

EBS/83/105
Supplement 1

CONFIDENTIAL

June 28, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Western Samoa - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Western Samoa agreed at Executive Board Meeting 83/92, June 27, 1983.

Att: (1)

Stand-By Arrangement--Western Samoa

Attached hereto is a letter with annexed memorandum dated May 1983 from the Prime Minister and Minister of Finance of the Government of Western Samoa requesting a stand-by arrangement and setting forth the objectives, policies and measures that the authorities of Western Samoa intend to pursue for the period of this stand-by arrangement.

To support these objectives, policies and measures, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from June 27, 1983 to June 26, 1984, Western Samoa will have the right to make purchases from the Fund in an amount equivalent to SDR 3.375 million, subject to paragraphs 2, 3, and 4 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 0.844 million until July 31, 1983, the equivalent of SDR 1.69 million until the completion of the review referred to in paragraph 3(b) below, and the equivalent of SDR 2.532 million until January 31, 1984.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Western Samoa's currency in the credit tranches beyond 25 per cent of quota.

3. Western Samoa will not make purchases under this stand-by arrangement, that would increase the Fund's holdings of Western Samoa's currency in the credit tranches beyond 25 per cent of quota:

a. during any period in which the data at the end of the preceding period indicate that:

(i) the limit on net domestic assets of the banking system, or the limit on net credit from the banking system to the public sector, as referred to in paragraph 15 of the Memorandum of the Government of Western Samoa on Certain Aspects of its Economic Policy annexed to the attached letter, is not observed; or

(ii) the cumulative limit on the authorization of contracting of new public and publicly guaranteed external debt in the maturity ranges of up to 12 years and up to 5 years, described in paragraph 18 of the Memorandum of the Government of Western Samoa on Certain Aspects of its Economic Policy annexed to the attached letter is not observed; or

- (iii) the intention to provide foreign exchange for payments in arrears in the amounts specified in paragraph 19 of the Memorandum of the Government of Western Samoa on Certain Aspects of its Economic Policy, annexed to the attached letter, is not carried out; or
- b. during any period after October 31, 1983 if the review contemplated in paragraph 2 of the attached letter, has not been completed, or if any performance clauses having been established pursuant to the review are not observed; or
- c. if Western Samoa:
- (i) imposes or intensifies restrictions on payments and transfers for current international transactions; or
 - (ii) introduces or modifies multiple currency practices; or
 - (iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or
 - (iv) imposes or intensifies import restrictions for balance of payments reasons.

When Western Samoa is prevented from purchasing under this arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Western Samoa and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Western Samoa's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Western Samoa. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 4, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Western Samoa and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Western Samoa, the Fund agrees to provide them at the time of the purchase.

6. Western Samoa shall pay a charge for this arrangement in accordance with the decisions of the Fund.

7. a. Western Samoa shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Western Samoa's balance of payments and reserve position improves.

b. Any reduction in Western Samoa's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

8. During the period of the stand-by arrangement, Western Samoa shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Western Samoa or of representatives of Western Samoa to the Fund. Western Samoa shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Western Samoa in achieving the objectives and policies set forth in the attached letter and annexed Memorandum.

9. In accordance with paragraph 2 of the attached letter, Western Samoa will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Western Samoa has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Western Samoa's balance of payments policies.

Apia
Western Samoa

May 24, 1983

Dear Mr. de Larosière:

1. Attached is a memorandum setting forth major elements of Western Samoa's economic program for 1983. The objectives of the program are to effect a better balance between domestic spending and available local and foreign resources, to lower the rate of inflation, to achieve an overall balance of payments surplus, and to lay the groundwork for achieving a sustainable external current account position over the medium term. In support of these objectives, and in view of the expected balance of payments need, we request a one-year stand-by arrangement from the International Monetary Fund in an amount equivalent to SDR 3.375 million.

2. The Government of Western Samoa believes that the policies set out in the annexed Memorandum are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultations. Moreover, the Government will conduct with the Fund a mid-term review of policies, including interest rate and exchange rate policies, before the end of October 1983, and in the course of that review will reach understandings with the Fund in accordance with paragraphs 16 and 17 of the attached Memorandum.

Sincerely yours,

Tofilau Eti Alensana
Prime Minister and
Minister of Finance

Attachment: Memorandum of the Government of
Western Samoa on Certain Aspects
of its Economic Policy

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Memorandum of the Government of Western Samoa on
Certain Aspects of its Economic Policy

1. The economy of Western Samoa has been operating well below its potential, with negative real economic growth since 1980. This unsatisfactory economic performance has been due mostly to depressed conditions in the agricultural sector which accounts for about half of GDP and about 90 per cent of exports. The production of the two major export crops, copra and cocoa, has been constrained by the old age of most trees; moreover, variations in weather conditions have resulted in sharp fluctuations in output. In the period from 1980-82 the export prices of copra, cocoa, and other commodities fell sharply, while import prices of oil and other goods increased. Overall, the terms of trade deteriorated by about 45 per cent. With only a modest increase in workers' remittances from abroad, the external current account deficit, excluding foreign grants, has averaged about 27 per cent of GDP during this period. Such large external deficits were clearly unsustainable and resulted in the steady accumulation of external payments arrears, including those on government and government-guaranteed debt, which totaled SDR 13.0 million at the end of December 1982. The Government of Western Samoa adopted a financial program for the 12-month period ended February 1982 aimed at creating a more favorable climate for an improvement in the balance of payments over the medium term; the program was supported by a first credit tranche drawing from the Fund. The objectives and targets of that program were not realized, due, in part, to the conditions outlined above; in part, to the adverse impact of a three-month civil service strike in 1981 that disrupted financial and economic activity; but also, to insufficient domestic policy response.

2. The adjustment of economic policies to the deterioration in the external environment has so far been limited, in particular with respect to the public sector. Total government expenditure continued to increase, largely reflecting the growth of current expenditure; the major element was an increase in the wage and salary bill by 76 per cent between 1978 and 1982. The growth of revenues was constrained by the shortage of foreign exchange which limited the growth of dutiable imports, by the impact of a three-month civil service strike in 1981 which hampered revenue collection, and also by the fact that tax rates remained unchanged and government fees and charges were not adjusted to fully reflect increased costs. As a result, the Government budget deficit averaged over 16 per cent of GDP during 1980-82, and banking system financing of the deficit, about 8 per cent of GDP. Moreover, the overall financial position of the public enterprises weakened markedly as a result of unrealistic pricing policies and inefficient operation; the losses of these enterprises were equivalent to about 6 per cent of GDP in 1980-81 and about 3 per cent of GDP in 1982. The increased recourse to domestic bank financing by the public sector resulted in an excessive growth of total liquidity, which, in conjunction with the decline in import availabilities, contributed to the high rate of inflation, averaging close to 20 per cent annually since 1979.

3. The close link maintained between the exchange rate of the Western Samoan tala and the New Zealand dollar since 1979 has led to a progressive nominal depreciation of the tala vis-a-vis the currencies of other major trading partners. However, given the differential in inflation rates between Western Samoa and its trading partner countries, there has been an appreciation of the real effective exchange rate by about 17 per cent from the third quarter of 1979 through the third quarter of 1982, a development that has adversely affected the profitability of the export sector.

4. The achievement of a satisfactory rate of growth with the restoration of a sustainable external current account position and price stability will require a fundamental redirection of economic policies. Therefore, the stabilization measures discussed below have been prepared within a three-year framework aimed at effecting a better balance between domestic spending and available resources and laying the foundation for achieving a sustainable external current account position over the medium term. In 1983, the major objectives of economic policy are to sharply reduce the external current account deficit by about 7 percentage points in relation to GDP, to generate an overall balance of payments surplus equivalent to SDR 1.2 million, or 1 per cent of GDP, and to lower the rate of inflation to about 10 per cent on an annual basis by the final quarter of 1983. These objectives are to be achieved through the adoption of restrictive fiscal and monetary policies and an exchange rate policy geared to restoring the competitiveness of the export sector. The concentration of major policy efforts on achieving external adjustment will, of necessity, rule out real growth in 1983.

Production policies

5. Agricultural policies have aimed at developing commercial plantations under the aegis of the Western Samoa Trust Estates Corporation (WSTEC), a statutory government body which controls about 30,000 acres of prime land. In addition, the Government has attempted to raise the productivity of traditional agricultural holdings and encourage crop diversification through the provision of subsidized inputs and preferential credit. The output of the major export crops, copra and cocoa, has been adversely affected by the old age of many trees and the impact of disease; replanting programs initiated in the 1970s have been only partly effective. Moreover, production by WSTEC has been substantially below potential, due to operating difficulties and weaknesses in management practices. In order to stimulate copra production a replanting program has been established using hybrid seed nuts developed locally. By 1986-87 enough seed nuts will be available to plant 2,500 acres annually, or about 2 per cent of total acreage under coconut. Cocoa farmers have been assisted through the establishment of four Cocoa Field Extension Teams during 1982. Farmers participating in the cocoa planting scheme were distributed sufficient Amelonado cocoa seed nuts to plant 300 acres in 1982, and it is estimated that sufficient seeds will be available to plant 600 acres in 1983.

6. Increased production of agricultural export crops also requires the provision of adequate financial incentives to producers. The sharp fluctuations in world market prices of copra and cocoa have been reflected in producer prices, and the resulting uncertainty of growers' incomes has adversely affected output and investment. To attenuate fluctuations in growers' incomes arising from price movements, producer price stabilization schemes were established for copra and cocoa at the beginning of 1982. These schemes helped moderate the impact of the sharp decline in world market prices during 1982, and are expected to provide a basis for renewed investment in these industries over the medium term.

7. The Government has also sought to increase the value added of domestic exports and expand the export base. In 1982, a government-owned copra crushing mill was established which is expected to substantially increase the value added of copra exports through the processing of copra into coconut oil and coconut meal; although operating at full capacity for only part of the year, the mill increased the value of copra exports by 16 per cent in 1982. Similarly, the recent completion of a veneer mill is expected to double the value of wood products exports. Also, a program is in operation to re-establish bananas as a major export item through the development and operation of a 250-acre commercial banana plantation at Tanumalala and improved marketing arrangements.

8. Since the late 1970s, various manufacturing enterprises geared to import substitution have been established with foreign participation. These enterprises have been encouraged through the Enterprise Incentives Act, which provides for tax relief for up to five years and exemptions from customs duties on most imported inputs. Production of most goods, in particular beer and cigarettes, has increased steadily, and moderate amounts of both beer and cigarettes are now being exported. The Government's policy is to continue to promote foreign investment, and a review of the Enterprise Incentives Act is underway, with the aim of increasing the efficiency of incentives while limiting the overall budgetary cost.

9. Western Samoa has adopted a comprehensive energy policy which includes the production of energy from hydropower. During 1982 two new hydropower plants were completed, increasing the share of electricity generated by this source from 20 per cent to 48 per cent. A third plant is expected to be in operation by late 1984, which should increase the share of electricity generated by hydropower to 70 per cent. The increased use of hydropower has been reflected in a decline in oil imports, as diesel fuel used by the Electric Power Corporation fell from 1.6 million gallons in 1980 to an estimated 1.0 million gallons in 1983; further reductions will be realized upon the completion of the third hydropower plant. In line with our standing policy of ensuring that selling prices of all petroleum products fully reflect the imported costs, prices of petroleum products were raised by 17-21 per cent effective April 8, 1983. These prices have been adjusted to reflect the impact of recent exchange rate and customs valuation changes. Furthermore, it is not proposed to adjust the prices of petroleum products during the program period to reflect possible downward movements in the international prices of oil and oil products.

Fiscal policies

10. Government revenue in 1982 fell well below budget estimates, largely because of lower than expected import duties due to the impact of the tight external resource constraint on imports, a shortfall in collections of fees and charges, and a further deterioration of the overall net financial position of departmental enterprises. Although development expenditures were substantially below original budget estimates, total expenditures were higher, reflecting increased expenditures on advance accounts. As a result, the overall budget deficit rose to WS\$19.1 million, and domestic bank financing of the deficit, to WS\$11.8 million, from WS\$17.6 million and WS\$10.1 million, respectively, in the previous year. Fiscal policy in 1983 aims at a very significant reduction in the overall budget deficit, from 16 per cent to about 6 per cent of GDP, to be achieved by a substantial increase in revenues and strict expenditure controls. Consequently, recourse to the domestic banking system is expected to be sharply reduced compared with the previous year.

11. The 1983 budget outlook calls for an increase in total revenues of about 24 per cent, including new revenue measures intended to yield WS\$5.9 million, or about 4 per cent of GDP. Of the new revenues, more than half will be derived from increased customs revenue. In line with the recommendations of the 1981 FAD mission on Tax Reform, the basis of assessment of customs duties (import and primage) was changed from current domestic value (c.d.v) to cost including insurance and freight (c.i.f.); this change will facilitate customs collection and is estimated to raise WS\$1.5 million in new revenues. In addition, primage duty (import surcharge) was increased from 4 per cent of c.d.v. to 8 per cent of c.i.f., which is estimated to yield an additional WS\$1.5 million in revenue. Also, the Electric Power Corporation Act was amended to require the EPC to pay import duty on petroleum products; this measure is expected to raise an additional WS\$0.5 million in 1983. Excise taxes on cigarettes and beer were increased by 50 per cent and 43 per cent, respectively, which, combined, are estimated to yield an additional WS\$1.3 million in revenue. Government fees and charges, which have not kept pace with increased costs, have been raised in the 1983 budget and will yield WS\$0.8 million. Other revenue measures include the introduction of a tourist tax and an increase in the airport departure tax, which, together, are expected to provide an additional WS\$0.2 million. Also, the depreciation schedules under the Income Tax Act were amended to yield an additional WS\$0.1 million.

12. While the tax measures described above will substantially increase the Government's revenue effort in the short run, they represent only a first step in a longer-term process of tax reform aimed at broadening the tax base and reversing the eroding revenue elasticity of the tax system. Other measures detailed in the above-mentioned FAD report are now under study with the aim of incorporating some of these measures in the 1984 Budget. These measures include revisions in the tariff structure to remove inconsistencies and provide incentives for present and potential industries; an extension of the excise tax and a change in the basis

of valuation from specific to ad valorem; and the introduction of a general sales tax. The status of these measures will be discussed during the mid-term review of policies in October.

13. The 1983 budget envisages a 6 per cent decline in total expenditures to be achieved by a decline in domestically-financed development expenditures and a sharp reduction in expenditures on advance accounts, the latter reflecting, in part, the anticipated improvement in the financial position of the public enterprises. Current expenditures are budgeted to increase by less than 2 per cent, due to the implementation of a number of expenditure-saving measures. These measures include a reduction in the maximum overtime limit from 33.5 per cent to 15.0 per cent of salary, the elimination of funding for most existing vacancies in Government departments, a significant reduction in the number of wage earners in the Education Department, and the limiting of recruitment by the Education Department to returning overseas scholarship holders and graduates of the Teachers' College, and a reduction in wage earners in the Public Works Department. The reduction in domestically-financed development expenditures reflects a consolidation of the development effort as well as increased foreign participation in financing the domestic costs of development projects. To ensure that outlays do not exceed appropriations, expenditures will be closely monitored through quarterly reviews of departmental budgets; those departments exceeding their targeted expenditures in a particular quarter will be required to explain the overexpenditure to Cabinet, and adjustments to expenditure targets for the remainder of the year will be made to bring the department's budget back on track.

14. It is the Government's intention to strengthen the financial position of the public enterprises in order to lessen their claims on the budget and on bank credit. To achieve this result, more realistic pricing policies, particularly the adjustment of prices to reflect the impact of exchange rate and customs valuation changes on operating costs, as well as improved management practices, have been adopted. These policies will permit a reduction of public enterprise losses from about 3 per cent of GDP in 1982 to about 1 per cent in 1983, and include specifically:

a. The Western Samoa Trust Estates Corporation (WSTEC) will sell and/or exchange land holdings unfit for agricultural development and close down some unprofitable operations. In the latter half of 1982 substantial reductions in costs were realized through a sharp cutback in staff size, and further reductions in staff will occur in 1983. As a result of these measures the financial position of WSTEC should improve in 1983.

b. The Government intends to rationalize the operations of the marketing boards (Copra, Cocoa, Banana, and the Produce Marketing Division) in order to increase efficiency and make them more effective instruments of export promotion.

c. The Electric Power Corporation (EPC) has increased electricity rates by 22 per cent to 28 sene per kilowatt hour, to be effective June 1, to reflect the impact of exchange rate adjustments and the introduction of customs duty on its diesel fuel imports. Charges will remain under review and will be increased if necessary.

d. The Special Projects Development Corporation (SPDC) has reduced its operating deficit through improved management practices and better utilization of resources. In 1983 the SPDC plans to extend its operations through construction contracts on neighboring islands.

Money and credit policies

15. The increased recourse to domestic bank credit to finance public sector deficits has resulted in an excessive growth of total liquidity, which averaged over 30 per cent in 1981-82. The projected improvement in public sector finances is expected to contribute to a slowing down in monetary expansion in 1983. The demand for bank credit is likely to be weak in view of the expected stagnation in economic activity, the decline in import financing, and the increased availability of resources from nonbank financial institutions including the Development Bank of Western Samoa, the National Provident Fund, and the Samoa Public Trust. Credit to the private sector is projected to grow slightly in real terms, while there will be a real decline in net credit to the public sector. The credit program for 1983 is predicated on virtually no growth of real output, an increase in average consumer prices of 17 per cent, and an expansion in total liquidity of 25 per cent. Taking into account projected changes in net foreign assets of the banking system, net domestic assets can be expected to increase by about 11 per cent, compared with 36 per cent in the previous year. Accordingly, taking into account the projected credit needs of the public and private sectors and the relevant seasonal patterns of credit demand, quarterly ceilings have been set on the outstanding level of net domestic assets of the banking system and on net credit to the public sector as shown in the attached table.

16. Interest rates in Western Samoa have remained substantially negative in real terms for the past several years, which has had an adverse impact on domestic resource mobilization and the efficient use of credit. Moreover, the large differentials between domestic rates and those in neighboring countries, particularly New Zealand, have impeded the flow of remittances from Western Samoans living abroad. Accordingly, effective February 7, 1983, most bank deposit rates were increased by 5-6 percentage points, and average lending rates were raised by about 4 percentage points. As a result, the differentials between New Zealand and Western Samoan deposit rates have largely been eliminated, thereby removing the disincentives for the repatriation of funds. Also, positive real interest rates have been established on deposits with maturities of 12 months and longer, and lending rates for personal and business loans have become positive in real terms. The Government will closely monitor interest rates in light of domestic price movements and developments in interest rates abroad, and will maintain key interest rates positive in

real terms and avoid the re-emergence of significant adverse interest rate differentials with neighboring countries. Interest rate policy will be reassessed at the time of the mid-term review in October 1983, and further adjustments in interest rates, if required, will be implemented.

External policies

17. The Government recognizes that an active exchange rate policy is needed to promote external adjustment. The objective of exchange rate policy in 1983 is to improve profitability of the export sector and raise the prices of imported goods to realistic levels by reversing the real appreciation of the tala recorded since the third quarter of 1979. To achieve this objective, the tala has been depreciated by about 17.5 per cent on a trade-weighted basis. The tala was devalued by 10 per cent in terms of the New Zealand dollar on February 7, 1983. Moreover, the rate between the tala and the New Zealand dollar was maintained unchanged following the devaluation of the New Zealand dollar by 6 per cent on March 8, 1983; the latter resulted in a further depreciation of the tala on a trade-weighted basis of 2.5 per cent. The tala was again devalued in steps by a total of 5 per cent against the New Zealand dollar during the period April 8-May 13, 1983. We intend to pursue a flexible exchange rate policy in order to maintain competitiveness, and exchange rate policy will be reassessed at the time of the mid-term review in October.

18. Western Samoa has relied, in large part, on concessional external assistance to finance its external current account deficit. Nevertheless, the external debt service burden has become considerable and is projected to remain heavy over the medium term. Moreover, the schedule adopted for the elimination of external payments arrears will have a crucial bearing on the debt service profile. During the program period, the contracting or guaranteeing of new external loans by the public sector with an original maturity of up to 12 years will not exceed US\$4 million. In view of the already considerable external debt service burden, the contracting of new loans with an original maturity of up to five years will not exceed US\$2.5 million during the program period. These amounts are net of any rescheduling of external payments arrears outstanding at the end of 1982.

19. Beginning in 1980 Western Samoa incurred external payments arrears, of which SDR 13.0 million remained outstanding at the end of 1982. Our policy will be to effect a reduction through cash payments of SDR 2.9 million in these arrears in 1983, including a reduction of SDR 1.6 million by the time of the mid-term review in October 1983. Furthermore, it is our intention to establish a schedule for the orderly elimination of all payments arrears. In this connection, the ongoing negotiations with our seven major creditors to reschedule outstanding arrears are expected to be successfully concluded in the near future.

Attachment

Apia, Western Samoa
May 24, 1983

Western Samoa: Limits on Selected Financial Aggregates

	As of Dec. 29 1982	Up To		
		June 29, 1983	Sept. 28, 1983	Dec. 28 1983
<u>(In thousands of tala)</u>				
Net domestics assets of the banking system (stock) <u>1/</u>	57,067	64,050	61,500	63,300
Credit to public sector (stock) <u>1/</u>	43,722	47,800	46,800	46,900
<u>(In millions of U.S. dollars)</u>				
Contracting of public and publicly guaranteed external debt during the year with maturity of:				
Up to and including 12 years <u>1/</u>				4.0
Up to and including 5 years <u>1/</u>				2.5
<u>(In millions of SDRs)</u>				
Minimum repayments in external payments arrears			1.6	2.9

1/ As defined in the Memorandum of Understanding.