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AGENDA**

EBS/83/105
Correction 1

CONFIDENTIAL

June 22, 1983

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

The following corrections have been made in EBS/83/105 (5/25/83):

Page 10, 2nd full para., line 8: for "44 per cent to 33 sene"
read "22 per cent to 28 sene"

Page 31, column 4, last line: for "... " read "0.28"

Page 49, para. c., line 2: for "44 per cent to 33 sene"
read "22 per cent to 33 sene"

Corrected pages are attached.

Att: (3)

The estimated budget outcome envisages a 6 per cent reduction in total expenditures through a lowering of domestically financed development expenditures and expenditures on advance accounts; the latter reflects, in part, the anticipated improvement in the financial position of the public enterprises. Current expenditures are expected to increase by less than 2 per cent, due to the implementation of a number of cost-cutting measures, including a reduction by more than half in the maximum overtime limit; in addition, no provision is made for salary increases beyond normal increments associated with regular promotions. Also, the budget eliminates funding for most existing vacancies in line with the "sinking lid" policy aimed at gradually reducing the size of the public sector; the current budget provides for an 8 per cent reduction in the number of public sector positions compared with the 1982 budget. Although total development expenditures are expected to increase by 7 per cent, domestically financed development expenditures are scheduled to decline by nearly 20 per cent, due to the postponement of less urgent projects and the transfer of others to the private sector and increased foreign participation in financing the domestic costs of development projects.

To ensure that budgeted expenditures are not exceeded and revenue targets are met, the Treasury will undertake quarterly reviews of each department's expenditures and revenues. To assist the Treasury in conducting these reviews, each department will provide forecasts for revenue and expenditures on a quarterly basis, updated as soon as possible after the end of each quarter. Each review will include a report to Cabinet on trends in departmental operations and department heads will be called before Cabinet to explain overexpenditures. Moreover, the quarterly format will permit subsequent adjustments to appropriations to bring departmental budgets back on track.

(ii) Financial operations of public enterprises

In 1982, the financial position of the public enterprises improved with the adoption of better management practices and the elimination of some unprofitable operations; overall, both the operating deficit and bank borrowing of these enterprises were halved, compared to 1981, to 3 per cent and 2 per cent of GDP, respectively. Further strengthening of the financial position of these enterprises is expected in 1983 through realistic pricing policies, the impact of exchange rate adjustments on the profitability of the export boards, continued improvements in management practices, and further elimination of unprofitable operations. As a result of these measures the operating deficit of the public enterprises is expected to decline to about 1 per cent of GDP in 1983.

In terms of specific public enterprises, a marked improvement in the operations of the Western Samoa Trust Estates Corporation (WSTEC) was recorded in 1982, when the operating deficit was more than halved, through sharp reductions in staff size. Losses of WSTEC are expected to be reduced further in 1983 through continued cost-cutting measures, including the sale of some unprofitable operations 1/ and the sale and/or exchange of

1/ Such as the dairy and wood by-products factories.

land unfit for agricultural development; it is estimated that the sale of land will yield WSS\$0.5-1.0 million. In the medium-term, WSTEC intends to acquire and develop suitable land to expand its acreage under high quality cocoa.

The Special Projects Development Corporation (SPDC) also recorded a marked improvement in financial performance in 1982 as a result of management reorganization and consolidation. In 1983, the SPDC is extending its operations to other islands in the region to fully utilize its capital equipment and labor resources.

The Government is planning to rationalize the operations of the marketing boards (Copra, Cocoa, Banana, and the Produce Marketing Division) to increase efficiency and make them more effective instruments of export promotion. Moreover, increased domestic currency prices of copra and cocoa due to the depreciation of the tala and some recovery in world market prices are expected to substantially reduce the combined losses of the Copra and Cocoa Marketing Boards.^{1/} 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 offset the impact of the depreciation of the tala and the introduction of an import duty on its diesel fuel imports; rates will remain under review and will be further increased, if necessary.

b. Monetary policy

Monetary policy during the program period will be aimed at supporting the external adjustment effort through a tight credit policy and an interest rate policy that will keep key interest rates positive in real terms. There will be a significant deceleration in the growth of domestic bank credit, in particular to the public sector, and in the growth of total liquidity. To promote the adoption of a more active monetary policy, legislation has been drafted and will be submitted to Parliament before the end of the year in order to transform the Monetary Board, which is presently a division within the Treasury, into an independent Monetary Authority by January 1, 1984.

(i) Domestic credit program

The credit program for 1983 has been drawn up on the assumption of no real growth in GDP, an 18 per cent increase in the GDP deflator, an overall surplus in the balance of payments of SDR 1.2 million, and the maintenance of key interest rates positive in real terms. On the basis of recent GDP estimates, the velocity of broad money (M2) has shown a declining trend over the years, possibly a reflection of increased monetization, which has been accentuated during periods of interest rate adjustment. The velocity of M2 is projected to decline again in 1983, largely in response to the increase in interest rates in February, which is expected to result in the growth of savings held in the form of bank deposits.

^{1/} Since January 1982 a price stabilization scheme has been in effect for copra and cocoa producer prices (see Section III. 4 below).

Table VIII. Western Samoa: Energy Statistics, 1980-83

	1980	1981	1982	1983 Estimate
	(In Kilowatts)			
Electricity <u>1/</u>				
Generating capacity <u>2/</u>	11,399	11,335	14,535	14,535
Hydro	1,294	1,230	4,430	4,430
Diesel	10,105	10,105	10,105	10,105
	(In millions of kilowatt hours)			
Production	31.69	30.59	30.72	31.20
Hydro	6.77	7.31	12.29	15.00
Diesel	24.91	23.27	18.43	16.20
Consumption	31.69	30.59	30.72	31.20
Sales	24.28	25.20	25.26	25.70
Transmission and distribution losses	7.41	5.39	5.46	5.50
	(In millions of gallons)			
Petroleum imports				
For electricity generation	1.6	1.5	1.2	1.0
For other uses	5.7	7.6	6.9	6.7
Total	7.3	9.1	8.1	7.7
	(In tala per unit at end of period)			
Energy prices				
Petroleum (gallon)	2.32	3.30	3.30	3.87 <u>3/</u>
Kerosene (gallon)	1.84	2.74	2.74	3.31 <u>3/</u>
Electricity (kilowatt hour)	0.19	0.23	0.23	0.28

Sources: Data provided by the Western Samoan authorities; the Electric Power Corporation of Western Samoa; and staff estimates.

1/ Figures only relate to government-owned electric power plants. Village lighting schemes and other private plants are not included

2/ Generating Capacity is based on nameplate ratings of the generators. Some machines due to age and cooling problems cannot reach full rated output.

3/ As at April 8, 1983.

Table IX. Western Samoa: External Debt Projections, 1982-88

	1982 Actual ^{1/}	1983 Program	1984	1985	1986	1987	1988
	Projections						
(In millions of SDRs)							
External debt outstanding ^{2/}	53.8	58.9	63.8	67.0	70.6	74.4	78.2
Of which: IMF ^{3/}	(3.8)	(5.7)	(6.6)	(5.2)	(3.9)	(1.8)	(0.1)
Loan disbursements	4.8	9.2	8.9	8.0	8.0	7.8	7.5
Of which: IMF	(--)	(2.8)	(1.7)	(--)	(--)	(--)	(--)
Amortization	2.5	4.1	4.0	4.8	4.4	4.0	3.7
Of which: IMF	(0.7)	(0.9)	(0.8)	(1.4)	(1.3)	(2.1)	(1.7)
Interest payments	1.6	1.8	1.9	1.9	1.9	1.9	1.9
Of which: IMF	(0.3)	(0.3)	(0.5)	(0.4)	(0.3)	(0.2)	(0.1)
(In per cent of GDP)							
External debt outstanding							
Excluding IMF	56	58	55	52	50	48	45
Including IMF	60	64	61	57	53	49	45
Including IMF and external payments arrears	75	75	68	61	55	49	45
(In per cent of exports of goods and services)							
Debt service payments							
Excluding IMF	19	24	22	22	20	15	15
Including IMF	25	31	28	30	27	24	22
Including IMF and repayments of external payments arrears	25	46	44	40	36	33	22
Interest payments							
Excluding IMF	8	8	7	7	7	7	7
Including IMF	10	9	9	8	8	8	7
(In millions of SDRs)							
Memorandum items:							
Exports of goods ^{4/}	10.6	12.9	14.2	15.1	16.0	17.0	18.0
Imports of goods ^{5/}	-44.4	-42.0	-43.0	-44.6	-46.4	-48.0	-51.0
Net services and private transfers	16.2	17.0	16.9	17.5	17.8	18.0	18.5
Current account balance	-17.6	-12.1	-11.9	-12.0	-12.6	-13.0	-14.5
Official transfers and capital flows (net)	13.5	13.3	14.5	15.6	16.1	17.3	18.0
Overall balance	-4.1	1.2	2.6	3.6	3.5	4.3	3.5
Net use of Fund resources	-0.7	1.9	0.9	-1.4	-1.3	-2.1	-1.7
Repayment of arrears ^{6/}	--	-2.9	-3.5	-2.2	-2.2	-2.2	--
Stock of arrears outstanding	13.0	10.1	6.6	4.4	2.2	--	--

Sources: Information provided by the Western Samoan authorities; and staff projections.

^{1/} Amortization and interest payments in 1982 reflect actual payments excluding arrears on external debt servicing; debt service ratios for 1982 are calculated accordingly on the basis of actual payments.

^{2/} Including public, publicly guaranteed external debt, and use of Fund credit; end of period.

^{3/} Use of Fund credit outstanding at end-period; no further drawings from the Fund are assumed for the period 1983-88 beyond the requested stand-by and CFF purchases.

^{4/} Export volume is assumed to grow by about 2 per cent annually between 1984-88.

^{5/} Imports are derived as a residual; the implied volume growth is just over 1 per cent annually between 1984-87, and about 3 per cent in 1988.

^{6/} Illustrative schedule for the repayment of external payments arrears during 1984-87.

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