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INFORMATION

December 30, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Western Samoa - Staff Report for the 1982 Article IV
Consultation

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Western Samoa. A draft decision appears on page 17.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

WESTERN SAMOA

Staff Report for the 1982 Article IV Consultation

Prepared by the Staff Representatives for the
1982 Consultation with Western Samoa

Approved by Tun Thin and Manuel Guitian

December 28, 1982

<u>Contents</u>	<u>Page</u>
I. Introduction	1
II. Background to Discussions	1
1. Economic trends	1
2. Performance under the 1981/82 first credit tranche program	7
III. Policy Discussions	8
1. Budgetary policy	9
2. The public enterprises finances	10
3. Monetary and credit policy	11
4. External policy	12
5. Medium-term outlook	13
IV. Staff Appraisal	
 <u>Text Tables</u>	
1. Balance of Payments Summary, 1979-83	3
2. Budgetary Operations of the Government, 1979-83	4
3. Operating Surplus or Deficit of Public Enterprises, 1979-82	5
4. Monetary Survey, 1979-82	6
5. External Debt Projections, 1981-85	15
 Appendix I. Fund Relations with Western Samoa	 18
Appendix II. World Bank Group Operations in Western Samoa	19
Appendix III. Basic Data	20-21

<u>Contents</u>	<u>Page</u>
<u>Charts</u>	
Chart 1. Volume of Major Exports, 1974-83	2a
Chart 2. Domestic and Foreign Consumer Prices, 1974-83	2b
Chart 3. Government Budget, 1974-83	2c
Chart 4. Monetary Survey, 1974-82	2d
Chart 5. External Current Account, 1974-83	2e
Chart 6. Terms of Trade, 1978-83	2f
Chart 7. Trade Weighted Effective Exchange Rate Indices of Western Samoan Tala, 1978-82	8a

I. Introduction

The 1982 Article IV consultation discussions with Western Samoa were held in Apia during October 12-26, 1982. The Western Samoa representatives included Mr. A. Hutchison, Financial Secretary; Mr. Kolone Vaai, Deputy Financial Secretary; and officials from the Departments of Treasury, Economic Development, Customs, Inland Revenue, Agriculture, and Statistics, and the public enterprises. Meetings were also held with the Prime Minister, Mr. Tupuola Efi, and the Minister of Finance, Mr. Aliimalemanu Sasa. The staff team consisted of Messrs. Al-Eyd (ASD, Head), Browne (ASD), Sukachevin (ETR), Tsukahara (FAD), and Miss Rosario (ASD, Secretary).

Western Samoa continues to avail itself of the transitional arrangements of Article XIV. In April 1981, Western Samoa purchased the equivalent of SDR 0.745 million (16.56 per cent of quota) in the first credit tranche in support of a financial program covering the 12-month period ended February 1982, and the equivalent of SDR 2.0 million (44.44 per cent of quota) under the compensatory financing decision.

II. Background to the Discussions

1. Economic trends

Over the past decade, the average growth rate of the economy of Western Samoa has only slightly exceeded the growth rate of the population. Economic expansion has been limited primarily by the weak performance of the agricultural sector, which accounts for about half of GDP and about 90 per cent of exports. Output of copra and cocoa, the main export crops, and bananas has been adversely affected by the relatively old age of many trees, the impact of disease, and fluctuating export prices (Chart 1). In the latter part of the 1970s, the authorities embarked on an ambitious development strategy, which increased markedly the share of total resources absorbed by both the Central Government and the public enterprises.^{1/} The substantial increases in public sector expenditure, coupled with sluggish revenue performance and losses of public enterprises, caused partly by delays in price adjustments, resulted in serious fiscal imbalances which contributed to a pronounced acceleration in the rate of inflation (Charts 2, 3, and 4). Concurrently, the slow growth of export earnings, combined with increased import requirements of food, energy, and goods related to the expanded investment program, led to balance of payments pressures that became progressively more severe (Chart 5). In June 1979, the tala was depreciated by 19 per cent on a trade-weighted basis and a financial program was adopted in order to moderate demand, alleviate the balance of payments pressures and contain inflation. However, the subsequent economic performance fell short of expectations.

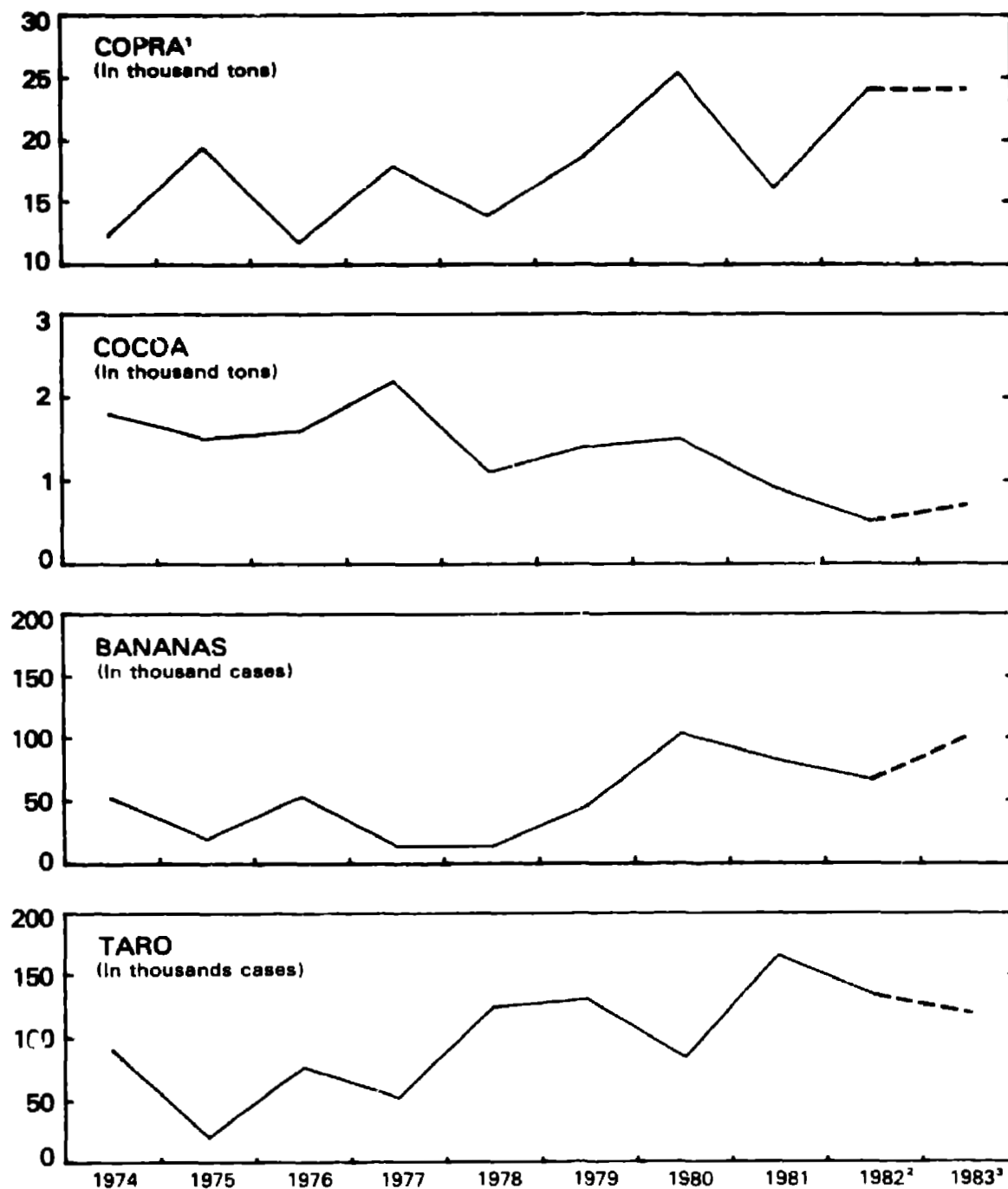
^{1/} Principal public enterprises include Western Samoa Trust Estates Corporation (WSTEC), the Copra, Cocoa and Banana Marketing Boards, the Special Projects Development Corporation (SPDC), Polynesian Airlines and the Electric Power Corporation (EPC).

Western Samoa experienced negative economic growth in 1980 and 1981 and only a modest recovery in 1982. Although no official national accounts statistics are available and the sparse available data make estimation difficult, particularly in relation to the subsistence sector, it appears that the decline in real GDP for the two years 1980 and 1981 together was about 10 per cent, and the increase in real GDP in 1982 was probably about 3 per cent. In the agricultural sector, the production of copra was volatile (declining in volume by about 30 per cent in 1981 and increasing by about 40 per cent in 1982), while the production of cocoa fell steadily (declining in volume in 1982 to only about 25 per cent of the output achieved in 1979). However, production of bananas began to recover after a long period of decline, and production of taro continued to increase. Movements in the terms of trade were highly unfavorable; between 1979 and 1982 export prices decreased by 40 per cent--with an even more pronounced decline for copra--while import prices increased by 35 per cent (Chart 6). With only modest increases in workers' remittances and in external grants and concessional loans, and despite substantially lower volumes of imports, the overall balance of payments deficit averaged almost 6 per cent of GDP in the period 1980-82 (Table 1). International reserves were virtually exhausted, and external payments arrears steadily accumulated to SDR 10.5 million by mid-October 1982, equivalent to one year's export earnings.

The potential benefit of the mid-1979 exchange rate adjustment was largely eroded by reductions in import duty rates and compensatory wage increases in the public sector, which employs about half of the nonsubsistence labor force. While the Government's total expenditure continued to increase strongly, the growth in receipts was constrained by the shortage of foreign exchange, which limited the imports on which duties could be levied, and the absence of measures to increase existing tax rates and government charges, broaden the tax base, and strengthen revenue collection procedures. Public finances were also adversely affected by a three-month civil service strike over wage claims during 1981. Consequently, the government budget deficit averaged about 14 per cent of GDP in 1980-82, and domestic bank financing of the Government, negligible prior to 1978, rose to an average of 5.5 per cent of GDP in this period (Table 2). Further, the overall financial position of the public enterprises weakened markedly, their published losses were equivalent to almost 5 per cent of GDP in 1980-81 and are estimated at 3.5 per cent of GDP in 1982 (Table 3).

Domestic credit expanded at an annual average rate of 31 per cent during 1980-82 (Table 4). Most of the expansion was accounted for by the increase in public sector credit, private sector credit increased by an annual average of only 10 per cent over the period, reflecting the reduced demand for trade financing associated with the lower level of imports and the increased availability of credit from other sources, particularly the Development Bank of Western Samoa in the case of agriculture and industry, and the National Provident Fund in the case of

CHART 1
WESTERN SAMOA
VOLUME OF MAJOR EXPORTS, 1974-83



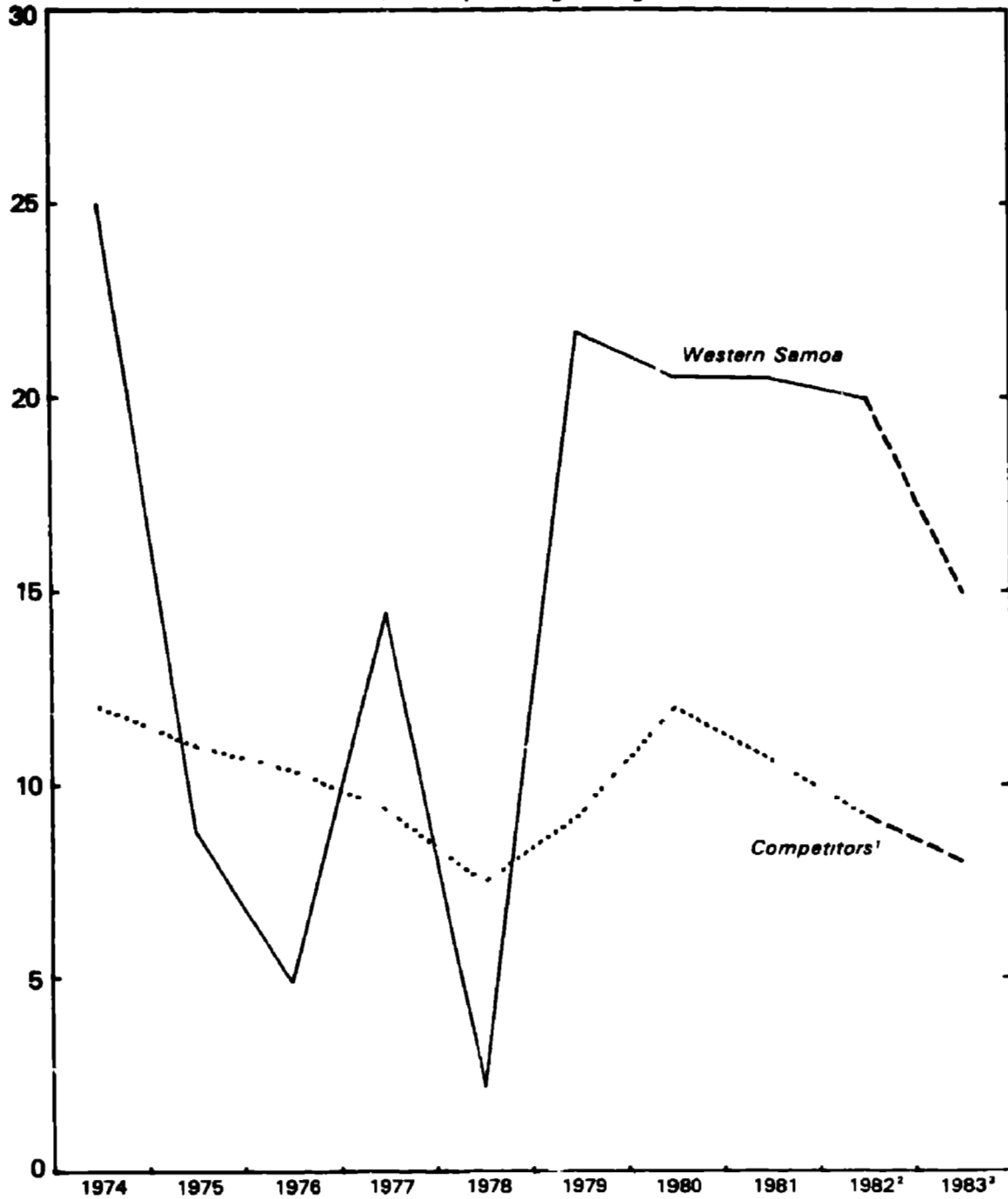
Source: Data provided by the Western Samoan authorities and staff estimates

¹Includes the copra equivalent of coconut oil and meal exports in 1982 and 1983

²Estimate

³Projection

CHART 2
WESTERN SAMOA
DOMESTIC AND FOREIGN CONSUMER PRICES, 1974-83
 (Annual percentage change)



Source: Data provided by the Western Samoan authorities and staff estimates

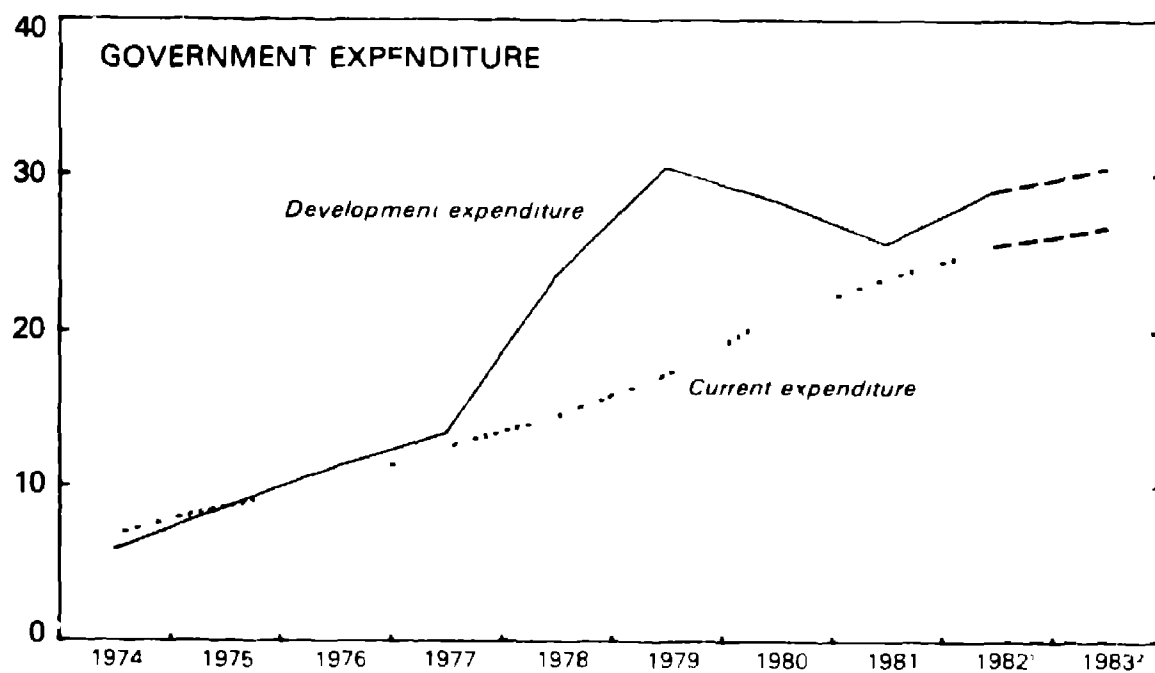
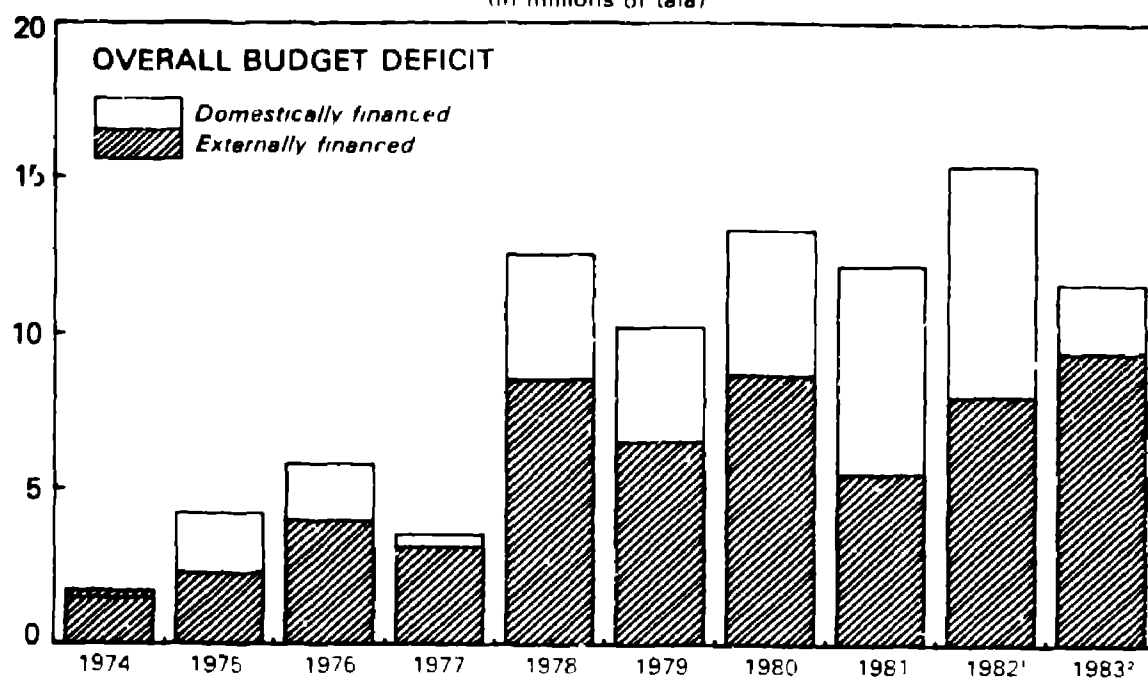
¹Trade weighted index of consumer prices in partner countries.

²Estimate

³Projection

CHART 3
WESTERN SAMOA
GOVERNMENT BUDGET, 1974-83

(In millions of tala)



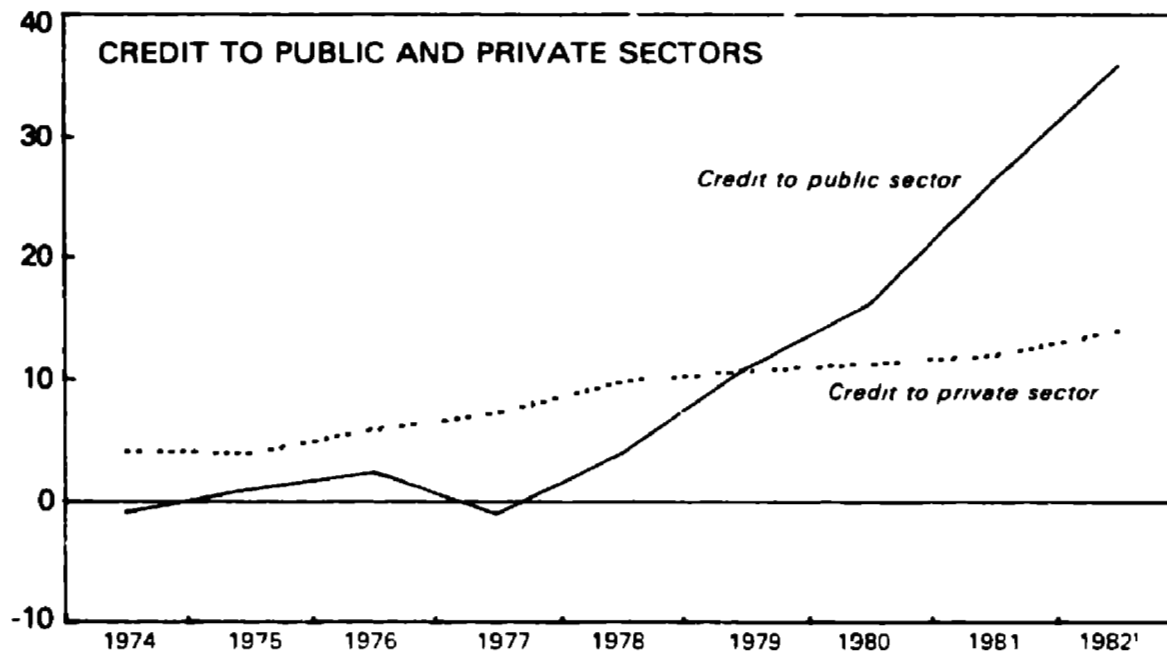
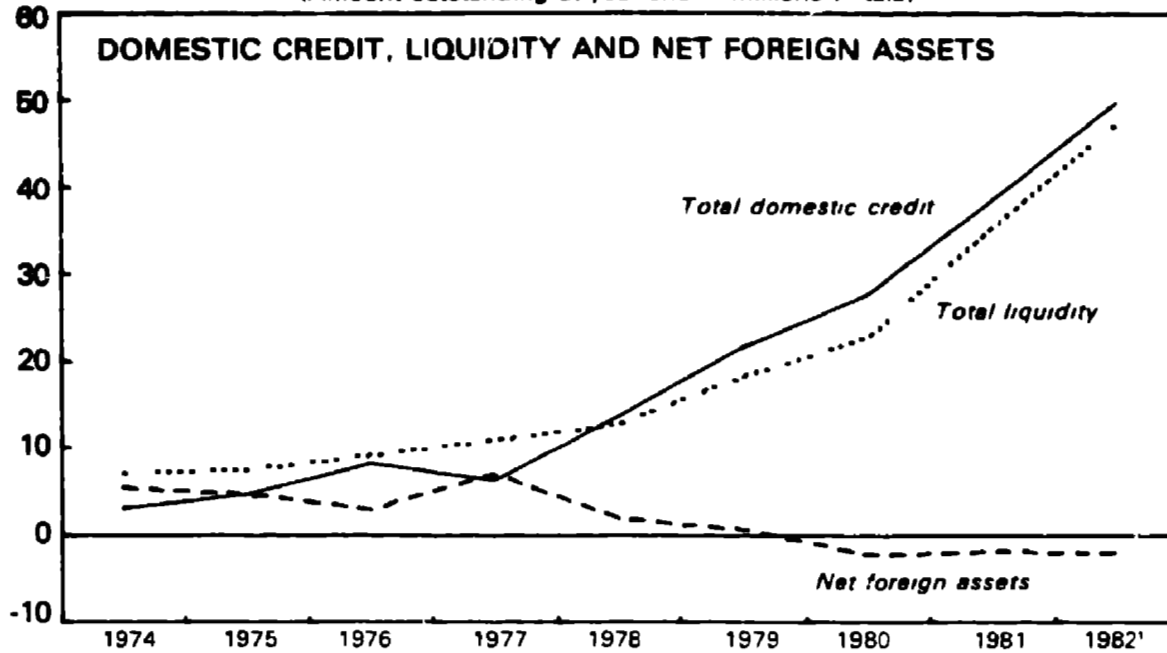
Source: Data provided by the Western Samoa authorities and staff estimates.

¹ Estimate

² Projection

CHART 4
WESTERN SAMOA
MONETARY SURVEY, 1974-82

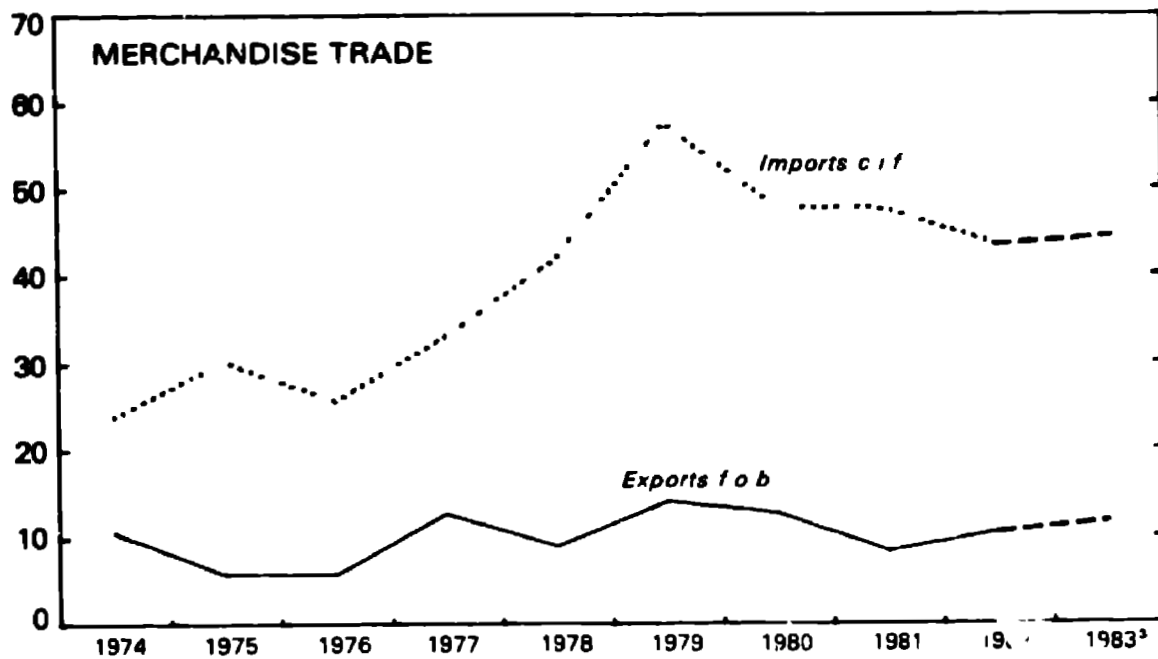
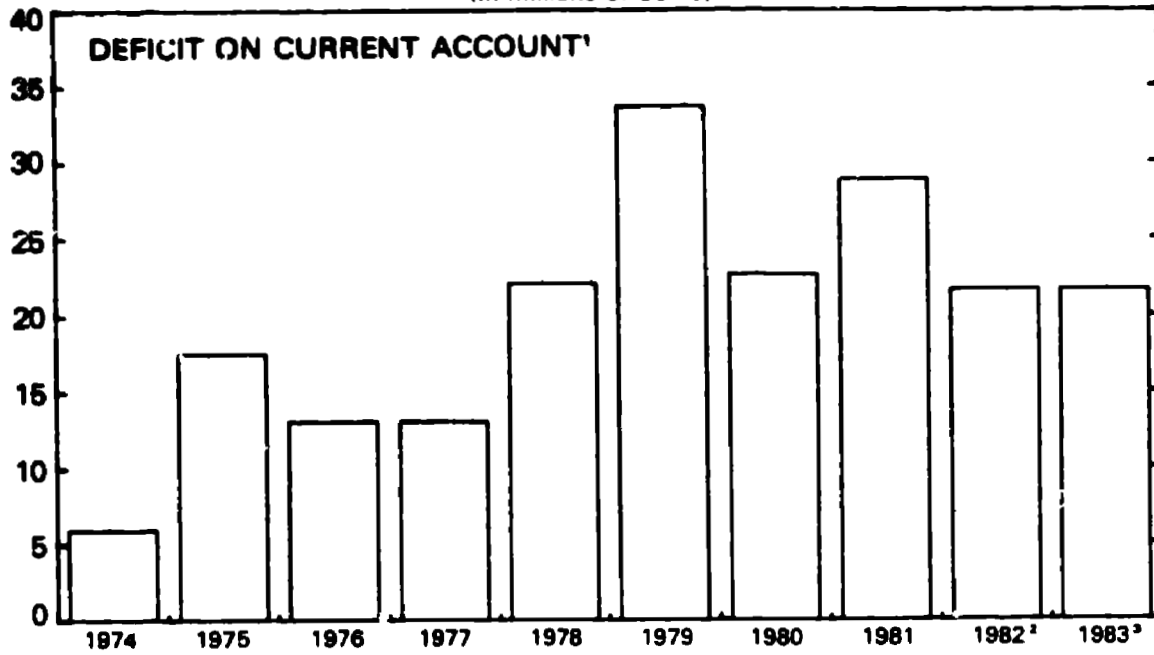
(Amount outstanding at year end in millions of tala)



Source: Data provided by the Western Samoan authorities and staff estimates

²Estimated

CHART 5
WESTERN SAMOA
EXTERNAL CURRENT ACCOUNT, 1974-83
 (In millions of SDRs)



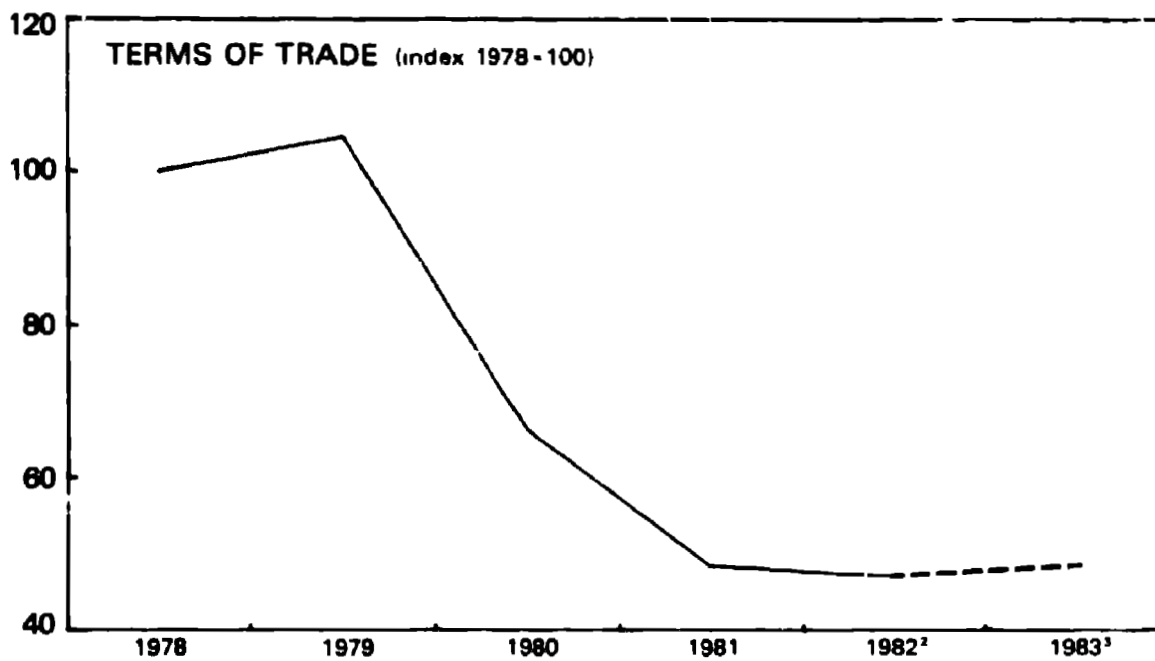
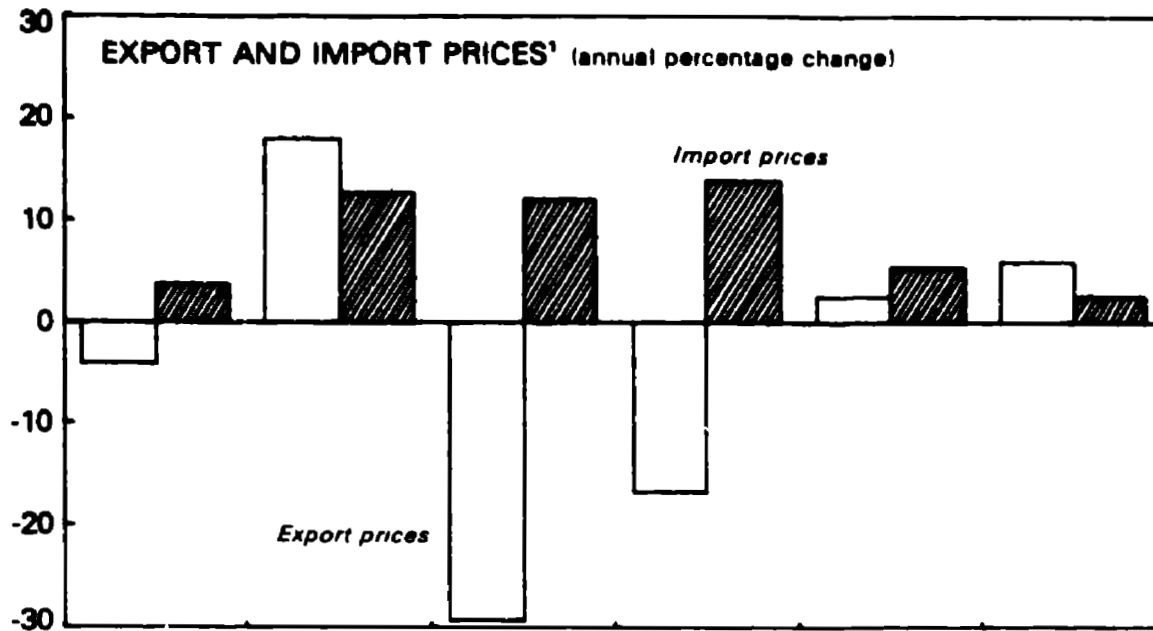
Source: Data provided by the Western Samoan authorities and staff estimates

¹Balance of goods, services and private transfers

²Estimate

³Projection

CHART 6
WESTERN SAMOA
TERMS OF TRADE, 1978-83



Source: Data provided by the Western Samoan authorities and staff estimates

¹ Expressed in terms of SDRs

² Estimate

³ Projection

Table 1. Western Samoa: Balance of Payments Summary, 1979-83

(In millions of SDRs)

	1979	1980	1981		1982	1983
			Proj. <u>1/</u>	Actual	Est.	Proj.
Exports, f.o.b.	14.2	12.8	13.9	8.4	10.5	11.7
Of which: coconut products	(8.2)	(7.0)		(3.4)	(5.5)	(5.8)
cocoa	(3.4)	(2.4)		(1.1)	(0.5)	(0.9)
Imports, c.i.f.	-57.5 <u>2/</u>	-47.9	-57.6	-47.7	-43.5	-44.4
Of which: oil	<u>(5.3)</u>	<u>(7.9)</u>		<u>(10.1)</u>	<u>(9.0)</u>	<u>(9.0)</u>
Trade balance	-43.3	-35.1	-43.7	-39.3	-33.0	-32.7
Services (net)	-0.8	0.5	1.0	-1.1	0.2	-0.8
Private transfers (net)	<u>10.5</u>	<u>11.9</u>	<u>10.5</u>	<u>11.5</u>	<u>11.2</u>	<u>11.8</u>
Current account	-33.6	-22.7	-32.2	-28.9	-21.6	-21.7
Government transfers	16.7	11.0	15.5	12.2	10.9	11.2
Nonmonetary capital (net)	15.3	7.8	13.9	10.3	6.7	7.0
Government	(6.1)	(7.3)		(4.5)	(5.9)	(7.0)
Other <u>3/</u>	(9.2)	(0.5)		(5.8)	(0.8)	(--)
SDR allocations	0.4	0.3	0.3	0.3	--	--
Overall balance	-1.2	-3.6	-2.5	-6.1	-4.0	-3.5
Of which: financed by arrears <u>4/</u>	(--)	(1.2)	(--)	(6.1)	(3.2)	(--)

Sources: Data provided by the Western Samoan authorities; and staff estimates.

1/ Assumption of March 1981 first credit tranche program.

2/ Includes the import of a ship for SDR 10 million financed by external grants and concessional loans.

3/ Government-guaranteed borrowing, private capital flows, and errors and omissions.

4/ Includes end-period valuation adjustment.

Table 2. Western Samoa: Budgetary Operations of the Government, 1979-83

(In millions of tala)

	1979	1980	1981	1982 Est.	1983 Proj.
Total revenue and grants	38.5	38.0	38.6	41.3	47.5
Total revenue	20.8	24.9	23.8	26.8	32.8
Tax	(16.6)	(20.4)	(20.3)	(22.1)	(26.7)
Nontax	(4.2)	(4.5)	(3.5)	(4.7)	(6.1)
External grants	17.7	13.1	14.9	14.5	14.7
Total expenditure	48.7	51.3	50.8	56.6	59.1
Current expenditure	17.2	21.0	23.4	25.5	26.7
Development expenditure	30.5	28.3	25.6	29.1	30.4
Domestically financed	(9.1)	(7.4)	(8.1)	(7.5)	(6.0)
Project loan-financed	(5.1)	(8.1)	(5.6)	(8.1)	(9.8)
Project grant-financed	(16.3)	(12.8)	(11.9)	(13.5)	(14.6)
Treasury advance account	1.0	1.9	1.9	2.0	2.0
Overall deficit (-)	-10.2	-13.3	-12.2	-5.4	-11.6
External financing	6.5	8.7	5.5	8.0	9.4
Domestic financing	3.7	4.6	6.7	7.4	2.2
Banking system	(4.1)	(3.5)	(6.2)	(6.4)	(1.2)
Nonbank	(-0.3)	(1.1)	(0.5)	(1.0)	(1.0)

(In per cent of GDP)

Memorandum items:

Total revenue and grants	46.9	41.7	40.8	36.5	36.5
Total revenue	25.3	27.4	25.1	23.7	25.2
Tax revenue	(20.2)	(22.5)	(21.4)	(19.5)	(20.5)
Total expenditure	59.2	56.3	53.7	50.1	45.5
Current	20.9	23.1	24.7	22.6	20.5
Development	37.1	31.2	27.0	25.7	23.4
Overall deficit (-)	-12.4	-14.6	-12.9	-13.5	-8.9
Domestic	4.5	5.1	7.1	6.5	1.7
Banking system	(4.9)	(3.9)	(6.5)	(5.6)	(0.9)

Sources: Data provided by the Western Samoan authorities; and staff estimates.

Table 3. Western Samoa: Operating Surplus or Deficit of
Public Enterprises, 1979-82

(In millions of tala)

	1979	1980	1981	1982 Est.
Western Samoa Trust Estates Corporation	-0.1	-0.6	-0.8	-1.1
Copra Board	0.9	-0.3	0.3	-0.8
Cocoa Board	-0.5	-0.1	-0.2	-0.3
Special Projects Development Corporation	-0.5	-1.1	-1.7	-0.6
Polynesian Airlines	-1.2	-0.8	-1.2	-0.2
Electric Power Corporation	-0.9	-0.7	-0.9	-0.3
Other	<u>-0.4</u>	<u>-0.6</u>	<u>-0.5</u>	<u>-0.5</u>
Total	-2.7	-4.1	-5.0	-3.8
Total as per cent of GDP	3.3	4.5	5.3	3.5

Sources: Data provided by the Western Samoan authorities; and staff estimates.

Table 4. Western Samoa: Monetary Survey, 1979-82

(In millions of tala; end of period)

	December			February		December
	1979	1980	1981	1982		1982
				Program 1/	Actual	Projection
Net foreign assets	0.6	-2.3	-1.9	-5.8	-2.5	-2.0
Net domestic assets	17.7	25.0	37.2	32.3	35.8	49.2
Public sector	7.0	13.7	25.2	19.2	22.9	35.2
Government	(6.1)	(9.6)	(15.8)		(13.2)	(22.2)
Enterprises	(4.8)	(6.7)	(10.5)		(11.4)	(13.5)
Other items, net	(-3.9)	(-2.6)	(-1.1)		(-1.7)	(-0.5)
Private sector	10.7	11.3	12.0	13.1	12.9	14.0
Total liquidity	18.3	22.7	35.3	26.5	33.3	47.2
Money supply	8.6	11.8	13.4		12.7	
Quasi-money 2/	9.7	10.9	21.9		20.6	

(Annual percentage change)

Memorandum items:

Net domestic assets	73.1	33.7	48.8	26.0	36.2	32.3
Credit to public sector, net	179.5	49.5	83.9	32.0	39.8	39.7
Credit to private sector	9.7	5.6	5.8	14.0	11.6	16.7
Domestic credit	57.1	27.9	36.2		34.3	29.8
Government	199.6	58.6	64.6		40.9	37.9
Public enterprises	147.3	39.0	58.1		62.9	27.9
Private sector	9.7	5.6	5.8		11.6	16.7
Total liquidity 2/	44.1	24.5	55.4	20.0	47.2	33.7

Sources: Data provided by the Western Samoan authorities; and staff estimates.

1/ Targets of March 1981 first credit tranche program.

2/ Includes counterpart deposits to external arrears.

construction. The limited range of monetary policy instruments coupled with negative real interest rates contributed to the growth in total credit. This was an important factor, together with the progressive curtailment of imports and the rise in import prices, contributing to the high rates of inflation. The 1980-based consumer price index increased by over 20 per cent annually in 1979-81 and is projected to rise at almost that rate in 1982.

Although these adverse developments hampered the authorities' adjustment efforts, certain actions to deal with the domestic and external imbalances met with success. Price stabilization schemes for copra and cocoa introduced at the beginning of 1982 helped to moderate the impact of the decline in world market prices on producers. While favorable weather was the main reason for the higher copra production in 1982, the increase in producer prices appeared to induce greater coconut collection and marketing efforts. The export base was diversified with the opening of a copra crushing mill, which should add 40 to 50 per cent in export value through the processing of copra into coconut oil and coconut meal, a recently-completed veneer mill should more than double the value of timber exports. The establishment of a brewery and a cigarette factory and the exploitation of local fishing resources made some import substitution possible. The completion of two hydropower projects in 1982 significantly reduced reliance on imported diesel fuel. Presently, about 50 per cent of electricity is generated from hydropower, and another hydro-project is under construction. The growth in public expenditure in 1982 was held to substantially less than the rate of inflation by limits on recruitment, the absence of a cost of living adjustment, tightened controls on other expenditure, and restraints on the activities of the public enterprises, including the reorganization of several loss-incurring concerns.

However, balance of payments pressures continued in 1982. Although exports of coconut products increased strongly and imports were reduced further, the external current account deficit remained at an unsustainable level. The competitiveness of the export sector was further weakened during 1982 because of the continued high rate of domestic inflation. Staff estimates indicate an appreciation of the tala on a trade-weighted basis of 22 per cent in real terms between the third quarter of 1979 and the fourth quarter of 1982, despite a depreciation of 10 per cent in nominal terms (Chart 7). The external debt service ratio (including repurchases to the Fund) also increased sharply, partly because of the repayment of commercial debts obtained in the late 1970s, from 15 per cent of exports of goods and services in 1980 to 35 per cent in 1982.

2. Performance under the 1981/82 first credit tranche program

The main objective of the financial program adopted by the authorities for the 12-month period ended February 1982 was to achieve a progressive reduction in the rate of inflation in order to create a more

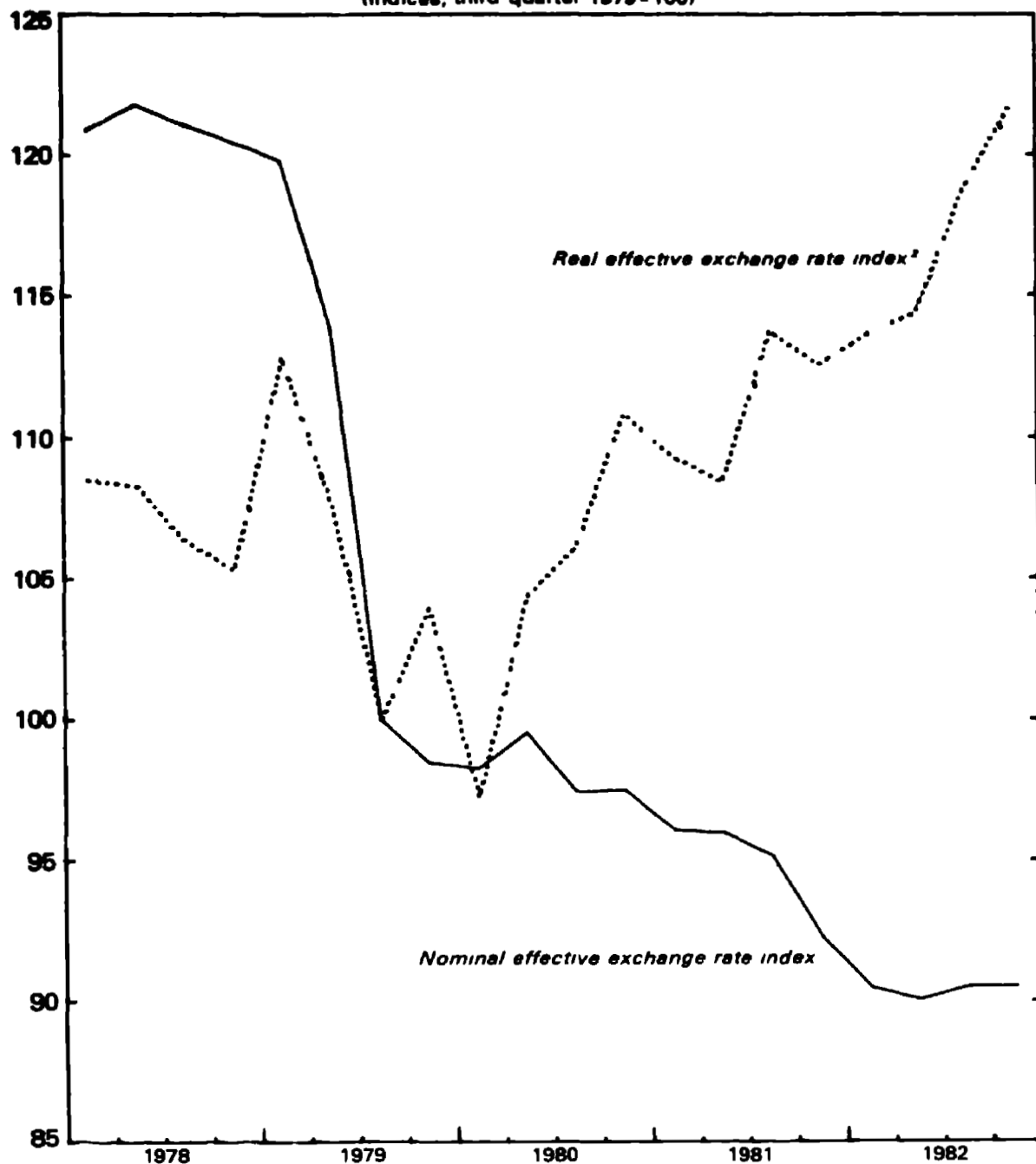
favorable climate for an improvement in the balance of payments over the medium term. This was to be secured through restraint in the budget stance and in credit policies, as well as an increase in interest rates, to moderate domestic demand. Real GDP growth of about 4 to 5 per cent in 1981 was envisaged, through a recovery in the production of cocoa and secondary crops with a substantial decline in the annual average inflation rate. Interest rates on bank deposits, government securities, and bank lending were raised by about 2 percentage points in February 1981, and targets were established for the increase in net domestic assets of the banking system and in net credit to the public sector for the year ended February 1982. For the calendar year 1981, an overall balance of payments deficit of SDR 2.5 million was projected. Export receipts were expected to increase 9 per cent because of the minimal recovery in world prices for copra and cocoa, while imports were expected to increase by 14 per cent, contributing to some increase in the external current account deficit that would be only partly offset by net capital inflows.

The objectives and targets of the financial program were not realized. As indicated earlier, real GDP declined sharply because of poor coconut and cocoa harvests, and no progress was made toward reducing inflation. The monetary targets for the 12 months to February 1982 were exceeded by a wide margin as net domestic assets increased by 36 per cent, compared with the target of 26 per cent. With declining volumes and lower world prices, export receipts declined by 34 per cent in 1981, instead of increasing as projected in the program. Although the value of imports was unchanged, the external current account deficit widened to SDR 29 million, equivalent to 37 per cent of GDP, and the overall balance of payments deficit at SDR 6.1 million in 1981 was substantially higher than anticipated.

III. Policy Discussions

The policy discussions centered on the economic policy stance that should be taken in 1983 to achieve quickly the overriding objectives of a substantial reduction in the rate of inflation and the re-establishment of a sustainable external current account position. The economic outlook foreseen by the authorities and the staff representatives made clear that, without a determined adjustment effort, the adverse trends of recent years would not be reversed. In the short term, the critical external financing position could be eased only by bringing domestic spending closely into line with available resources. The implementation of a stabilization program in 1983 was seen as an essential prerequisite for the restoration of sound and balanced growth in the medium term. The staff representatives discussed with the authorities a package of measures--including action to strengthen public finances, reduce the growth of credit, and pursue flexible interest and exchange rate policies--to moderate the rate of price increase by curbing consumption and to move the internal terms of trade in favor of rural producers. The proposed 1983 budget closely follows the draft budget discussed with the staff, and the other measures are currently under active consideration. In the medium term, prospects

CHART 7
WESTERN SAMOA
TRADE WEIGHTED EFFECTIVE EXCHANGE RATE INDICES
OF THE WESTERN SAMOA TALA, 1978-82
(Indices, third quarter 1979 = 100)¹



Source: Staff calculations

¹ Increase represents an effective appreciation

² Nominal effective exchange rate index adjusted for relative consumer price movements

for economic growth and balance of payments viability would depend largely on increases in agricultural output to expand exports and on more efficient use of available resources.

1. Budgetary policy

The proposed 1983 budget, approved by the Cabinet and presented to Parliament on December 18, 1982,^{1/} was designed with a view to minimize recourse to the banking system. The Government proposed to limit severely the growth in current expenditure and to reduce domestic financing of development expenditure to its lowest level in six years. The Government also proposed new revenue measures equivalent to about 3 per cent of GDP including changes in excise taxes, import duties and government fees and charges. With these measures, the overall deficit would be reduced to 9 per cent of GDP and the domestic bank financing of the budget would decline from 6 per cent of GDP in 1982 to 1 per cent of GDP in 1983 (Table 2).

The experience of 1982 indicated that cuts in government expenditure were feasible; it is estimated that the increase in current expenditure was held to 9 per cent in 1982, substantially below the rate of inflation. The increase in the wage and salary bill, which accounts for about half of appropriated budgetary expenditure, was limited to 10 per cent by curtailing recruitment and not permitting the regrading of jobs and cost-of-living adjustments. The increase in current expenditure other than wages and salaries and interest on public debt was held to 8 per cent, partly by improved administrative procedures. Domestically financed development expenditure was reduced, although an increased volume of external assistance was disbursed. More comprehensive expenditure restraint measures are to be imposed in 1983. The Government intends to allow only a small increase in the wage and salary bill, to freeze job classifications, and to effect a reduction of 4 per cent in the number of employees by the abolition of certain positions and strict observance of the sinking lid policy, under which vacancies created by retirement and other voluntary separation cannot be filled by recruitment. Further savings are to be sought in nonwage expenditure, including the transfer of some functions to the private sector. In curbing development spending, the authorities will take special care to avoid jeopardizing the flow of external assistance. The staff representatives stressed that stricter controls on the use of advance accounts and other forms of extrabudgetary spending and an improved system of monitoring to ensure that departments did not overspend their allocations would also be needed.

Government revenues as a proportion of GDP have been declining for several years, from over 27 per cent in 1980 to less than 24 per cent in 1982, because of the constraints on imports and the low elasticity of revenue. The authorities recognized that rates of taxation, which have been little changed for a considerable period, needed to be increased over a wide range if the budget deficit were to be held to the desired level in 1983. From domestic sources, apart from higher government fees and charges, the budget provides for increased excise duties on beer

^{1/} On December 21, 1982 the Government resigned. The status of the 1983 budget is in doubt pending clarification of the political situation.

and cigarettes and the reintroduction of a luxury hotel occupancy tax. Changes in income tax rates were not planned, but an increased collection effort that was underway was expected to reduce the amount of overdue payments. Additional levies on imports to raise revenue and to discourage consumption were also proposed in the 1983 budget, including an alteration in the base of duty collection from the traditional current domestic value method to the c.i.f. system that should raise receipts by about 17 per cent and make evasion more difficult.^{1/} A Fiscal Affairs Department mission that visited Apia in March 1981 submitted a series of recommendations for a reform of the tax structure. Some of these recommendations were incorporated in the 1983 budget; others, especially the imposition of a broadly based sales tax and a full-scale review of the customs tariff, were under examination by the authorities with the assistance of a team of foreign experts.

2. The public enterprises finances

The authorities intended to make substantial progress in 1983 toward improving the finances of the public enterprises and reducing their borrowing from the Treasury and the banking system. In the past few years, the contribution of these enterprises to the national development effort had not been commensurate with the large share of resources at their command. Large losses were incurred by the agricultural organization (Western Samoa Trust Estates Corporation or WSTEC), the export marketing boards (the Copra Board, the Cocoa Board and the Banana Board), the construction contractor (Special Projects Development Corporation), the national airline (Polynesian Airlines), and the electricity generation and distribution company (Electric Power Corporation). Some progress toward reducing the strain on the public finances by these enterprises was made in 1982. The losses of the construction company have been reduced by the installation of new management and the near completion of projects that the company obtained several years ago by offering unrealistically low tenders. Any losses made by the airline since the beginning of 1982 are borne by the foreign airline that has acquired a financial interest in it and which also assumed management responsibilities. The electricity corporation is now breaking even as a result of the sizable tariff increases of 1980-81 and the greater use of hydropower that reduces operating costs.^{2/}

^{1/} Import levies including the primage duty accounted for 47 per cent of tax revenue in 1982, but this ratio had declined steadily from 67 per cent in 1978; duties had been equivalent to about 18 per cent of total imports in 1980-82, compared with 25 per cent prior to the June 1979 depreciation.

^{2/} There are no explicit subsidies on retail prices of electricity and petroleum products. Ad valorem duties are levied on the c.i.f. value of petroleum imports at rates of 36 per cent for gasoline, 22 per cent for diesel (with an exception of duty for diesel used in electricity generation), and 6 per cent for kerosene. Petroleum products are also subject to the 4 per cent primage duty.

The enterprises that were likely to face difficulty in avoiding losses on their operations in 1983 were WSTEC and the marketing boards. In the case of WSTEC, which the authorities believe must play a crucial role in the expansion of agricultural production, improved management performance was essential to ensure that loan disbursements to the organization from the Asian Development Bank and the International Development Association continued smoothly. In the case of the marketing boards, an appropriate balance had to be struck between the provision of adequate incentives for producers and the financial impact on the budget. Given the present formulas for price determination under the stabilization schemes and the existing exchange rates, the maintenance of present producer prices would result in further losses by both the copra and cocoa funds in 1983.

3. Monetary and credit policy

The authorities' objective of reducing the rate of growth of credit expansion in 1983 depends crucially on the achievement of the planned improvement in public finances. In 1979-82, the public sector pre-empted 85 per cent of the total increase in domestic credit, with Government accounting for about 50 per cent, and credit to the public enterprises, accounting for about 35 per cent of the total increase. In 1982, the staff estimated that credit to the public sector, increased by about 35 per cent, and credit to the private sector, by about 17 per cent. However, the increase in total liquidity (including the deposits that are the counterpart of the external payments arrears) slowed from 55 per cent in 1981 to 34 per cent in 1982. In 1983, if the proposed measures to improve public finances are fully implemented, the increase in credit to the public sector might be limited to 10 per cent. The increase in total liquidity could fall to about 17 per cent, even assuming that the rate of increase in credit to the private sector was of the same magnitude as in 1982. Since the constraints on imports would continue to depress the demand for bank credit for trade financing and since the recent faster growth in private sector credit was associated mainly with the financing of construction activity, a somewhat slower rate of growth of bank credit to the private sector might be appropriate.

The authorities were concerned about the effects of the present level of interest rates on domestic savings, workers' remittances from abroad, and the allocation of resources. At present, bank deposit rates averaged 6 per cent on savings accounts and 9 per cent on term accounts, and bank lending rates averaged 12.5 per cent; all bank interest rates had been substantially negative in real terms for some time. The authorities were considering proposals to increase time deposit rates by an amount sufficient to remove the differential between Western Samoan and New Zealand rates for one to six-month deposits and to make the rate positive in real terms for one-year deposits. It was tentatively estimated that the required adjustment in time deposit rates would be 5-6 percentage points. The rate on savings accounts, which were used primarily as an alternative to checking accounts, would be increased by smaller

amounts. The authorities were also considering proposals to make key lending rates positive in real terms. If adopted, these proposals would raise rates for businesses (other than manufacturing) by 5 percentage points to 18 per cent, and for personal loans, by 6 percentage points to 20 per cent. Rates for priority areas would be increased by smaller amounts, by 2 percentage points to 14 per cent for agriculture, and by 2.5 percentage points to 16 per cent for manufacturing. It was estimated that the weighted average increase of these proposals would be about 4 percentage points. The staff representatives encouraged the authorities to proceed with these proposals and to strengthen the Monetary Board so as to enable it to perform a gradually increasing range of central bank functions and thus promote the adoption of a more active monetary policy.

4. External policy

The authorities did not expect any marked improvement in the underlying balance of payments position in 1983 and agreed with the staff representatives that the emergence of a financial gap could be prevented only by a further reduction of real imports. In 1982, the external current account deficit was reduced by SDR 7 million to the equivalent of 25 per cent of GDP, as a result of an improved export performance, a decline in oil imports achieved mainly by running down stocks, and a sharp fall in non-oil imports. However, despite higher external aid disbursements, total capital inflow was smaller and external payments arrears increased by SDR 3.2 million to SDR 10.5 million. In 1983, the external current account deficit would have to be reduced further, the emergence of new payments arrears would have to be prevented, and arrangements for the orderly elimination of existing payments arrears would have to be made.

Exports are projected to increase by 11 per cent in SDR terms in 1983. Despite world prices for copra and coconut oil that would on average be lower than in 1982, the value of exports of coconut products was expected to increase, since the copra crushing mill would be in operation for the whole year. Some recovery in the volume of cocoa exports could be expected from the depressed level of 1982, and further expansion in timber and veneer exports was in prospect. The authorities were projecting an increase in imports of 2 per cent in SDR terms in 1983, unchanged in real terms. The value of non-oil imports was expected to increase slightly, reflecting primarily an increase in imports financed through external assistance. The external current account deficit was projected to remain unchanged in SDR terms, but would decline as a proportion of GDP.

External assistance in the form of grants and loans was projected to increase by about 8 per cent in 1983. Among bilateral donors, assistance from Australia was expected to increase markedly as a result of the bunching of disbursements in the final months of the current three-year aid program ending in June 1983, and assistance from New Zealand was being maintained. With regard to multilateral assistance, larger disbursements

were expected out of existing loans from the AsDB and IDA and additional loans from OPEC sources. Other capital inflow was expected to be relatively small in 1983, particularly because of a decline in donations to finance church buildings that were an important source of funds in earlier years. Government-guaranteed borrowing had been negligible for some time, because of the completion of major industrial projects, and other private capital inflow appeared to have been affected by the poor economic situation.

On the above assumptions, an overall balance of payments deficit of about SDR 3 million was in prospect for 1983 (Table 1). Additional financing would be required to meet Fund repurchases of SDR 0.8 million and to reduce external payments arrears. If it appeared that the required financing would not become available, imports would have to be reduced in volume for the fourth consecutive year. The authorities intended to enter shortly into negotiations with foreign oil companies, whose overdue bills amounted to about two thirds of total arrears, and with other creditors. At present, an informal arrangement existed with the oil companies whereby an additional 5 per cent was paid on each shipment in order to reduce outstanding liabilities.

The authorities intended to pursue a flexible exchange rate policy aimed at restoring the competitiveness of the export sector and containing the demand for less essential imports. For this purpose, it was considered essential to allow the impact of the envisaged flexible exchange rate policy to be fully reflected in public sector prices, and not to grant compensatory wage increases or reductions in import duties. With the present shortage of foreign exchange, the scope for easing the restraints on imports under the foreign exchange allocation system was likely to remain limited for some time.^{1/}

5. Medium-term outlook

While implementation of the proposed stabilization policies should result, within the next year, in a marked decline in the rate of inflation, the shortage of foreign exchange is likely to remain a major constraint for a substantially longer period. Beyond 1983, in order to prevent the re-emergence of inflationary pressures and to promote the shift in resources toward the external sector, the authorities intend to reduce substantially the public sector's share of total domestic resources. Government spending in relation to GDP is estimated to have fallen from 59 per cent in 1979 to 50 per cent in 1982, and the authorities intend to ensure that this trend is continued. Apart from continued restraint on all public expenditure, including a cutback in public sector wages in real terms, the Government has also initiated arrangements to sell certain state commercial activities to the private sector.

^{1/} This exchange restriction is maintained in accordance with Article XIV and does not require Fund approval.

The authorities believed that growth prospects would not be seriously affected if the total volume of imports remained unchanged over the next few years; some reduction in oil imports was expected as a result of the increased availability of hydropower, and food imports could also be reduced. However, illustrative staff projections indicate that maintaining imports constant in real terms may not be possible. No substantive improvement in the terms of trade is in prospect in this period, and, in the absence of additional incentives, the increase in merchandise exports would be modest. The growth in workers remittances would probably be constrained by restrictions on opportunities for employment abroad. Under these circumstances, the current account deficit would average SDR 22 million during 1983-85. Prospects for attracting additional concessional assistance would appear to be limited, not least because of budgetary constraints in donor countries, while prospects for obtaining commercial bank foreign credit are tightly constrained because of payments arrears and the prospective debt burden. The above assumptions suggest that in 1983-85 the overall balance of payments deficit would average SDR 3 million annually, in addition to Fund repurchases becoming due (Table 5). Without allowing for any reduction in external payments arrears, projected external debt service payments (including Fund repurchases) are estimated at 30 per cent of exports of goods and services. In order to prevent the emergence of new arrears and to permit the elimination of existing arrears by the end of 1985, additional external financing of about SDR 7.5 million annually would be needed. In the absence of such flows, real imports would have to be substantially lower than in 1982 for the next three years.

IV. Staff Appraisal

Over the past few years, Western Samoa experienced a sizable decline in real income combined with high rates of inflation and severe external financing problems. The difficulties stemmed partly from a pronounced deterioration in the terms of trade and were compounded by several poor harvests of major export commodities, including coconuts in 1981 and cocoa in 1980-82. The adjustment of the domestic economy to the worsening external situation was modest, mainly because spending by the Government and the public enterprises could not be sufficiently constrained. Public sector finances deteriorated because of the rapid growth in government spending, lack of expenditure controls, sluggish revenue performance, and substantial losses by the public enterprises. The resulting public sector deficits required extensive use of domestic bank financing thus contributing to the high rate of inflation and balance of payments pressures.

In order to promote a sound and broadly based rate of economic growth, domestic and external imbalances must be greatly reduced. A comprehensive economic adjustment program will need to be implemented soon to moderate the rate of inflation and to move the balance of payments toward a sustainable position. A combination of measures is needed to bring domestic demand closely into line with financial availabilities. The most crucial policy element of a stabilization program will be the 1983 government

Table 5. Western Samoa: External Debt Projections, 1981-85

	1981 Actual	1982 Estimate	1983 Projections	1984 Projections	1985 Projections
(In millions of SDRs)					
External debt outstanding <u>1/</u>	51.7	57.6	62.3	65.4	69.8
Of which IMF <u>2/</u>	4.5	1.7	2.8	2.0	0.6
Loan disbursements	8.4	7.4	7.7	7.6	8.1
Of which IMF <u>3/</u>	2.8	--	--	--	--
Amortisation	2.3	3.5	3.3	3.7	4.1
Of which IMF	0.8	1.8	1.9	1.8	1
Interest payments	2.2	2.0	1.6	1.8	1.8
Of which IMF	0.2	0.3	0.2	2	0.1
(In per cent of exports of goods and services) <u>4/</u>					
Debt service payments					
Excluding IMF	24	28	25	24	3
Including IMF	31	35	31	30	10
Interest payments					
Excluding IMF	13	11	10	9	8
Including IMF	15	13	11	11	9
(In per cent of GDP)					
External debt outstanding					
Excluding IMF	64	64	61	58	56
Including IMF	69	68	64	60	57
Memorandum items					
(In millions of SDRs)					
Exports of goods <u>5/</u>	8.4	10.5	11.7	13.1	14.0
Imports of goods <u>6/</u>	-47.7	-43.5	-44.4	-46.6	-48.2
Net services and private transfers <u>7/</u>	10.4	11.4	11.0	11.5	12.0
Current account balance	-28.9	-21.6	-21.7	-22.0	-22.2
Official transfers and capital flows <u>8/</u>	22.8	17.6	18.2	18.9	19.7
Overall balance	-6.1	-4.0	-3.5	-3.1	-2.5
Fund repurchases	--	--	0.9	0.8	1.4
Repayment of arrears <u>9/</u>	--	--	3.1	3.5	4.0
Additional financing needed	--	--	7.4	7.4	7.9

Source: Data provided by the Western Samoan authorities, and tentative Fund staff projections for 1983-85.

1/ Including public, publicly-guaranteed external debt, and use of Fund credit, end of period.

2/ Use of Fund credit outstanding at end-period. The 1982-86 figures are derived based on the assumption that there will not be any use of Fund credit during this period. Therefore, the outstanding amount at end-period will increase by the amount of any Fund drawing inclusive of repayments.

3/ Use of Fund credit during the period.

4/ Excluding repayment of existing arrears.

5/ Export volumes are assumed to increase by about 2 per cent annually in 1983-85. A substantial part of the increase in export values is related to the value added to coconut products from the operations of the copra crushing mill.

6/ Import volumes are assumed to be constant in 1982-85 and import prices are assumed to increase by 2 per cent in 1983, 5 per cent in 1984 and 4.5 per cent in 1985.

7/ Net services are assumed to be approximately in balance in 1983-85. Workers remittances are assumed to increase by about 4.5 per cent annually.

8/ The value of aid imports is estimated to increase by 8 per cent in 1983 and about 4 per cent annually in 1984-85.

9/ Illustrative scheme for the repayment of existing arrears by end-1985.

budget, supplemented by necessary improvements in the financial operations of public enterprises, adjustments in interest rates, and a flexible exchange rate policy.

The 1983 budget has been designed with the aim of minimizing recourse by the Government to the domestic banking system. Domestic resource mobilization has been inadequate in recent years, and government revenue has declined in relation to GDP. The improved import duty valuation system, enhanced excise duties, stricter collection procedures in the customs and inland revenue departments, and higher government fees and charges, envisaged in the 1983 budget, constitute important initiatives to reverse this trend. The authorities are firm in their intention to restrain strictly public expenditure, and their efforts to this end are welcome. The proposed curbs are ambitious, and their successful implementation will require a greatly improved system of expenditure control and intensified monitoring of all spending. In addition, to achieve the desired reallocation of resources over the medium term, measures to transfer resources to export-oriented and import-substituting sectors, as proposed by the Government, will need to be vigorously pursued.

In order to encourage domestic savings, as well as to promote the repatriation of earnings by Western Samoan residents abroad, bank deposit rates should be raised substantially. If key deposit rates were made positive in real terms, the differential between rates in Western Samoa and New Zealand would be virtually eliminated. With commensurate increases in bank lending rates which at present are highly negative in real terms and the planned improvement in public sector finances, the growth of the main monetary aggregates would be appropriately modest.

Amelioration of the heavy pressure on the external payments position is dependent both on the pursuit of fiscal and monetary policies to restrain domestic demand and on measures to stimulate production in the export sector. Balance of payments viability in the medium term will require a strengthening of the export sector and a reduction of import levels from those prevailing over recent years. The gradual nominal depreciation of the tala since July 1979 has offset only part of the sharp rises in the relative costs of producers in the export sector. Continued exchange rate flexibility will be necessary to strengthen and safeguard export competitiveness. The staff would also urge the authorities to undertake the necessary steps toward the orderly elimination of external payments arrears, including, if possible, negotiations with creditors to this effect.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Western Samoa's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1982 Article XIV consultation with Western Samoa, in the light of the 1982 Article IV consultation with Western Samoa conducted under Decision No. 5392- (77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

2. The Fund notes that the exchange system of Western Samoa involves restrictions on payments and transfers for current international transactions, of which those evidenced by payments arrears are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to eliminate payments arrears as soon as possible.

Fund Relations with Western Samoa
As of November 30, 1982

Date of membership:	December 28, 1971		
Status:	Article XIV		
Quota:	SDR 4.5 million		
Use of Fund resources:		<u>SDR Millions</u>	<u>Per cent of Quota</u>
	CFF	2.63	58.44
	Regular tranches	1.12	24.89
	Oil facility	0.02	0.44
	Total	3.77	83.77
SDR position:	Cumulative allocation: SDR 1.14 million. Present holdings: SDR 14,306 (1.25 per cent of net cumulative allocation).		
Trust Fund:	First period: SDR 0.83 million. Second period: SDR 1.13 million.		
Exchange rate system:	The exchange rate of the tala is determined with reference to a composite of currencies. Under Rule 0.2, the mid-point between the Bank of Western Samoa's buying and selling rates for the U.S. dollar was established with the Fund on August 18, 1975 as the representative rate for the tala.		
Representative rate:	US\$1 = WS\$1.26		
Exchange and trade restrictions:	A foreign exchange allocation system for imports has been maintained since Western Samoa became a member of the Fund.		
Last Article IV consultation:	Staff discussions were held in September 1980. The Executive Board discussed the Staff Report (SM/80/243 and SM/80/251) on December 8, 1980.		
Technical assistance:	An FAD mission reported on possibilities for tax reform in June 1981.		

World Bank Group Operations in Western Samoa

Statement of IDA credits (as of September 30, 1982)

<u>Credit Number</u>	<u>Date of Approval</u>	<u>Purpose</u>	<u>Commitment</u>	<u>Undisbursed</u>
			<u>(US\$ mn.)</u>	
535	March 1975	Highways	4.4	--
951	November 1979	Agricultural Development	8.0	4.1
1080	November 1980	Agricultural Development	2.0	1.97

Statement of IFC investments (as of September 30, 1982)

None

The 1979 credit, was for the initial phase of a long-term agricultural development program under the Western Samoa Trust Estates Corporation, aimed primarily at increasing productivity, production and exports of cocoa, coconuts, coffee and other crops; implementation difficulties were encountered during 1982. Following a meeting in June 1982 of the co-financiers (IDA, UNDP, AsDB, and the Australian Development Assistance Bureau), a six-month program was agreed on completion of which progress will be reassessed. Disbursements of the 1980 credit, which is co-financed by the AsDB and the Australian Development Assistance Bureau, have so far been small.

Western Samoa

Basic Data

Area:	1,097 square miles
Population (1981):	158,000
Population growth rate:	2.8 per cent annually
Population growth rate, net of migration:	0.8 per cent annually
GDP per capita (1982 estimate):	SDR 500

<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> <u>Est.</u>
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(Annual percentage change)

Selected economic indicators

GDP at constant prices	12.0	-3.0	-7.0	3.0
Consumer price index	21.7	20.5	20.5	19.5
Government revenue <u>1/</u>	14.3	19.7	-4.4	12.6
Government expenditure	23.0	5.3	-0.8	11.4
Total domestic credit	57.1	27.9	36.2	32.3
Total liquidity <u>2/</u>	44.1	24.5	55.4	33.7
Merchandise exports, f.o.b.	59.6	-9.8	-34.4	25.0
Merchandise imports, c.i.f. <u>3/</u>	13.4	-0.3	-0.4	-8.8
Export volume	35.4	27.4	-21.2	22.0
Import volume <u>3/</u>	0.7	-9.9	-12.4	-13.5
Terms of trade (deterioration -)	4.7	-36.7	-26.9	-2.8
Effective exchange rate index (depreciation -) <u>4/</u>				
Nominal	-19.5	-1.0	-5.3	-2.0
Real	-1.3	6.7	1.5	8.3

(In per cent of GDP)

Selected financial ratios

Government revenue	25.3	27.4	25.1	23.7
Government expenditure	59.2	56.3	53.7	50.1
Budget deficit	12.4	14.6	12.9	13.5
Domestic bank budgetary financing	4.9	3.9	6.5	5.6
External budgetary financing	7.9	9.5	5.8	7.0
Total liquidity <u>2/</u>	22.2	24.9	37.3	41.4
External current account deficit	43.2	29.9	37.1	25.4
Oil imports (per cent of total imports)	11.2	16.5	21.2	20.7
External public debt, excluding IMF	47.9	56.7	63.6	63.6

Western Samoa

Basic Data (concluded)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> <u>Est.</u>
	<u>(In per cent of goods and services)</u>			
<u>External debt service ratios</u>				
Debt service, excluding IMF	10.8	12.6	24.3	27.7
Debt service, including IMF	12.1	15.2	31.1	34.6
Interest payments, excluding IMF	5.2	.2	13.5	10.7
Interest payments, including IMF	6.1	8.0	14.7	12.6
	<u>(In millions of SDR)</u>			
<u>External payments data</u>				
Overall balance of payments deficit	1.2	3.6	6.1	4.0
Gross official reserves	4.3	3.0	3.6	3.4
(In months of imports)	(1.1)	(0.8)	(0.9)	(0.9)
External payments arrears	--	1.2	7.3	10.5

Sources: Data provided by the Western Samoan authorities, and staff estimates.

1/ Excluding external grants; 1981 figures are affected by a public service strike.

2/ Including the counterpart deposits to external payments arrears.

3/ Excluding a ship imported for SDR 10 million in 1979.

4/ Change between fourth quarters.