaining international routes[44] and without competition on its domestic routes. While there are no restrictions to competition on these routes, they are not profitable and would, therefore, need to be contracted on a fee for service basis (as a CSO) in order to attract private service providers. The company is currently undergoing financial restructuring to shore up operating losses, but should also prepare its remaining operations for competitive tender (including its ground handling contract) to the most efficient service provider. As part of this exercise, a thorough cost-benefit analysis of the social objectives met with continued operation of the unprofitable routes should be conducted.

86. Apart from Polynesian Airlines, the only other SOE involved in passenger transport is the Samoa Shipping Corporation (SSC), which operates domestic ferries between Upolu and Savai'i, and international service between Apia and Pago Pago. While no private operators have found the domestic routes profitable enough to compete with SSC, competition does exist in the international routes. SSC generated a return on equity of 4% in FY2007, which would have been notably lower had the company been operating on a commercial basis. For example, SSC has had a significant advantage in that two of its four vessels were funded by aid from the Japan International Cooperation Agency and leased to SSC by the Samoan Government (World Bank 2006).

87. In summary, the private sector dominates transport services provision in Samoa, with the exception of selected airline and ferry routes that are not profitable on a stand-alone basis. Further analysis of the benefits provided by these routes should be conducted and evaluated against the cost of subcontracting the services to the most efficient provider.

[44] International routes are from Apia to American Samoa, Tonga, Niue, and Nadi (code share).

E. State-Owned Enterprise Reform

88. With the passage of the Public Bodies Accountability Act and the SOE Policy,[45] the Government of Samoa established the principles by which it would place its SOEs on a commercial footing, and divest non-strategic SOEs.[46] This progressive new policy and SOE law follows the first period of SOE reform from 1987 to 1996 when 21 SOEs were either divested or liquidated. In the absence of a formal legal and policy framework, these divestitures were conducted on an ad-hoc basis, with mixed results. The new framework provides a sound basis for the restructuring of SOEs, the strengthening of their corporate governance practices, and the creation of a privatization pipeline so that non-strategic SOEs can be transferred to the private sector. Despite the successful divestiture of three minority holdings and almost half of Polynesian Airlines in 2004–2005,[47] implementation of the new SOE framework has been proven difficult for a number of reasons outlined in the following section.

89. SOE divestiture takes time even in the most buoyant markets. In Samoa, where the domestic market remains small, it can be more challenging still. While the smaller, more profitable SOEs should find ready buyers, others will require some pre-privatization restructuring and/or carving out of viable business lines for sale. Assessing the divestiture prospects of each SOE in the Government's portfolio would be an important step to preparing a more comprehensive SOE reform strategy going forward. Corporate governance reforms, already underway and supported by ADB TA on Strengthening State-Owned Enterprise Corporate Governance[48] will be essential for improving the management and oversight of SOEs that will remain in state hands for the foreseeable future.

1. The SOE Portfolio, Privatization, and Reform

90. This section describes the SOE portfolio and current status of the Government's privatization program, and makes some preliminary recommendations to help maintain the current momentum for reform. An overriding recommendation is the need to strengthen the State-Owned Enterprise Monitoring Division (SOEMD) which is responsible for the implementation of both the Public Bodies Accountability Act and the SOE Policy. Currently, the SOEMD does not have the necessary resources to effectively execute this mandate. In some countries, whole ministries are focused on SOE reform and management (e.g., the Fiji Islands), while in others, special bodies have been formed with donor support to undertake the process of SOE reform (e.g., the Privatization Commission in Papua New Guinea, supported by the Government and the World Bank). Based on the Samoan Government's commitment to SOE reform, it is suggested that consideration be given to establishing an agency with a specific charter for SOE reform and management, and that TA be provided to strengthen the existing capabilities in financial analysis, accounting, corporate governance, privatization planning, and execution of transactions.

a. The SOE Portfolio

91. The SOE portfolio is comprised of 24 SOEs (18 for-profit trading bodies and 6 non-profit beneficial bodies).[49] The SOEs play an important role in the economy, contributing the lion's share of the state sector's 40% of GDP. The SOEs employ approximately 3,000 workers, or 15% of the active workforce, to generate a total of ST400 million in revenue in

[45] The Public Bodies Accountability Act was passed in 2001. The SOE Policy was approved by Cabinet decision FK 03/27–23 in July 2003.
[46] Strategic SOEs are the Samoa Airport Authority, Electric Power Corporation, Samoa Ports Authority, Samoa Water Authority, and the Samoa Shipping Corporation. All others are to be divested.
[47] The Polynesian Airline transaction has relieved a significant burden on government finances as the airline had been absorbing the equivalent of 1% of GDP per year in subsidies and transfers.
[48] Strengthening State-Owned Enterprise Corporate Governance (TA No. 4513–SAM), approved in 2004.
[49] Samoa Polytechnic, National University of Samoa, Apia Park Board, Samoa Tourism Authority, Samoa Qualifications Authority, and the National Kidney Foundation.

FY2005. SOEs also play a significant role in the financial sector, albeit more as providers than consumers of commercial credit.[50] As a whole, the SOE portfolio generates a net deficit,[51] as SOEs continue to operate inefficiently and engage both willingly and unwillingly in non-commercial or unprofitable activities estimated at over ST30 million annually.[52] With the sale of its stake in Polynesian Airlines in 2005, the situation is improving, although the SOEs continue to generate low or negative returns on the already scarce capital resources available to the Government. In 2005, the return on equity on the entire portfolio was 3.3%, an exceedingly low number, far below current risk-free deposit rates.

92. To review the SOE portfolio more effectively, the 18 for profit SOEs have been divided into three categories in Table 5:

(i) Three mutual companies which are owned by their contributors and do not pay a dividend to the Government; [53]

(ii) Five SOEs categorized as "strategic" by the Government, and which are therefore to remain in state hands; and

(iii) Ten SOEs which, according to the SOE Policy, should be divested.

93. The Table summarizes the FY2006 and FY2007 audited financial statements of the SOEs. The data show that of the three groups, the largest, by far, in terms of assets and losses is the "strategic enterprise" group or those SOEs engaged in providing essential public services. These SOEs (EPC, SAA, and SWA, in particular) need comprehensive financial and operational restructuring, including corporate governance and CSO policy reform. To be successful, these restructuring efforts need to be combined with tariff adjustments that allow for full cost recovery. The EPC is currently developing a restructuring plan with support from ADB[54] and SWA is undergoing operational reforms under ADB TA.[55] However, SAA has not yet developed a restructuring plan, which should be pursued urgently.

94. The three SOEs that are mutual companies generate some of the highest returns in the portfolio. One of these companies, the National Provident Fund is, in fact, the largest financial institution in the country, with ST353 million in assets as of June 2007. As these three SOEs are owned by their members, they are effectively "private," so the oversight role of the SOEMD is limited to ensuring their compliance with the Public Bodies Act. The more technical oversight issues, such as risk management, are left to the Central Bank as the financial sector supervisor.

95. For the 10 SOEs that are available for privatization, the aggregate financial picture is problematic, with a return on equity of just 4.1% for the financial year ending June 2007.[56] These SOEs, with the exception of Samoa Land Corporation (SLC), Samoa Trust Estates Corporation (STEC), and Samoa Shipping Services (SSS), combine purely commercial business activities with non-commercial ones (i.e., CSOs) for which they do not always receive compensation. In most cases, the SOEs already compete with the private sector in business activities that are purely commercial. While 7 of the 10 SOEs slated for privatization have at least one or more viable business activities that could be of interest to

[50] The private sector accounted for an estimated 64% of total financial institution credit outstanding in FY2006. The two largest state-owned credit institutions, the Development Bank of Samoa and the National Provident Fund accounted for an estimated 31% of total credit outstanding in FY2006.
[51] Over the five-year period 1997–2001, total government inputs to SOEs, either as capital injections or grants, totaled US$173 million. Estimates of comparable costs from 2002 to the present are under development.
[52] This is the total CSO compensation request from the SOEs for FY2006, of which ST15 million was paid. The Ministry of Finance's calculation of compensation due for CSOs is based on the guidelines provided by the Public Accountability Act.
[53] National Provident Fund, Accident Compensation Board, and Samoa Life Insurance Corporation. These companies cannot be considered SOEs in the same sense as the other 15 as the Government does not have any claims on the underlying equity.
[54] Preparing the Power Sector Expansion Program (TA No. 4791–SAM), approved in 2006.
[55] Institutional Strengthening for Drainage and Wastewater Management (TA No. 4229–SAM), approved in 2003.
[56] This figure for FY2005 does not include Polynesian Airlines which has since been partially privatized.

private investors (including current management), two of the SOEs are struggling to demonstrate any commercial prospects. These SOEs (the Public Trust Office and STEC), should consider redeploying their assets to better use, as STEC has already begun doing by selling off some of its land holdings. STEC, along with SLC, is in a unique position as one of the largest landowners in Samoa, and regularly receives expressions of interest from agribusinesses and property developers. Given its poor track record in extracting value from the land and the shortage of non-customary land available for lease, proposals from potential lessors should be actively reviewed. The Public Trust Office, which administers estates and prepares wills, is technically insolvent and appears to have few prospects for recovery in its current form. An asset sale may allow the Government to extract some value to retire a portion of the company's substantial liabilities. Another potentially problematic SOE on the privatization list is Polynesian Airlines, which is still trying to determine whether its remaining activities are viable as a going concern. In its downsized form, it is greatly exposed to increases in fuel costs and is competing with two private operators on the Western Samoa to American Samoa route. As the airline has no community service activities, it should be either wound up or sold. The seven remaining SOEs all have reasonable prospects for successful privatization and should now be prepared for sale.

Table 6: A Summary of SOEs' Audited Financial Statements for FYs2006 and 2007
('000 Tala)

Public Trading Body	Total Revenue		Net Profit/Loss Before Tax		Total Assets		Total Liabilities		Return on Equity (%)
	2007	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**
Mutual Institutions									
1. Samoa National Provident Fund	27,788	23,792	18,999	15,965	353,415	326,865	10,180	13,370	5.5
2. Accident Compensation Corporation	11,453	10,123	6,414	5,508	54,593	49,852	1,468	3,141	12.1
3. Samoa Life Assurance Corporation	8,581	7,936	789	707	32,105	31,433	920	842	2.5
	47,822	**41,851**	**26,202**	**22,180**	**440,113**	**408,150**	**12,568**	**17,353**	**6.1**
Strategic Enterprises									
4. Electric Power Corporation	77,936	66,572	2,543	1,436	210,607	211,391	56,735	66,621	1.7
5. Samoa Ports Authority	11,188	10,844	82	244	124,900	117,794	86,321	79,260	0.2
6. Samoa Water Authority	11,334	13,210	-4,644	-2,481	98,038	98,892	2,970	2,759	-4.9
7. Samoa Airport Authority	9,365	9,156	-825	-2,025	61,597	64,729	25,948	31,259	-2.3
8. Samoa Shipping Corporation Limited	14,070	14,429	400	2,196	16,886	17,638	7,606	9,709	4.3
	123,893	**114,211**	**-2,444**	**-630**	**512,028**	**510,444**	**179,580**	**189,608**	**-0.7**
Privatizable									
9. Samoa Tel	61,754	52,270	7,835	9,495	135,321	126,161	67,288	64,454	11.5
10. Development Bank of Samoa	9,733	9,087	-719	185	134,545	96,256	74,192	63,585	-1.4
11. Samoa Land Corporation	5,902	4,290	481	-376	46,860	48,565	26,566	33,767	2.4
12. Samoa Trust Estates Corporation	498	2,812	-719	1,657	45,147	45,166	2,310	1,695	-1.7
13. Polynesian Airlines Limited	20,397	12,077	2,044	-4,025	13,834	12,793	24,100	25,099	-19.9
14. Samoa Housing Corporation	2,286	1,925	308	161	21,755	17,776	7,937	4,361	2.2
15. Agricultural Stores Corporation	5,274	5,004	214	-184	8,492	7,760	786	1,228	2.8
16. Samoa Shipping Services Limited	5,164	5,590	-454	325	3,865	4,946	2,917	3,151	-47.9
17. Public Trust Office	608	468	-539	-858	3,693	3,508	7,239	15,366	15.2
18. Samoa Broadcasting Corporation[a]	3,149	3,227	-134	259	3,724	3,844	713	700	-4.5
	114,765	**96,750**	**8,317**	**6,639**	**417,236**	**366,775**	**214,048**	**213,406**	**4.1**
TOTAL	**286,480**	**252,812**	**32,075**	**28,189**	**1,369,377**	**1,285,369**	**406,196**	**420,367**	**3.3**

[a] Figures are for 2005 and 2006.
FY = fiscal year.
Source: Government of Samoa, Ministry of Finance, State-Owned Enterprise Monitoring Division.

b. Community Service Obligations

96. Many of the SOEs are required to provide subsidized or free services to communities through CSOs. In the past, they were expected to defray these expenses by raising charges to paying customers—a process generally known as cross-subsidization. Today, the Public Bodies Accountability Act allows SOEs to claim reimbursement from the Government for the cost of providing CSOs. Conflicting interpretations of what constitutes a CSO have led to SOEs requesting CSO payments for services that they are under no explicit obligation to provide or simply cannot provide efficiently. Similarly, there appear to be cases where SOEs fulfill CSOs that do not qualify for direct compensation. Table 7 lists the SOEs that filed for CSO compensation in FY2006 and other potential CSOs for which no direct compensation has been sought.

Table 7: Community Service Obligations of State-Owned Enterprises

State-Owned Enterprise	Community Service Obligation Claims
Electric Power Corporation	Various
Polynesian Airlines Limited	Uneconomic routes
Samoa Broadcasting Corporation	Religious service broadcasts free of charge
Samoa Housing Corporation	Establishment of remote branch
Samoa Water Authority	Electricity for boreholes
	Free water supply

State-Owned Enterprise	Potential Community Service Obligations
Agriculture Store	Subsidized chemical distribution
Polynesian Airlines Limited	Uneconomic routes
Samoa Airport Authority	Operation of remote airports
Samoa Housing Corporation	Establishment of remote branch
Samoa Ports Authority	Operation of remote ports
	Navigation markers
Samoa Shipping Corporation	Operation of domestic ferry services at capped fares
	Training of Samoan seamen
SamoaTel	Universal service obligation
	Postal services

Source: Government of Samoa, Ministry of Finance, State-Owned Enterprise Monitoring Division.

97. As in most countries, the bulk of CSO payments in Samoa have gone to the power sector. In FY2006, EPC received ST10.7 million of the ST14 million provided for all CSOs,[57] while SWA and the Samoa Broadcasting Corporation (SBC) received ST3 and ST0.3 million respectively.

98. To clarify the Government's goals for CSO delivery and simplify its implementation, the SOEMD submitted a revised CSO policy paper to Cabinet in June 2007, which has now been approved. This policy effectively limits CSOs to projects that are consistent with the goals identified in the strategy for the development of Samoa that alleviates hardship in Samoa. The new policy also includes a streamlined CSO identification, prioritization, approval, and compensation process. If strictly applied, this new CSO policy should result in SOEs discontinuing activities that they consider to be CSOs, but for which no further compensation will be received from the Government. However, the previous policy also contained strict guidelines with significant pentalies for none adherence, but many SOEs still undertook activities that were not consitent with the principle objective of SOEs, as set out in

[57] The total claim for CSO compensation was ST30 million, but only ST14 million was approved.

legislation.[58] The new policy might provide further incentives for SOEs to restructure loss-making activities, but it requires Ministers, boards, and managers to adhere to the guidelines and legal requirements relating to CSOs.

Box 2: Suggested Guiding Principles for the Provision of Community Service Obligations

- The provision of community service obligations (CSOs) should be based on current sector regulations or formal statements of government policy.
- The objective and purpose of a CSO should be clearly defined, including its target beneficiaries.
- Responsibility for subsidizing a service should be located with the level of government that regulates its provision.
- Wherever possible, CSO payments should be provided for delivery of specified service outputs rather than for inputs to service production.
- The amount of CSO compensation should be based on costs of efficient service provision.
- CSO payments should be explicit, and information on their budgetary costs and benefits should be made publicly available.

99. Implementation of the new CSO policy framework should be guided by the clear separation of the Government's dual role as both the purchaser and provider of CSOs. International experience shows that functioning purchaser-provider models are critical to enabling all stakeholders in CSO delivery to efficiently articulate and deliver on their commitments. In practical terms, the purchaser-provider model requires the formulation of a contract specifying the precise nature of the service to be provided and the mechanisms by which that service will be measured and compensated. In the case of EPC and SWA, CSO payment should be linked to specific outputs where possible. For example, SWA's provision of electricity for boreholes could be compensated according to quantity of water pumped, thus proving an incentive to explore alternative delivery mechanisms. Similarly, the provision of power to rural communities could be compensated by kilowatt hours delivered, according to an efficient benchmark. CSOs should also be subject to pre-approval and post implementation cost/benefit analysis.

2. Corporate Governance

a. Corporate Governance Reform

100. While it is understood that corporate governance reform in SOEs cannot provide the full benefits of independence and profit incentives available to private companies, they are an important and necessary step to improving the performance and transparency of the SOEs that will remain under state ownership. If, subsequently, the Government decides on privatization, this restructuring will add value.

101. With the enactment of the Public Bodies Accountability Act in 2001, SOEs were given a set of guidelines and requirements to strengthen their corporate governance practices and support a more commercial orientation. The Act, which took effect in 2003, sets out a number of key prescriptions, namely:

(i) The process for selecting and appointing directors;

(ii) The role of directors;

(iii) Reporting requirements;

(iv) Disclosures of conflicts of interest;

(v) The role and composition of the audit committees; and

(vi) Policies and procedures for contracting CSOs.

[58] The Principle objective of every Public Trading Body is to operate as a successful business (section 8 of the Public Bodies Act 2001).

102. While the Act is based on international best practice in SOE corporate governance, implementation has proven to be a challenge and, as of end 2006, only the reporting and disclosure requirements are being fully met by the SOEs. Of the other provisions, only one SOE (SamoaTel) has complied with the spirit of the selection and appointment process for directors, and appointed a Chairman of the Board from the private sector. While many SOEs now have audit committees, few of these are fully operational. Article 3.1 of the Act's regulations specifically prohibits members of Parliament, public servants, or constitutional officers from serving as directors of SOEs, unless Cabinet certifies that their appointment is in the national interest or that they have unique qualifications needed by the SOE.[59] This loophole has been used to allow the continued presence of large numbers of ex-officio directors on SOE boards.[60] Indeed, of the 235 positions available on SOE boards, 106 are currently held by public servants.[61] The prescriptions of the Public Bodies Act on the presence of ex-officio directors conflicts with the founding legislation of at least 15 of the 18 existing trading SOEs. This founding legislation, typically in the form of sector acts, includes detailed prescriptions for the composition of the board, including the nature and number of ex-officio members. The legislative conflict has not been resolved with the amendment to the Public Bodies Act in 2006, and is likely to require further amendment of the Act.

103. The continued presence of department heads on the boards, and ministers as chairmen,[62] create pressures to use SOEs as instruments of government policy, rather than as independent operating entities. Moreover, it distorts competition as ministries will have a vested interest in ensuring that SOEs can benefit from sector policy. Looking forward, amendments to the Public Bodies Act should address these weaknesses by encouraging consultation between SOEs and their sector ministries outside the boardroom, and not including ministerial staff on SOE boards.

104. Transparency and independence in the operation of SOEs will also be enhanced by the development and implementation of statements of corporate intent as well as employment contracts for SOE managers. Few SOEs have these fundamental management tools in place, outlining the roles, responsibilities, and performance measures of key managers, and aligning these with the performance goals of the SOE. There is an urgent need to develop these employment contracts.

b. The Samoa Institute of Directors

105. The Samoa Institute of Directors was established in November 2005, with ADB TA,[63] to provide a training and future certification body for professional development programs for directors. Currently, it is working on the reform of SOE board structure and composition. The TA also includes a component to strengthen the capacity of the SOEMD to implement the reporting and disclosure requirements of the Public Bodies Act. A number of high quality seminars have been held for directors of SOEs as well as some private companies, in which participation far exceeded expectations.

106. Government requires directors of SOEs to attend training courses at the Institute of Directors as part of the capacity building program to strengthen the corporate governance of SOEs. As reforms proceed in Samoa, further opportunities for training will expand. For example, the ongoing land reform initiative will involve considerable participation from village councils, whose members will require training in governance. Possibilities for tailoring

[59] Cabinet maintains ultimate approval authority over the composition of all SOE boards.
[60] Article 3.4.3 of the Public Bodies Act also prescribes that within 5 years of the Act coming into force, all ex-officio board members of SOEs should be replaced.
[61] The fact that sitting fees are paid to board members gives public servants undesirable incentives to hold additional meetings. There are anecdotal reports of this happening.
[62] Of the 18 trading SOEs, 14 are chaired by their sector ministers.
[63] Strengthening State-Owned Enterprise Corporate Governance (TA No. 4513–SAM), approved in 2004.

courses for other countries in the region as they implement SOE reform provide possibilities for further expansion as well.

107. The training program for directors is now being strengthened and complemented with assistance from the European Union and NZAID. The Institute of Directors is an important initiative which we support strongly.

c. Status of the Privatization Program

108. With the sale of three minority holdings in 2004, and the Polynesian Airlines transaction in 2005, the Government of Samoa effectively restarted its, until recently, dormant privatization program. Another company, SBC, is in the final stages of privatization, with support from ADB.[64] A formal offer to buy the company was made by a group comprising senior managers and local investors before the end of 2007. It is understood that some issues need to be resolved prior to finalizing the sale. These outstanding matters should be resolved before the end of June 2008.

109. A second SOE, Agricultural Stores Corporation (ASC), whose sale had been under consideration by Cabinet since early 2007, has been effectively withdrawn from the privatization pipeline by Cabinet decision in April 2007 due to "legal complications." The precise nature of these legal complications is unknown, but it appears that strong resistance to the privatization of ASC was expressed by certain Cabinet Ministers on the grounds that it would jeopardize the supply of essential farming inputs to the agricultural community. The removal of ASC from the privatization pipeline, after close to a year of preparatory work, underscores the continued ambivalence of certain key policymakers toward the privatization program. Addressing these points of resistance should, therefore, be an important component of the Government's privatization strategy going forward. A third SOE, Samoa Shipping Services, was also taken off the privatization list on the basis that further restructing was required prior to sale. ADB funded a Restructuring Task Force that provided recommendtions to the board of SSS in October 2007. Despite the board endorsing those recommendations in late 2007, no further action has been taken and it is unclear whether the Govrnment will move ahead to privatize SSS.

110. The SOEMD has recently completed a high level review of the seven remaining SOEs on the privatization list to define preliminary additional transaction options. Given the small number of SOEs on the privatization list, an overall review of the portfolio can be conducted relatively quickly, and will be useful in helping the Government sequence the transactions in a way that maintains momentum for reform. In any privatization program, transaction sequencing is critically important to build stakeholder support for the program. Sales of attractive SOEs should, therefore, be sequenced between more difficult ones, so that the overall momentum of the program is sustained.

111. If the Government is successfully to execute the privatization of its remaining non-strategic SOEs as per the terms of its 2003 policy paper, it will need political commitment at the highest levels to overcome existing points of resistance—from vested interests within the SOEs to potential public opposition. International experience has demonstrated that public support for SOE divestiture can be garnered through:

(i) Disclosure of SOE financial performance;

(ii) Illustration of the benefits of improved services through private provision; and

(iii) Public participation in transactions.

[64] Privatization Support (TA No. 4417–SAM), approved in 2004; and the Private Sector Development Initiative (TA No. 6353–REG), approved in 2006.

In Samoa, the success of the Polynesian Blue transaction has clearly demonstrated the benefits of private sector participation, which advocates of the privatization program are using effectively to support their case. Further public support for the privatization program could be encouraged through the annual publication of SOE accounts in widely circulated newspapers, together with key performance indicators. Lastly, where privatization is resisted because of an inherent distrust of the private sector, the Government can retain a stake in the SOE (as it did with Polynesian Blue) and/or offer to reserve shares for public distribution. This can be effective in diffusing the opposition to privatization on the grounds that the Government would be denying itself future dividends from the privatized SOE.[65]

112. As the Government proceeds to implement its privatization program, sales strategies will need to be developed for each SOE. To do this objectively, the Government should determine its objectives for each transaction. Such objectives are typically expressed in terms of:

(i) Employment preservation;

(ii) Service continuity; and/or

(iii) Maximization of proceeds.

The last objective, maximization of proceeds, is generally only possible when assets are competitively tendered and no conditions of service are placed on the investor. Indeed, any requirement on a buyer to perform a service that he would not otherwise freely choose to provide with the acquired assets will depress the price that he is willing to pay. This also holds true for the cost of restructuring or selling off unwanted business lines and assets. Investors always prefer to buy only those assets or business lines from which they can extract immediate value. An additional consideration in extracting maximum value is to ensure effective competition or regulation of the newly privatized entity. In some countries, governments have chosen to extract value by granting monopolies, to the long-term detriment of the competitiveness of the economy.

113. Where the Government decides to maximize proceeds on a transaction, it must avoid the trap of investing additional monies to “enhance the value” of SOEs before sale. Pre-transaction restructuring should be focused on eliminating unviable business activities, not creating new ones. Experience has shown that monies invested in SOEs prior to privatization are rarely recouped in the transaction price as investors invariably have their own plans to enhance enterprise value, and these plans rarely match those of the Government.

F. Property Rights and Land Issues

1. The Importance of Property Rights

114. There is a great deal of evidence that property rights are the foundation of competitiveness (Acemoglu et al 2004). Without strongly entrenched property rights, many transactions in both goods and financial markets do not occur. If investors and entrepreneurs cannot buy high return assets or if they are faced with the likelihood of losing their investment, they will not invest. If assets cannot be freely bought and sold, they will not be acquired by those who can use them most productively. The weaker the system of property rights, the fewer the number of investors that will engage in economic activities using such assets. Similarly, well developed, secure, and enforced property rights allow financial contracts to align the incentives of lenders with those of borrowers. They reduce the ability of borrowers to renege on debt obligations. In turn, this lowers lenders’ risks, making them more willing to lend.

[65] It should be noted that the retention of government interest in an SOE can depress the overall share value of the transaction as the new investors tend to price in the risk of retaining a shareholder that they cannot control.

115. There are three types of property rights:

(i) Fixed property rights in land and buildings;

(ii) Movable property rights, which allow the pledging of chattels as security for loans; and

(iii) Intellectual property rights, which protect inventions, patents, and copyright.

2. Land Rights in Samoa

116. In Samoa, about 80% of land is under customary ownership, while 16% is owned by the Government, and about 4% is freehold. Traditionally, customary ownership is vested in the *matai* (elected head of an extended family) or a local chief. Tackling the problems of a customary system is difficult and highly sensitive, and it is not surprising that the Government has moved cautiously on resolving land issues. Nevertheless, a number of important issues need to be addressed.

117. The discussion of land issues is moving forward. The Government has taken the position that change can only occur after extensive consultation, which reflects the central importance of land in the Samoan context. Land issues lie at the heart of the traditional Samoan way of life, and any decisions on changes cannot be taken lightly. On the other hand, significant anomalies in the current system that do not appear to have any bearing on the foundations of the customary land system are holding back land leasing in general, and the agricultural sector in particular. The most important of these are:

(i) Obtaining a lease often takes up to 12 months because of cumbersome approval procedures. This raises costs for investors. Approval time can be reduced, however, by replacing publication of prospective leases in the infrequently published official gazette, the “Savali,” with publication in the local newspaper; affixing the notice on the land in question; and putting notices on the Government website. These changes could be further supported by a database recording all leases. The extension of the Personal Property Securities Act, allowing leases to be used as collateral would be a further modification that would greatly enhance the use of land as an asset without compromising the traditional system of land tenure.

(ii) While there has been some growth in organic farming under customary tenure, the system continues to have a negative impact on investment in agriculture.[66] By law, only Samoans holding a matai title may lease land for agricultural use—a provision that prevents untitled Samoans (but not foreigners or companies) from leasing customary land for agricultural purposes. This is one of the several existing barriers in the country that discriminates against Samoans being able to engage in business and agricultural development.

(iii) Under the system of customary tenure, titleholders (matai) are only likely to be knowledgable farmers and investors by chance. It is much more likely that a non-titleholder will have the skills and entrepreneurial drive to farm land for commercial purposes. But modern farming requires substantial investment and a long time horizon to become effective. As long as land use is at the whim of the titleholder, it is unlikely that such investment will take place. While non-matai farmers that have been granted land use rights can use the court system at the event that their rights are abrogated, the social system surrounding village life makes legal challenges unlikely. Security of long-term use rights need to be resolved. On a positive note, passage of the new Companies Act should simplify the process of company formation. This would allow not only individuals to form companies, but village groups and women’s groups to formalize the process under which they farm land.

[66] There has also been investment in beach *fale* tourism under the communal system.

(iv) Currently, there are restrictions on the ownership of freehold land, such as citizenship and residence requirements. The Government should lift these restrictions. In addition, there is great uncertainty on whether leases could be used as collateral for securing loans.

(v) Large amounts of land are underutilized as they remain in the State's hands.

(vi) There is considerable lack of awareness and information on the practical workings of leasehold arrangements and the issues to be resolved when entering into a lease agreement. As a result, investors seriously fear that traditional landowners will not respect lease agreements. This could be rectified with a strong awareness building and dissemination program.

118. It is, however, up to the Samoan people to decide which route to take.[67] If Samoa is to enhance income growth and increase employment opportunities, there is an urgent need to commence a process that brings more simplicity, clarity, and certainty to land transactions while still respecting the traditional values of Samoan society.

3. Rights for Movable Property

119. Movable property rights are essential to the institutional framework that underlies financial market development. When the law permits effective use of collateral, the risk from lending falls. Lenders react by offering more credit at the same or better terms. More credit at lower interest rates permits higher rates of investment and more capital per worker, leading to much higher incomes. The fundamental economic feature of collateral and the distinguishing trait of a secured lending system lies in allowing borrowers to pledge collateral to a lender easily and at low cost, with the expectation that in the event of default, the lender can readily repossess and sell the assets that have been pledged as security for the loan.

120. Samoa has made significant steps toward strengthening its collateral framework. It has drafted the Personal Property Securities Act, which governs the ability of borrowers to pledge collateral as security for loans. The Personal Property Securities Act allows for the merging of the companies registry and the new pledge registry that will be created by the Act. The passage of the law should significantly strengthen the lending framework, which in turn will deepen financial markets in Samoa. However, the passage of the law waits upon decisions regarding the companies registry. Hence, passage of the Act is being held up by delays on the decisions regarding the companies registry.

G. Financial Markets in Samoa

121. While financial markets in Samoa are relatively underdeveloped, further advances in funding investment and entrepreneurship should result from the passage of the Personal Property Securities Act. With a well functioning collateral framework in place, bank lending will have a stronger foundation, and the range of potential clients should widen. Also, since a debt collection company has commenced operations, and a credit bureau is planned, additional building blocks for financial market development are emerging—an encouraging sign in a reform environment such as Samoa. Furthermore, if the issues regarding the lease of land for agriculture and other purposes can be resolved, there will also be potential to use leases as collateral for lending. This should lead to a substantial expansion in credit, particularly to the agriculture sector.

[67] ADB technical assistance Promoting Economic Use of Customary Land (TA No. 4712–SAM), is underway to tackle some of these issues, particularly the administrative system for leasing. It examines a number of other issues including the prohibition of the leasing of land by a Samoan not holding a matai title. It also works on improving the availability of information on customary land titles and boundaries.

122. The largest microfinance provider in Samoa is the SPBD, which does not receive official donor assistance, but solicits private donations. Currently, it has 3,000 outstanding micro loans. It uses a group guarantee system similar to that used by the Grameen Bank, although a partial move to an individual loans system is under consideration. SPBD interest rates are significantly higher than those of donor-funded agencies.[68]

123. Women in Business also runs a small microcredit scheme, but it only has some 80–100 loans outstanding. Its small number of loans reflects caution in giving loans, which generally carry interest rates below those of profitable microcredit institutions in other parts of the world.

124. Small businesses can get access to credit by participating in training programs with the Small Business Enterprise Center (SBEC). Typically, program participants are eligible for the loans guaranteed through the small business loan guarantee scheme, a component of the ADB-funded Small Business Development Project Loan.[69] There is also an NZAID-funded guarantee scheme that operates on the same principles. The Government guarantees up to 80% of loans provided by banks to small businesses that have gone through training courses at SBEC and have been endorsed by SBEC to participating banks. Approximately 7% of total loans have been unrecoverable. In addition, about 25% of total loans are in arrears. However, SBEC is making progress in improving the performance more proactively (e.g., a debt recovery expert has been recruited) and creditors with substantially overdue accounts have been identified on local television. Nevertheless, this initiative is not self-sustaining. SBEC acknowledges that it will continue to depend on donor support for its funding.

125. There are concerns that guaranteeing 80% of a loan may not send the right signals to banks in terms of their appraisal processes and risk taking. From the Government's perspective, the fact that many of the loan guarantees are subscribed by the state-owned Development Bank of Samoa increases the contingent liabilities for Government through this scheme even beyond 80%. As such, a review of the risk sharing and incentive structures of the program is recommended. Two other factors are important in the short to medium term. First, if the recent liquidity problems in the financial sector recur, this will likely reduce the number of new loans issued under the scheme. Second, passage of the Personal Property Securities Act and accompanying implementing regulations over time will change the dynamics of the scheme by strengthening collateral. Any review of the current scheme needs to take these two factors into account.

126. One recent development in the financial sector is the establishment of the combined credit bureau and debt collection agency, Debt Free Limited. While it is still embryonic, it has information on about 2,000 people and its debt collection services are already being used even at this early stage. A number of companies have also expressed interest in their services. Initially, the credit information being offered is of the "negative" type—namely, it shows whether potential borrowers have negative credit histories, but does not provide comprehensive records regarding "positive" information.

H. The Legal Framework for Commercial Activity

127. Samoa's legal framework for private sector development is based on a mixture of common law and customary law, with the Constitution providing the ultimate reference. From

[68] It is generally accepted that real interest rates of at least 30% are necessary for microfinance institutions to be profitable. In other regions, donors have subsidized nongovernment micro lending institutions to lend at lower rates. However, this has resulted in the crowding out of sustainable microfinance institutions. For evidence of this, see Holden et al 2003.

[69] Small Business Development Project and Proposed Equity Investment in a Venture Capital Fund (Loan No. 1785–SAM), approved in 2000.

a business law standpoint, the commercial legal framework is a mixture of severely outdated legislation (some of which dating back to the beginning of the 20th century) and new legislation that reflects the latest in modern business law. Some important gaps exist (e.g., in the areas of arbitration and electronic transactions). Nevertheless, over the past few years, Samoa has embarked on a number of initiatives to modernize its commercial legal framework.

1. The Companies Act

128. The most important initiative in the recent past has been the passage of a new Companies Act in November 2006.[70] The Act was modeled on the New Zealand Act and reflects modern business practices.

129. Some of the features of the new Companies Act include the following:

(i) It allows single director and single shareholder corporations;

(ii) It drops the requirement that most companies produce audited accounts annually;

(iii) It greatly simplifies the process of companies registration as companies will be able to register electronically;

(iv) Once the Personal Property Securities Act is passed, the recording of company charges (i.e., security interests in company assets) will automatically be moved to the registry established under the Act;

(v) All Stamp Duties have been abolished;

(vi) The Registrar's Office is no longer required to examine and approve company documents as part of the registration process; and

(vii) Companies can be formed using standard "off-the-shelf" documents that do not require a lawyer.

130. As yet, the Act is not in force because it awaits the finalization of regulations and the establishment of the electronic registry. Once the Act becomes law, all companies in Samoa will have to reregister within 2 years.

2. Registry Issues

131. A key point that has delayed the issue of regulations centers around the electronic companies registry. The Companies Act provides for electronic registration and paperless filing. Work on the modernization of the companies registry commenced in late 2007. The process has gained momentum since discussions around technology sharing among Pacific countries have emerged.

132. The fees to be charged for registration will have an important bearing on how many small companies register. Too high a fee could discourage many sole proprietorships and other small and medium enterprises from registering. Instead, a sliding scale of charges based on the issued share capital and the number of directors is recommended.[71]

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[70] Strictly speaking, the new Companies Act is an extensive modification of the 2001 Act, which did not become effective, pending the issuance of implementing regulations and the finalization of complementary legislation covering securities, bankruptcy, and insolvency. In the meantime, government ministries underwent a major reorganization that significantly affected the Ministry of Commerce, Industry and Labor. Deficiencies in the 2001 Act were recognized, and now the current Act is a major redrafting of the 2001 Act.

[71] By comparison, the registration fees for small companies to register electronically in the United States average from US$20–30. While the number of transactions going through company registries in the United States is

133. The passage of the Personal Property Securities Act awaits the finalization of the design for the electronic registry. Once this issue is resolved, the Act should pass through Parliament relatively quickly. At this point, a new registry that combines the registration of security interests in chattels and company charges will be needed. The chattels registry is currently administered by the Ministry of Justice. Meanwhile, security interests in motor vehicles are registered in the motor vehicle registry, under the supervision of the Ministry of Transport. It is recommended that over time, all registries be combined within the Office of the Registrar. Once the personal property securities registry is operational, consideration should be given to allowing security interests in motor vehicles to be registered there. Doing so will simplify checking on security interests and ownership for lenders who currently view lending on motor vehicles as relatively high risk because of the danger that vehicles under lien are sold, making the recovery of debt lengthy and costly. Consolidating registries under one administration would simplify procedures for lenders in checking whether assets have already been pledged as security to other lenders.

3. The Bankruptcy Process

134. The failure of inefficient firms is essential to the process of economic growth.[72] And an efficient bankruptcy law promotes economic efficiency and growth by separating viable firms from those that are inefficient and unable to function effectively. Samoa's Bankruptcy Act is based on the United Kingdom Bankruptcy Act of 1906. Lawyers in Samoa describe it as extremely outdated, and the bankruptcy process as costly to undergo. Creditors must petition the Supreme Court to obtain a bankruptcy judgement. The Court then appoints a receiver, who takes a commission on the sale of assets of the bankrupt company. Winding up the process can take several years and involves a substantial amount of lawyers' time. As a result, there are few bankruptcy proceedings in Samoa.

4. Debt Collection

135. The existing debt collection process in Samoa is tortuous and costly. Collecting on all debts over ST10,000 requires a lawyer to represent the creditor in court.[73] Once a judgement is obtained, enforcement is a problem. Debt recovery is also hampered by the courts tending to allow debtors to pay "what they can afford." For example, if a creditor obtains a judgement, the courts also consider the debtor's other debts in setting the repayment amount. As a result, the notion of priority in collections is often not very meaningful.

136. Lawyers in Samoa report that only 30% of judgements are enforced, even though it is possible to jail debtors for non-payment following a judgement.[74] The Ministry of Justice is attempting to approve the collection process and set up a special unit within the Ministry that focuses on this issue. Debt recovery has been identified by private sector, financial sector, and legal practitioners as an important area to improve the workings of the financial sector and make credit more widely available in Samoa.[75]

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higher, the marginal cost of running an electronic registry in Samoa will be low. Initially, however, the capital cost will need to be recovered.

[72] A feature of dynamic economies is that a large number of firms fail, but even more are created. Central to the view of growth as a process of "creative destruction" is that failing firms should close quickly and at low cost so that resources can be reallocated elsewhere.

[73] Creditors who are owed less than ST10,000 can use the District Court, and those owed less than ST1,000 can use the Small Claims Court. Lawyers are not required for either of these courts.

[74] Debtors are jailed for contempt of court and can spend up to 90 days in prison.

[75] Capacity Building of Financial and Business Advisory Intermediaries (ADB TA 3549–SAM), approved in 2000, included a review of the laws and procedures relating to debt recovery and dispute resolution in Samoa to reduce costs and delays for parties and avoid inefficient use of judicial resources. Wide consultation was held with key stakeholders, and the report received full support from the judiciary. It was finalized in 2004. To date, no appropriate reforms have been taken to implement the report's recommendations.

137. The Personal Property Securities Act should assist in the collection of debts by speeding up and simplifying the process. The law has been drafted, and many of the implementing regulations have also been written. Passage of the Act is an urgent priority.

5. Arbitration

138. Samoa has an outdated arbitration framework, and lawyers report that it is rarely used. Current best practices usually reflect a legislative framework based on the UNCITRAL[76] Model Law. However, the arbitration framework in Samoa has few, if any, of the important elements of the Model Law. In particular, the discretion accorded to the courts gives wide scope for intervention in arbitration proceedings, which greatly reduces the usefulness of the process. This also reduces the usefulness of the arbitration framework for settling domestic commercial disputes and constitutes a significant barrier to foreign investment.

139. Another issue related to foreign investors is that enforcement of foreign arbitral awards are not guaranteed under the existing framework. Therefore, foreign investors cannot reliably enter into contracts that require arbitration to take place in foreign jurisdictions, such as Hong Kong, China. As the Samoan reforms attract the attention of potential foreign investors, the existing arbitration framework may increasingly become an impediment. Reform requires two steps. First, the current Arbitration Act must be abrogated for a new act that is based on the UNCITRAL Model Law. Second, as part of this new act, a section should state that Samoa will adhere to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Included in this section should be a simple enforcement regime that will allow foreign arbitral awards to be easily enforced in Samoa.

6. Electronic Transactions

140. Modern commerce increasingly involves electronic exchange—from electronic signatures on contracts to purchasing over the Internet. In some countries, the framework has advanced even further, with mobile phones being used to receive funds and pay bills. The ability to perform commercial transactions electronically greatly reduces the costs of contracting and is especially important for economies that are far from the main markets with which it deals. To fully modernize its commercial legal framework, Samoa will need to fill in this gap in its legislation.[77]

7. The Administration of Justice

141. Lawyers inside and outside government report that the administration of justice urgently needs modernization. The case management process is cumbersome and results in unnecessary delays in trials and court hearings. In addition, there is a shortage of judges and magistrates. At present, there are only two Supreme Court Judges, two District Court Judges, and 17 Land and Titles Judges. The Ministry of Justice intends to recruit more judges, but reports that funding is an issue. Currently, a new court complex is being built with a loan from the People's Republic of China.

8. Implementing Legal Reform

142. There are a number of key pieces of legislation and administrative procedures that require immediate implementation. And as considerable progress has already been made, there should be minimum delay. The immediate priorities are to:

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[76] United Nations Commission on International Trade Law.
[77] A useful model for reform could be the ADB-supported introduction of an electronic transactions law in the Fiji Islands.

(i) Establish a new companies registry (i.e., completing work on the registry);

(ii) Finalize and pass the Personal Property Securities Act, and establish a related registry to enhance the collateral framework; and

(iii) Consider consolidating the companies registry, the personal property securities registry, and the motor vehicle registry for efficiency purposes.

143. In the medium term, attention must be given to the Arbitration Act, the Bankruptcy Act, and a new Electronic Transactions Act.

I. Agriculture and Fishing

144. Agriculture and fishing constitute approximately 11% of Samoa's GDP (with a significant margin of error from difficulties in estimating subsistence output). Samoa has a year-round growing climate and fertile soil where many crops could be cultivated. There appears to be an evolution in the sector. However, it remains underdeveloped.

145. Fishing makes up a little less than half of the sector's output, with various types of agriculture accounting for the balance. Approximately 75% of the population live in rural communities, and about 80% of families engage in some form of agriculture. Deep water fishing for tuna is the primary fishing activity. Inshore fishing has not, as yet, developed.

1. Agriculture

a. Overview

146. The Government stressed in discussions that agriculture is a private sector activity and requires a favorable business environment. Larger-scale commercial agriculture is a small component of total agriculture, with coconut plantations surviving from the German colonial period accounting for most of the output. Much of this acreage is government-owned. Subsistence agriculture accounts for nearly half of agricultural output.[78] Agriculture is largely a part-time activity—only 6% of households earn all of their income from agriculture, and only 23% earn about half.

147. Taro has traditionally been the country's most important agricultural product, but production continues to suffer the after effects of the devastating taro leaf blight outbreak in 1994.[79] The introduction of more resistant varieties has since lead to partial recovery. Copra and bananas are the other important crops. But the negative effect on tree crops of a series of cyclones is evident. Production of non-commodity fruits and vegetables to Australia and New Zealand totaled only US$3.5 million in 2005, with by far the largest product being noni juice (United Nations Statistics Division).

148. The state still has a large and prominent role in agriculture. The Government of Samoa is the country's largest landowner, farmer, farm input retailer, and agroprocessor. The Government owns two large tracts of land—a 2,800 hectare plantation near the international airport and 9,700 hectares in the environs of Apia, which is being leased and sold for housing and smallholder farms. It is also the sole owner of the Agriculture Store Corporation, as well as the owner-operator of the only abattoir and high-temperature forced-air fruit treatment facility.

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[78] In the Samoan context, subsistence agriculture is not necessarily associated with poverty. Most families have home gardens for their own use (i.e., subsistence), but have sources of non-farm income such as intermittent employment and remittances.

[79] This led to many farmers temporarily taking up fishing.

149. Statistics on vegetable production are not available, but vegetables rank as a leading agricultural product. Agricultural processors indicate that there is an increasing amount and variety of vegetables available, as well as nonu, vanilla, and paw-paw. Several processors indicate that they cannot rely on having a regular supply of these crops because there is, as yet, insufficient production.

150. Communal property rights contribute to hindering agricultural development. Agriculture is an activity that requires substantial investment—in clearing land, in preparing the soil for cultivation, and in maintaining soil fertility. Many crops require large investments, which take an extended period of time to bear fruit. Communal property holdings mitigate against such investments. Uncertainty of ownership implies that investors risk losing the fruits of their labor when they do not have long-term control over the land they are working.

151. Anecdotal evidence bears this out. Several Samoan observers have related incidents in which farmers had begun to cultivate communally held land to sell high value crops, only to have a higher ranking family take over once efforts proved to be successful. This experience is similar to farmers on communally held land around the world, particularly in the former Soviet Union, where investment on land that continues to be communally held has languished. As two long time researchers on agricultural transition describe, “In the final analysis…we find that growth and rising efficiency occurred in almost all nations in which reformers created property rights and improved the marketing environment” (Rozell and Swinnen 2004). In Samoa, land rights are primarily communally held, and the marketing environment is weak. While freehold tenure is not an option, enabling Samoans to reliably lease land for agriculture purposes will be important for developing the agricultural sector.

152. Aside from the issue of land tenure, agricultural policies make private sector activities in agriculture more difficult despite Samoa’s many natural advantages. A number of factors likely contribute to this. These issues are explored in the following sections.

b. Problems with Agricultural Extension Services

153. Assistance is given to the agriculture sector through the Ministry of Agiculture’s extension services and through the agricultural research institute. While the institute undertakes useful research, its recommendations and findings are rarely communicated by agricultural extension, which is rarely market-oriented—a common problem with agricultural extension in many other countries around the world. However, given the preponderance of traditional agriculture and the commonality of property rights, the negative impact of Ministry of Agriculture policies has been significant, although the damage has likely been limited by many villages rarely receiving visits from extension officers.

154. In our view, the effects have been less than uniformly positive and, in many cases, have hindered the development of agriculture in Samoa. Agricultural extension services do not have a market-oriented, private sector development-based strategy for promoting agriculture in Samoa. Typically, advice does not take into account Samoa’s comparative advantage in producing high value, year round crops for winter markets in the northern and southern hemisperes, and ignores market demands both domestically and internationally. Examples of such advice include:

(i) Growing hybrid cocoa, which has a better appearance and high yield, but which is also a low-priced, mass market commodity in world markets. Lower yielding Samoa cocoa is much sought after, and commands much higher prices.

(ii) Growing robusta coffee because it has high yields. Arabica coffee, which has lower yields, but from which premium coffee is brewed, is well suited to Samoa’s climate, and commands much higher prices in world coffee markets.

155. There is also no more than limited support for the development of organic farming, a high value-added activity that commands significantly higher prices. In addition, agricultural extension services are unable to supply high value stock for planting as well as accurate information on health standards in foreign markets.

156. Other problems with state-owned and controlled entities in the agriculture sector include:

(i) Government farms not responding effectively to market needs. It could even be said that they are blocking change in the sector. In particular, the STEC, which has the largest amount of available arable land that could be leased, stated that if they were approached to lease land and the proposal was viable, they might undertake it themselves.

(ii) The unwillingness to obtain organic certification by STEC for a state-owned and operated farm while there is a substantial shortage and much higher prices for organic coconut oil pressed in Samoa. At the same time, STEC expressed an unwillingness to allow private sector agricultural activity on the estates despite leasing land to nonagricultural business (for boreholes) and to the state.

157. Information on markets and shortages is still not good. However, the expansion of the mobile phone network will contribute greatly to better information flows. There are other simple measures that could easily improve information flows, such as providing market prices on the morning radio in addition to other market information that is already supplied. Other problems include the following:

(i) Agricultural inputs are subject to a duty of 20% as well as a VAGST rate of 15%. However, agricultural imports enter duty free and are not subject to the VAGST, which puts the sector at a severe competitive disadvantage. Elimination of duty and the VAGST would allow the sector to compete more effectively.

(ii) Several observers and operators in the agricultural sector indicated that villagers lack the will to work. However, other explanations are more likely. For example, it is possible that villages are disillusioned with the incorrect or misleading advice they have received so far. Anecdotal evidence suggests several cases of small farmers being told of opportunities for profits with regard to specific crops, only to realize this to be incorrect after substantial investments have already been made.

(iii) Finance in this sector is still lacking. (See section on the financial sector.)

c. Low Number of Farms with Organic Certification

158. There are currently over 200 farms in Samoa, comprising 6,000 hectares[80] which are fully certified as organic. This represents a significant increase in the number of organic farms, as the process only commenced in 1998, and by 2004, there were only 12 farms certified. Women in Business, a donor-funded nongovernment organization, provides training and assistance to women micro-entrepreneurs, primarily in villages. They are currently the only organization assisting farmers (and sometimes villages) in obtaining organic certification, helping with the marketing of produce and crafts, and promoting cash crop farming. Currently, six processing plants, including one whole village, are organically certified to international standards by the National Association for Sustainable Agriculture, Australia. Fifteen farms are in "conversion" status and 150 farms, including two villages, are on a "waiting list."

159. Despite substantial progress in this area, the organic sector is still small. Exports are primarily confined to coconut oil and nonu. Coconut oil is exported through the Pure Coconut

[80] Source: NZAID comments on an earlier draft of this report.

Oil Company. In 2005, seven tons of organically certified oil was exported. Organically certified oil commands a 50% price premium over conventional oil. In 2005, 104 tons of organically certified nonu was exported, which amounted to an increase of 50% from the previous year, and growth in continuing. Most of the new organic farms are nonu growers. However, the price premium for nonu juice is not as large as that for coconut oil, which amounts to about 30%.

160. Potential also exists in organic cocoa, but the quantities currently produced are still comparatively small. Other organic crops with potential include ginger and certain vegetables, but problems exist with health certification. Additional opportunities being explored are whole village certification to promote “organic tourism," including homestays on organic farms, eating organic produce, and farms tours, which is now growing in popularity.

d. Agricultural Tariff Issues

161. Certain agricultural items still attract significant import duties. Eggs, for example, attract a 20% tariff, while pork cuts have a 10–20% tariff. Samoan products already have a high level of natural protection due to the cost of landing goods in Apia. Some livestock products may need tariff protection to remain competitive if the inputs to the industry (e.g., feed grains) are protected, but this only begs the question of why inputs would be taxed through tariffs. Imported inputs such as agricultural chemicals, machinery and parts, and fertilizer attract a duty ranging from 5–15%. Tariffs on other agricultural products vary within the tariff structure described above. A tariff on any product is equivalent to a tax on all others. So tariffs on pork, for instance, can be regarded as a tax on other agricultural goods and other Samoan products. This tax raises the cost of those goods, makes them less competitive internationally and more expensive domestically, and distorts investment decisions by artificially enhancing the profitability of the protected item.

162. Proposals have been made to increase agricultural tariff protection on the grounds that “the playing field is not level.” Recently, a submission to the Development Board, an ad hoc committee under the auspices of the Ministry of Trade, Commerce and Industry, requested a review of the tariff structure. We support such a review if it leads to lower duties on imported inputs. However, we do not feel that increased tariffs on finished goods are warranted. Any tariff increase would represent a reversal of the trade liberalization of the mid- and late-1990s, and would be a backward step, harming the competitiveness of the country in general, and the agricultural sector in particular.

e. Encouraging Private Sector Development in Agriculture

163. A number of factors determine the capacity for exports of high value-added agricultural products. The most important are: suitable climate and soil, availability of transport to air or sea links, availability of air and sea transport capacity at reasonable rates, private sector marketing capability, quarantine management facilities for pests, and the ability to deal with phytosanitary standards in recipient countries.[81]

164. Overall, Samoa’s agriculture sector is underperforming because only a small portion of arable land is farmed and its productivity is low. There are many reasons—some related to land tenure and crowding-out by government, and others intrinsic to the traditional Samoan way of life. Nonetheless, agriculture is inherently a private sector activity, is a stated government priority, and could make a much larger contribution to the wealth and welfare of the people of Samoa. There are many actions the Government could take to stimulate the private development of agriculture. The failure of this sector to develop more rapidly is the result of a number of interconnected factors that hold back the realization of its potential.

[81] See McGregor 2007.

(i) The agricultural sector is still state dominated and private sector principles are not being applied.

(ii) There is a considerable lack of information and expertise on export opportunities, markets, prices, transport costs, and health regulations in potential foreign markets.

(iii) There is a lack of expertise on growing high value, niche market crops. While the Ministry of Agriculture recognizes that services have been deficient in the past, it is doubtful whether they have the capacity to turn this around. Private sector forces may be more effective in doing so.

(iv) Major problems exist in dealing with phytosanitary and other market access issues, especially in New Zealand.

(v) There is a realization that the land issue needs to be explored, although there is a natural reluctance to move quickly.

165. Given the importance of agriculture to the economy, further work needs to be done in this area to identify, more thoroughly, problems with the whole growing and marketing chain. The state domination of the largest freehold areas of land for agriculture needs to be reexamined urgently. The role of agricultural extension could be complemented by adding private extension and marketing expertise from countries that have experience in niche marketing and services. Development partners could play an important role in helping provide such services.

166. A further contribution to agricultural sector development could be to bring to Samoa, lessons learned from the transformation of agriculture in Asia over the past two decades. Land intensive cultivation, combined with improved marketing and distribution have the potential to transform the sector. This, however, is unlikely to occur while agriculture is dominated by the state.

2. The Fishing Industry

167. Approximately one third of all households engage in fishing activities. While most of this is for home consumption, the fishing sector at its peak in 2001 contributed the equivalent of 8% of GDP. Subsequently, output from the sector declined because of a fall off in the tuna catch, although there appears to have been a sharp improvement in 2006/2007. Over the past few years, there have been efforts to reverse the decline in the habitat for in-shore fisheries through extension programs from the Department of Fisheries, which appear to have been relatively successful.

168. The Government has decreed that fishing in the Samoan export processing zone (EEZ) be reserved for Samoa-based companies, and that fishing licenses in return for royalties not be issued. As a result, the tuna catch is harvested exclusively by Samoan vessels. This policy should ensure that the benefits of the tuna migrating through Samoan waters are sustainably harvested by local fishing vessels, and that illegal fishing does not deplete the catch. Samoans associated with the fishing industry observed that enforcement of Samoa’s EEZ is a problem. Consideration could be given to a cost-benefit analysis of the tuna resources depleted by illegal fishing.

169. Fish exports represent nearly 38% of all export earnings for Samoa in 2005, and 60% in the second quarter of 2006, as tuna catches rose sharply with the improvement in climatic conditions. The bulk of exports is comprised of albacore tuna sent to American Samoa for canning. As these canneries are the only ones in the region, Samoan fishermen are price-takers in this product, and margins are thin. Fishermen complain that the Government has done little to help them develop alternative, more lucrative markets for tuna. The tuna catch, after declining sharply, has recovered recently and is approaching the levels of the mid-1990s.

170. As in agriculture, there is potential for niche markets. For example, aquarium fish and aquarium products remain underdeveloped, although the recent improvement in air links provide for the possibility of improved competitiveness. Infrastructure issues, including health inspections, hold back the development of high grade fresh tuna exports. Again, improved air links raise the possibilities for this product.

171. Representatives of the fishing industry commented that government support to the industry has been so limited that the fishermen themselves constructed the first fishing wharf. The wharf is currently being expanded with a grant from the Japan International Cooperation Agency. Infrastructure at the wharf remains less than adequate, with no shore power, alternative water supply, or fuel pumps. Erratic water supply is especially troubling, as the production of ice is critical to preserving the catch. Fishermen consider the new wharf still too small, forcing them to double up, which in turn slows turnaround time. Looking forward, there is a need for the Government to think strategically about the development of the sector and engage the fishermen in finding new markets for their products, thereby reducing their dependence on the American Samoa canneries.

172. An examination of the fishing industry by fisheries expert Tony Hand (2001) concluded that the structure of taxation in Samoa distorts investment in the industry—providing abnormal profits on the one hand, but adversely affecting investment on the other. In particular, the investment incentives allow very high rates of return on capital. Nevertheless, duties on vessels, inadequate audits, and costly infrastructure all distort returns. In addition, improvement in managing common resources is needed urgently to ensure the sustainability of the resource.

173. As in agriculture, the fisheries sector appears to have considerable potential for contributing to private sector development. At this point, much more information is needed on such issues as the implications for the West and Central Pacific Fisheries Convention, property rights in fisheries, conservation,[82] and health inspection in major markets. Further efforts at local conservation should also bear fruit for the sector to maximize its contribution to the economy.

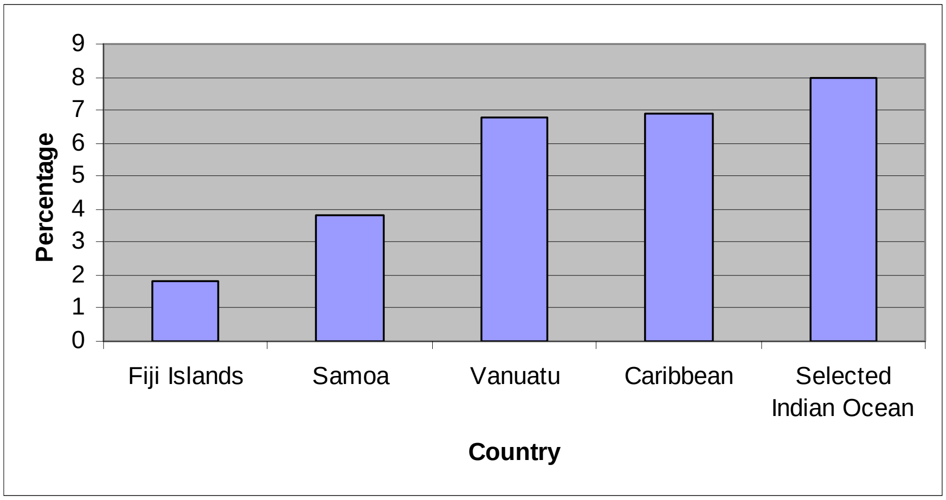
J. Foreign Investment Regulation

174. Although it is widely acknowledged that Samoa is the leading reformer in the Pacific and that FDI has increased, the volume has not risen substantially, with recent estimates for 2006/2007 totalling the equivalent of less than 4% of GDP. As the IMF 2007 Article IV Consultation Report states “Despite impressive growth in recent years, foreign investment in Samoa has historically been well below that elsewhere in the Pacific and extremely low compared with foreign investment in island economies.”

175. Foreign investors report that establishing a business in Samoa is still not easy even though some of the more onerous requirements have been lifted. For example, foreign investors are no longer required to partner with local investors on joint ventures. In addition, the list of prohibited activities has been substantially reduced. Nevertheless, costs remain. Reporting requirements still require foreign companies to file annual reports over and above those of domestic corporations, which departs from the principle of equal treatment for equal activities. In particular, restrictions on expatriate employment continue to pose problems for foreign investors.

[82] New Zealand, and to a lesser extent Australia, have been leaders in introducing tradable catch quotas as a conservation and management instrument.

Figure 4: Comparative Foreign Direct Investment
(% of GDP)



Source: IMF 2007.

176. Labor requirements are still onerous. Expatriates are subject to rigorous screening, and work permits are issued for only 2 years. Expatriates and their families must obtain exit visas and exit guarantees before they can leave the country. Imposing rigorous restrictions on foreign workers is based on a misconception known as "the lump of labor fallacy," which suggests that the amount of work in a given economy is fixed. In terms of this view, any job filled by a foreigner takes work away from a Samoan. However, the amount of work is not fixed—a well qualified productive foreign worker could possibly create jobs for Samoans, expanding the pool of available work. In addition, Samoa needs skills brought by foreign workers. Making it difficult to employ them is counter-productive and harms growth.

177. Since 2000, Samoa has gone through several evaluations of its laws and regulations governing foreign investment. A comprehensive report was completed by FIAS in 2007. It contains wide ranging recommendations for the reform of Samoa's foreign investment regime, specifically focusing on the Foreign Investment Act of 2000. Its recommendations cover four areas:

(i) Changes and additions to the Foreign Investment Act;

(ii) Changes and additions to the implementing regulations of the Act;

(iii) Revisions to the reserved list of activities and the restricted list of activities governing sectors and activities in which foreign investors can operate; and

(iv) Follow up actions to strengthen and improve the foreign investment regime.

1. Revision of the Foreign Investment Act

178. The FIAS report identifies the many ambiguities that exist currently in the foreign investment regime. For example, there is no consistent definition of a "foreign investor." If a company in which a foreigner is a shareholder invests in another Samoan company, it is unclear whether the Foreign Investment Act applies, and if so, which particular areas. Many other provisions of the Act appear to have no consistent rationale and no economic justification. Even the aims of the Act are not spelled out clearly. To attract more foreign investment, the FIAS report's main recommendations include:

(i) Defining clearly what a foreign investment is.

(ii) Making the reserved list and restricted list of activities governing foreign investment attachments to the Act to introduce greater flexibility.

(iii) Eliminating the requirement that certain activities be financed with equity from outside Samoa. Capital is not scarce in the country. Rather, the scarcity is in skills and expertise. The Act should reflect this.

(iv) Eliminating the maximum implementation period of 2 years, which appears to bring no benefit to the country and could actually discourage some investors.

(v) Eliminating the requirement that foreign investors submit annual reports, which are not required of local corporations nor foreign investors that established businesses prior to 2000.

(vi) Enhancing foreign investor protections by the state, which is consistent with the need to protect property rights more generally.

(vii) Enhancing the arbitration framework, as discussed earlier.

(viii) Eliminating application fees. It is anomalous that Samoa's stated aim is to attract foreign investment, yet one of the first requirements to achieve approved investor status is the payment of application fees.

(ix) Granting enterprises a certain number of work permits, which will allow them to employ foreign nationals, with the permits belonging to the firms, not the employees.

179. The overarching principle underlying the recommendations is that all investors, local and foreign, be accorded equal treatment, and that the process be transparent, inexpensive, and quick. A possible response to these aims is that the country must be protected against the infamous "two dollar investors." However, con men thrive in a climate of special favors and unclear rules. Samoa's best protection against possible fraud is to make the process of investing by foreigners as open and simple as possible, and to eschew the provision of incentives and other favors.[83]

2. Attracting Investment: Are Incentives the Answer?

180. Although Samoa does not have a comprehensive policy on incentives, foreign investors have been given both tax holidays and trade incentives (i.e., relief from import duties) to encourage them to locate in the country. We urge great caution in providing such incentives. The experience of other countries has mostly been negative in terms of the long-term effects of the provision of incentives. A comprehensive analysis of private sector development issues in Jamaica,[84] which has over 200,000 different incentives, shows that rather than encouraging growth as intended, these incentives have led to distorted resource allocation, low productivity of investment, and high unemployment. Jamaican incentives include lengthy tax holidays and relief from import duties. And because the incentive scheme encourages capital intensive investment, it has led to a strong bias against local employment. Those who promote incentives often overlook the fact that special privileges in one sector or for one type of investment tax sectors or investments that are not awarded incentives. In this regard, incentives discriminate significantly against local investors, which could be viewed as "captive" because their futures are tied up with the country. By contrast, incentives are offered to foreign investors, ignoring the evidence that they often abandon their investments when the incentives run out. Incentives also penalize smaller firms because in virtually all cases, incentives favor larger, more capital-intensive companies.

[83] This point is supported by a recent paper delivered to the Forum Economic Ministers' Meeting, in Koror, Republic of Palau on 10–12 July 2007. See Pacific Islands Forum Secretariat 2007.
[84] See Holden and Holden 2005.

181. Incentives severely distort investment and resource allocation decisions, and there is evidence that its net effect on economic growth could be negative. The argument typically used to justify incentives is that they must be offered to compete with other countries that offer them. However, studies of investment decisions reveal that companies first decide where they want to locate and then attempt to gain additional advantage by seeking incentives.[85] Furthermore, the typical country that offers incentives is generally a difficult place for doing business. By offering incentives to attract investors, such countries appear to be acknowledging this. A far better strategy would be to introduce business environment reforms to make doing business simple and low cost. Samoa has many advantages—if business environment reform sharply reduced the costs of doing business, incentives would be completely unnecessary.

182. We urge that the provision of investment and trade incentives be discontinued. The experience in other countries reveals that providing incentives is unsuccessful in raising growth rates and harmful in its effect on resource allocation. It is far preferable to compete with respect to being a low cost business environment. In this context, however, a review of company tax rates may well be necessary. Rapidly growing reform economies have prospered by introducing tax rates of as low as 12%. Doing this in Samoa would make it stand out as a low cost location for doing business.

K. Public-Private Dialogue and Cooperation

183. From interviews with both private sector and public sector representatives, it is apparent that a formal consultative process is needed to promote and build consensus for further reform. Currently, there is a gulf regarding how consultation between the private sector and the public sector is perceived, and this has resulted in frustration on both sides. The private sector feels that its concerns are being ignored, while the Government feels that it consults with the private sector, but gets no credit for doing so.

184. While communication between the two sectors has improved over the last 5 years, problems remain. For example, in our discussions with members of the private sector, few people knew that the Companies Act had been passed. And the majority claimed that there had been little consultation while it was being drafted. Similarly, banks claimed that they had little knowledge of the Personal Property Securities Act and had not been consulted in its drafting. We learned, however, that such consultation had taken place, but had been lost to lack of institutional memory due to high staff turnover in both the business and public sectors.

185. There is an urgent need for a more formal process of consultation between the private and public sectors, possibly supported by a small secretariat. While the Development Board has begun to meet again, its agenda is ad hoc, its members are appointed by the Chairman, and it is not used as a forum for developing a reform vision. We recommend the establishment of a relatively small committee with statutory authority, having public sector representatives appointed by the Ministry of Finance (but including the Ministries of Commerce, Justice, Agriculture, and the Tourist Board) and private sector representatives made up of the Chamber of Commerce, the Hotel Association, the Bankers Association, and representatives from the professional bodies. This committee should meet quarterly and act as the steering body for private sector development issues in Samoa. In addition, it is recommended that the private sector have input, through this body, in setting budgetary priorities. Recently, the Hotel Association, the Manufacturers Association, and Women in Business have agreed that the Chamber of Commerce should be the umbrella organization to represent Samoa's private sector.

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[85] See Farrell et al 2004.

186. There are a number of models for such consultative bodies. The successful ones include a process by which the public sector provides direct responses to private sector queries. For example, in Romania, the Public-Private Forum is chaired by the Minister of Commerce. The Minister makes a formal response within 4 weeks to queries and suggestions from the private sector members of the Forum. A similar body has been established in Viet Nam, with notable success in reducing the costs of doing business.

187. While senior staff in the progressive ministries are enthusiastic proponents of reform, their view is far from being shared universally. Mid-level staff in these ministries and senior staff in other ministries are far less reform oriented, and many view the private sector with suspicion. This is possibly the result of lack of knowledge of the issues, which could perhaps be changed by a series of workshops on issues related to private sector development and how they affect the economy.

188. The private sector has also voiced suggestions for an Economic Summit. The idea is to get together politicians, government, and the private sector to develop a vision and a program for the future development of the country. We support such a summit, and suggest that private sector development issues be at the forefront of its agenda.

189. On a more permanent basis, recommmendations for improving the public-private dialogue are to:

(i) Create a formal body that meets regularly. This would, in many ways, be a “super representative” group that consolidates the individual organizations that represent the private sector. These would include the Chamber of Commerce, the Manufacturers Association, the Hotel Association, the Tourism Association, the Samoa Institute of Directors, and SBEC. It would be important for each organization to appoint its own representatives.

(ii) Appoint public sector representatives from the highest level of government.[86]

(iii) Create a formal process by which the public sector must respond in writing to queries raised by the private sector within a specified period of time.

(iv) Issue an annual report from the committee/body, signed by all representatives, outlining progress made and issues still to be dealt with, including any reasons for delay.

L. Other Issues

1. Tourism

190. Tourism has the potential to be an important stimulus to growth in the Samoan economy. The culture of the residents is generally viewed as attractive and interesting. The country is unspoiled and safe, and tourist prices, while not inexpensive, are within international norms. Tourism is Samoa’s most important single commercial economic activity, and the largest source of foreign exchange. Yet, its development potential in terms of arrivals of genuine overseas tourists is barely tapped.[87] As an industry generating service income from foreign visitors, the benefits of tourism to Samoa are the foreign exchange generated, the enhanced return on fixed capital assets (e.g., land and property used directly or indirectly in the tourist industry), and the employment (direct and indirect) generated by the industry. It has broad links to the economy and benefits service providers such as the

[86] In most countries where such forums have been introduced successfully, senior civil servants and the ministers responsible for issues related to the economy and the private sector sit on the Committee. This ensures accountability.

[87] Statistics often fail to distinguish visitor arrivals by type, thereby distorting the size and importance of the industry by including the many non-resident Samoans who visit relatives each year.

airlines, hotels, restaurants, tourist operators in towns and villages, taxis and bus services, the handicraft industry, and the farming and fishing industries. The Government has repeatedly designated tourism as its top economic objective and key strategic area, and has produced a substantial development plan for the industry.[88]

Table 8: Gross Tourism Revenues and Tourist Arrivals
(Millions, US$ and '000)

	2003	2004	2005	2006
Gross Tourism Revenues	154	198	207	226
Tourist Arrivals	92	98	101	110

Sources: Government of Samoa Ministry of Finance 2006 and 2008.

191. The impact of tourism is reflected in revenues, which are growing and averaging close to 20% of GDP. Both revenues and arrivals are expanding rapidly. Statistics are already beginning to reflect the impact of lower fares as a result of Polynesian Blue. Arrivals appear to have grown significantly, with arrivals and tourism earnings in 2006 having grown by 14% and 9% respectively from 2005. And although the annual figures for FY2008 are not yet available, tourism revenues and tourist arrivals have been increasing on average over the first three quarters compared to the previous year (Central Bank of Samoa 2008b). It is likely that Samoa will also attract more tourists as a result of the political instability in other parts of the region, so prospects for the industry appear to be bright. A new beach resort opened within the 2007 financial year and two additional large hotels are either under construction or about to commence operation.

192. However, tourism policy has yet to reflect the improved prospects. Marketing of Samoa as a "destination" is still in its infancy, and there appears to be no clear direction on what the policy should be. At ST3.7 million, the budget of the Samoa Tourist Authority (STA) is low, and much of it is spent on administrative costs or projects—the aims of which are unclear.[89] At the same time, there is no comprehensive brochure marketing Samoa as a tourist destination, and the amounts devoted to media advertising are small.

193. This issue is contentious with tourist operators who interpret the size of the tourism budget as a lack of government commitment to their avowed priority. It is questionable how effective Samoa Visitors Bureau can be at this level of funding with no mandate to undertake cost sharing. Strategy should involve better targeting of tourist expenditures to attract "highest return" tourists and marketing expenditure that is concentrated, for instance, in Australia, California, and New Zealand, all of which have direct gateways to Samoa, and constitute a market size more than adequate to fill Samoa's existing tourist capacity.

194. Similar ambiguity exists with respect to the type of destination Samoa aspires to be. There is no clear policy on whether it should be a high end destination or aim at the lower part of the market. While this is not a major issue at the moment given that tourist arrivals are still relatively small, even if they are growing rapidly, success will quickly confront the country with some major decisions on the future development of the industry. If tourism expands haphazardly because no coherent policies are in place, it will become increasingly costly to change direction when a policy is eventually agreed upon. The lessons from other

[88] See Government of Samoa, Samoa Visitors Bureau 2002.
[89] For example, agents have been established in Germany and the United Kingdom at considerable cost. Also, a troupe of 86 dancers was sent to Germany for 6 months in 2005, although the number of Germans visiting Samoa is low and distances make it unlikely that a large number will be visiting in the future.

countries, such as the Fiji Islands and New Zealand is that tourism is successful when there is a coherent national plan and strategy, considerable private investment in facilities combined with equally large public investment in infrastructure, and significant public and private promotion of the destination.

195. Tourism operators complain of problems with the quality and supply of both water and electricity. One outcome of difficulties with the water and power supply is that meeting tourist needs requires them to install expensive backup systems, thereby adding to the capital and operating costs of tourism developments. The quality of the power supply is a particular problem, with operators complaining of damaged electrical equipment resulting in problems such as maintaining refrigeration. Power variations have caused tourism operators to install expensive surge protection equipment—yet another cost to their business. These issues illustrate powerfully how interlinked the problems associated with improving the environment for doing business are.

196. Many of these issues could be better resolved with more formal communication. Better organization of the STA, with more consensus on decisions could go a long way toward improving its operation. Furthermore, statutory membership of the various interest groups should be built into the STA. For example, although several hoteliers are on the STA's Board, the Samoa Hoteliers Association does not have an allocated board seat. More transparency in the STA budget process, with audited accounts published for public scrutiny, would also improve the operation of the Board.

197. Land issues also impact on the tourist industry. The two new hotels managed to avoid major controversies, however, by tapping local intermediaries for one, and using government land (from SPA) for the other. Future difficulties could arise, however, because stevedoring companies that operate at the port at night have been asked "to reduce the noise pollution" out of respect for hotel guests. Such potential conflicts are good neither for the operation of the port nor the tourist industry. Furthermore, the negotiations on the ground rent for one of the hotels could have raised unrealistic expectations regarding future income of landowners from leasing their land.

198. Discussions in Samoa also revealed a concern over the Samoan way of life being disrupted by a large influx of tourists. However, experience from other countries and some communities in Samoa shows how revenue needs, preservation of historic and ecological sites, and the frequency of foreign visitors can be balanced. The Government needs to undertake some tangible actions to support the thorough tourist reports that already exist. For this reason, we recommend that instead of keeping these concerns in the dark, the country should face them squarely and examine them in a national discussion that addresses the plusses and minuses that are already beginning to manifest themselves with increased tourist arrivals. The country urgently needs a national tourism policy that sets the direction for the industry. With tourism prospects especially bright at the moment, the need for such policy formulation is pressing. At the same time, the marketing of Samoa as a tourist destination needs to be upgraded and made more transparent.

2. Assistance to Business

199. Development partners, particularly ADB, have been active in assisting Samoa to promote smaller businesses. A loan and associated TA[90] sought to generate income and employment opportunities by expanding the micro and small enterprise sector by improving their integrated access to credit and through its business training and advisory services. The loan and TA had four components:

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[90] Small Business Development Project (Loan No. 1785–SAM) and Capacity Building of Financial and Business Advisory Intermediaries (TA No. 3549–SAM), approved in 2000.

(i) Expansion of the small business loans guarantee scheme;

(ii) Support of a pilot microfinance facility;

(iii) Enhancement of business advisory and training services (through the Small Business Development Fund); and

(iv) Improvement of the policy and legislative environment for business development, especially micro and small enterprises.

The latter issue has been addressed through policy reviews of the secured transactions framework and the land and company law, and by setting up a chattels registry and a credit bureau.

200. The SBEC, which was funded under the loan and TA, provides training to small businesses. It provides courses, with participants paying approximately one third of the cost. The rest of the costs are covered by donor grants, for example, under an ADB TA program. There has been a significant number of course participants, and with the opening of a Savai'i facility, demand is expanding. SBEC provides training in business practices such as accounting, marketing, administration, and sales. The course content includes the preparation of a business plan, and those deemed promising qualify for the guarantee program (discussed in the section on financial markets). SBEC assists businesses in negotiating with banks, although the bankers interviewed for this report expressed views that the quality of the SBEC-assisted business plans could be improved.

201. Women in Business also offers assistance to microentrepreneurs, particularly in the agricultural sector. They provide help with information on markets, agricultural methods, and organic certification.

IV. CONCLUSION

202. The conclusion of this review of private sector development issues in Samoa is that the country has made significant strides in reforming the economy to remove trade distortions, in promoting macroeconomic stability, and in making the economy an easier place for doing business. As a result, growth rates in the economy have risen substantially, and Samoa has expanded at a faster rate over an extended period than any other economy in the region.

203. In several areas, reforms have had a strong and positive impact on the economy. The sale of Polynesian Air's international routes have had the immediate effect of reducing airfares and encouraging tourism. Moreover, in its first year, the new airline registered a substantial profit. Digicel's entry to the mobile phone market has resulted in lower call rates and expanded service, which has the potential to transform parts of the Samoan economy. Public sector reform is proceeding, albeit at an irregular pace, as some SOEs have complied with the reform provisions while others lag. In particular, the Ministry of Public Works, which achieved sharply higher output with no increase in expenditure by contracting out its tasks to former employees who now operate as private companies, illustrates what can be done through enlightened reform. The Government remains committed to PPPs and, in some cases, outright privatization. We strongly support these moves. Implementing the provisions of the Public Bodies Act will improve governance and operating efficiencies. Introducing the private sector to areas such as power generation will bring down costs and increase capacity in an area that is strapped for capital—an issue that will become more pressing as the economy's growth rate increases, with concomitant increases in demand.

204. However, questions remain as to whether growth potential is being achieved and to what extent the private sector has responded to reforms. We conclude that there has been some response, although foreign investment—perhaps discouraged by political stability elsewhere in the region—continues to be disappointing. Nevertheless, there are strong grounds for optimism. We have identified the binding constraints to raising the growth rate of the Samoan economy. The priorities for reform arising from the preceding analysis are:

(i) The state still plays too large a role in the economy and raises the costs of doing business. The important reform priorities to remove this binding constraint involve: a) accelerating implementation of the Government's SOE Ownership and Divestiture Policy, which advocates reducing the role of SOEs in the economy by expanding private sector participation; b) developing a new Electricity Act, allowing expanded private sector participation in the power sector while expanding the capacity and governance of EPC through TA; c) implementing the Public Administration Reform Plan; d) supporting further contracting out by ministries and SOEs; e) calculating the costs of CSOs and explicitly including them in SOE budgets; and f) exploring alternative means to fulfill CSOs through competitive bidding for output-based subsidies.

(ii) Property rights, the foundation of development and prosperity, are not well defined because of weaknesses in the land leasing framework. This affects large areas of the economy, particularly financing, agriculture, and tourism. The land issue not only continues to hold back foreign investment, but also restricts opportunities for Samoans, especially in agriculture. While traditional values imply that land should not be alienated, there are several aspects of land rights that do not pose threats to tradition, but limit the ability of Samoans to invest productively in agriculture. Further debate on how to incorporate a reliable leasing framework for investors, both Samoan and foreign, needs to continue as a matter of priority.

(iii) Financial markets pose a binding constraint to growth. The financial market is "thin," and the cost of finance in Samoa is high. Weak property rights, lack of a collateral framework, difficulty in collecting debts, and poor credit history on borrowers hamper financial market deepening. But the most pressing policy priorities are to pass the Personal Property Securities Act and to promote the emergence of a full-fledged credit bureau.

(iv) The commercial legal framework constrains growth by making Samoa a costly place in which, and with which, to do business. Commercial law reform is incomplete, sustaining high transactions costs for doing business. Legal reform has commenced, and the passage of the Companies Act is a major step forward. However, the delays over the registry issue need to be resolved rapidly, both to allow the Act to take effect and permit the passage of the Personal Property Securities Act, which is key to the promotion of secured lending and the development of financial markets in Samoa. Once this is complete, examination of other aspects of Samoa's commercial legal framework is an urgent priority.

(v) One binding constraint to growth in Samoa is the failure of the agricultural sector to realize its potential. Samoa has a comparative advantage in niche product agriculture, but existing policies are not conducive to its development. Agriculture, in particular, suffers from weak property rights and state intervention that has prevented the sector from using its comparative advantage. Misdirected state intervention has had negative consequences for the sector and has led to disillusionment in some quarters regarding the potential for agriculture. However, the recent success of organic farming shows that Samoa can become a niche producer for export markets. Reform priorities are: a) closing supply-oriented agricultural extension services and increasing the number of organic farms; b) developing a private sector focused plan for agricultural development; c) improving knowledge and facilities for export market health standards; d) working with mobile network operators to provide market price information for agriculture and fishing.

(vi) A major binding constraint arises from the opaque and ad hoc processes that result in Samoa doing poorly in attracting FDI. Reform priorities are: a) simplifying procedures for foreign investors; b) introducing a new Arbitration Act, which includes the low cost enforceability of foreign arbitral awards; c) reducing barriers to employing skilled foreign workers that bring vital knowledge to the economy; d) making land leases easily available to foreign investors; e) eliminating investment incentives and competing for FDI by making Samoa a low cost environment for doing business.

(vii) Extensive consultation is needed for the process of removing the binding constraints to higher private sector inclusive growth to occur in a systematic manner. Currently, there is limited formal discourse between the Government and the private sector. Therefore, a reform priority is to establish a formal body for consultation, with private sector members nominated by their representative organizations. This could take place following a National Economic Summit that makes private sector development the centerpiece of the next Economic Development Strategy.

205. These are the areas that need urgent attention for the economy to achieve its potential. And potential there undoubtedly is. In an interview for this report, one local businessperson commented on Samoa achieving its economic growth potential saying "it is so close, I can almost taste it." This colloquial assessment is a view which we endorse. The potential of the Samoan economy is there, and further reform measures will allow the potential to be achieved within the foreseeable future.

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