

**FOR  
AGENDA**

SM/10/99

April 23, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Samoa—Selected Issues**

This paper provides background information to the staff report on the 2010 Article IV consultation discussions with Samoa (SM/10/98, 4/23/10), which is tentatively scheduled for discussion on **Friday, May 7, 2010**. At the time of circulation of this paper to the Board, the authorities of Samoa have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Any requests for modifications for publication must be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Unterroberdoerster, APD (ext. 35448).

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INTERNATIONAL MONETARY FUND

SAMOA

**Selected Issues**

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Approved by the Asia and Pacific Department

April 22, 2010

Contents	Page
I. Samoa: The Impact of the 2009 Tsunami on Tourism and the Economy .....	2
A. Overview .....	2
B. Background on Samoan Tourism Sector.....	2
C. Impact of Tsunami on Tourism and the Economy: Initial Assessment .....	4
D. What Do Recent Tourism Data Tell Us? .....	6
E. Conclusion.....	7
II. Samoa: Impediments to Bank Intermediation and Monetary Transmission.....	8
A. Overview .....	8
B. Background: Samoa's Monetary Policy and the Banking Sector .....	8
C. The Effectiveness of the Monetary Transmission Mechanism .....	9
D. Constraints on Bank Lending.....	10
E. Conclusion and Policy Implications.....	11
III. State-Owned Enterprise Reform in Samoa.....	13
A. Background .....	13
B. Community Service Obligations and Tariff Structure .....	14
C. Corporate Governance Reform .....	15
D. Status of Reform Program.....	16
E. Possible Ways Forward .....	16
F. Conclusion .....	18

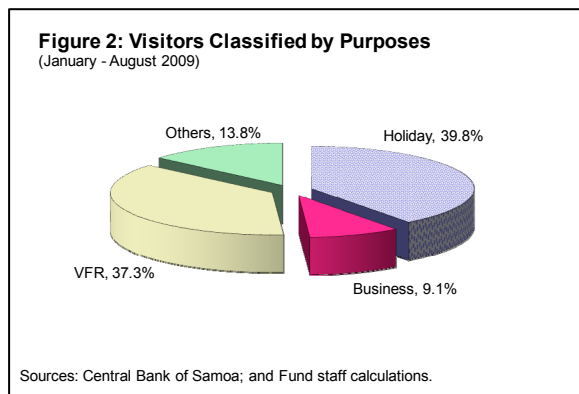
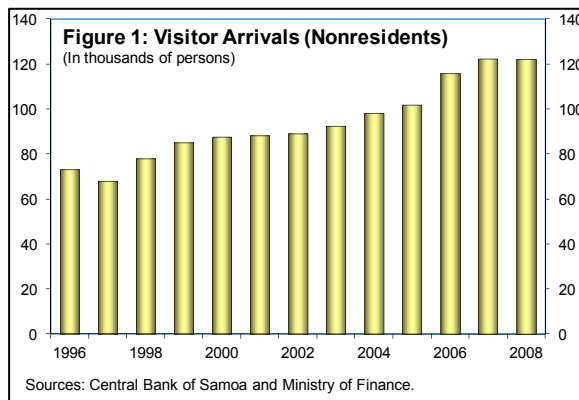
## I. SAMOA: THE IMPACT OF THE 2009 TSUNAMI ON TOURISM AND THE ECONOMY<sup>1</sup>

### A. Overview

1. **The tsunami that hit Samoa on September 29 has inflicted unprecedented damage to the tourism sector.** In addition to physical destruction, confidence in Samoa as a safe and attractive destination has been dealt a severe blow. With tourism being the economy's single most important commercial foreign exchange earner and source of formal and informal employment, the tsunami could well cause the economy to contract this year, resulting in significant balance of payments pressures and delaying Samoa's recovery from the global recession. Against this background, this paper assesses the impact of the tsunami on tourism revenue and the economy.

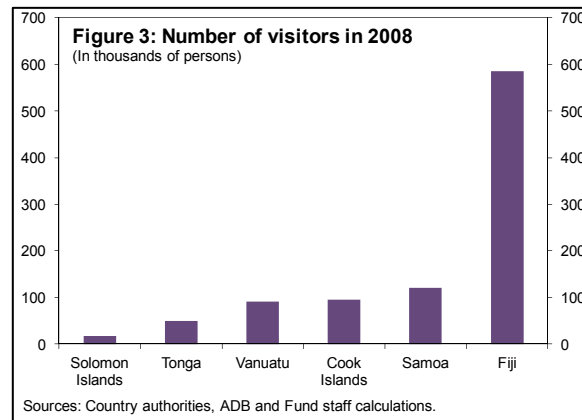
### B. Background on Samoan Tourism Sector

2. **Samoa has enjoyed strong and steady growth in visitor arrivals.** Over the past decade total visitor arrivals have increased nearly 80 percent to 122,163 in 2008 (Figure 1). Visiting friends and relatives (VFR) continues to be one of the most important segments, comprising 37.3 percent of all visitors in 2009 pre-tsunami (Figure 2). However, the share of holiday makers has steadily risen from 30.4 percent in 1997 to 39.8 percent in 2009 pre-tsunami, with the remainder being business visitors whose numbers have remained stable in absolute terms. Holiday visitor numbers surged in particular after 2005, when the introduction of flights by Polynesian Blue—Samoa's privatized state carrier—meant more competition with Air New Zealand and led to a substantial lowering of airfares. Direct flights from the east coast of Australia were also introduced by Polynesian Blue, giving Samoa access to an enlarged tourist market.

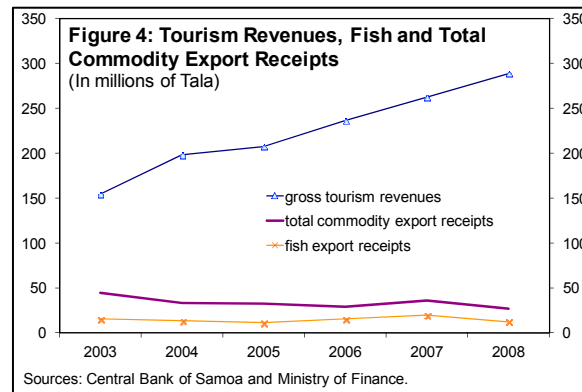


<sup>1</sup> The main contributors are Runchana Pongsaparn (APD) and Dominic Mellor (AsDB).

3. **Prior to the tsunami, Samoa had been relatively competitive as a tourist destination.** Relative to other Pacific islands, Samoa's share of visitors from New Zealand gradually increased from 11.9 percent in 2002 to 16.9 percent in 2008, while the share of visitors from Australia stabilized at 5–6 percent. Comparing the total number of visitors to the Pacific islands in 2008, Samoa came second after Fiji (Figure 3). Samoa has found its niche market with the fale (traditional beach hut) experience as a distinctive selling point. Furthermore, strong kinship ties with Samoans living in New Zealand, Australia, and American Samoa have significantly contributed to the growing strength of its tourism industry.



4. **As a result, tourism has become a key source of income and economic growth.** While total visitor numbers increased by almost 80 percent over the past decade, earnings in the sector increased even faster, by 191 percent with growth particularly evident in the past three years (Figure 4). Tourism receipts are equivalent to about 20 percent of GDP, making the sector by far the single largest commercial earner of foreign exchange.<sup>2</sup> Staff estimates suggest that the tourism sector's contribution to GDP is substantial, ranging from about 9 percent of GDP, taking into account direct value-added in hotels and restaurants, to 14 percent if the indirect value-added of related sectors such as transport and communication, commerce, and agriculture is considered.<sup>3</sup>



<sup>2</sup> By contrast, the value of fish exports, which as the second most important commercial activity account for about 50 percent of Samoa's goods export, was only about 4 percent of that of tourism receipts in 2008.

<sup>3</sup> Samoa's national accounts data do not provide data on the tourism value-added as related spending cuts across various sectors. The estimates are based on: (1) the imputed value-added used for VAT tax assessments in the hotel and restaurant sector (about 45–49 percent of gross receipts), and (2) cross-country experience suggesting that for small island economies, such as Samoa, the direct and indirect value-added (embedded in domestically produced intermediate goods provided to the tourism sector) is about 70 percent of gross tourism expenditure. This is in line with the total direct and indirect value added of around 70–80 percent of gross tourism expenditure in the case of Tonga, the Maldives, and Fiji in 2008 (based on World Tourism and Trade Council data) and around 80 percent in the case of the Canary Islands in 1992 (see Martin, R. H. (2004), "Impact of Tourism Consumption on GDP. The Role of Imports," *Fondazione Eni Enrico Mattei*, Working Paper

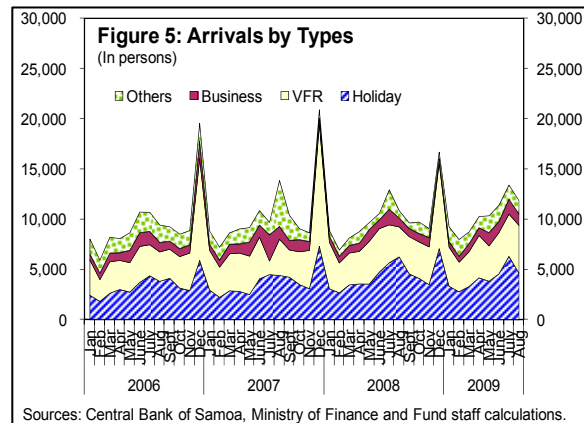
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### C. Impact of Tsunami on Tourism and the Economy: Initial Assessment

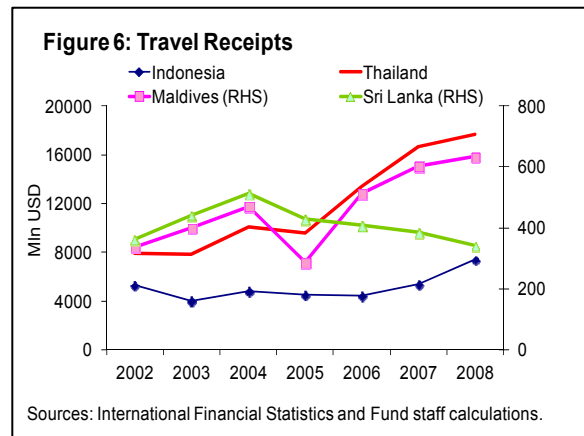
*To gauge the impact of the tsunami on tourist receipts we consider: (1) the damage to capacity, (2) Samoa-specific tourism demand patterns, and (3) international experience.*

5. **Damage to capacity:** Various damage assessments, including by the UN and World Bank or the Samoa Tourism Authority (STA), suggest that around 20 percent of the capacity (in terms of number of rooms and beds) was disabled. While there appears to have been generally less destruction among STA accredited hotels and resorts, in certain areas all of small-scale beach fale<sup>s</sup>, which are unique to Samoa, were destroyed. However, the Faleolo International Airport has remained open.

6. **Samoa-specific tourism demand patterns:** Tourism is seasonal and can be split into two broad categories: Visiting friends and relatives (VFR) and holiday makers. Official tourism data show that most visits occur during June/July and December (Figure 5). The June/July period coincides with the southern hemisphere winter and is a popular time for holiday-makers from New Zealand and Australia to visit, which is where the majority of tourists originate from. The December period is when most VFRs return. The timing of the tsunami at the end of September was therefore just after the peak tourist season but before the festive season when the majority of VFR arrive. This suggests that the damage to the tourism infrastructure may not be a binding constraint on near-term visitor arrival numbers.



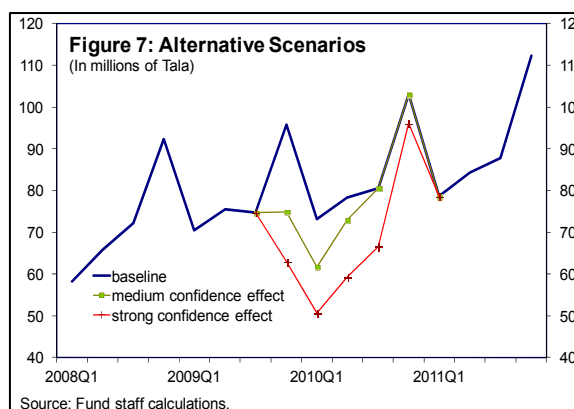
7. **International experience:** The tsunami will have changed perceptions about the desirability of Samoa as a holiday destination. The extensive damage to existing tourism infrastructure, including surrounding village communities that make it a unique holiday experience, will need to be repaired. The Thai, Indonesian, and Maldives experience after the 2004 tsunami



No. 2004.27). Separately, AsDB estimates an economic multiplier of 0.7 for every tala spent by tourists. ("Taking the Helm: A Policy Brief on a Response to the Global Economic Crisis," Asian Development Bank, 2009).

suggest that it may take between 4–8 quarters before tourism revenue returns to its comparable pre-tsunami level (Figure 6).

8. **As a result, we consider three alternative scenarios.** The baseline scenario is pre-tsunami, scenario 1 is for medium confidence effect with a recovery over 4 quarters, and scenario 2 is for strong confidence effect with a slower recovery after 6 quarters. The baseline follows the long-run industry growth trend and is seasonally adjusted.<sup>4</sup> VFR visitor arrivals are assumed not to be impacted by the tsunami. Tourism spending per person for each category of visitors remains constant in real terms. Under the alternative scenarios, the loss in tourism earnings in 2009/10 varies between US\$14–28 million depending on the speed of recovery and the impact on confidence. This means that for FY 2009/10 tourism revenue could be 9–20 percent lower than in FY 2008/09.<sup>5</sup> However, in FY 2010/11 tourism would rebound, with revenues growing between 22–31 percent (year on year).



9. **The resulting impact on economic activity and the current account deficit would be substantial.** Based on the importance for employment and value-added creation and on the backward linkages of the tourism sector with Samoa's economy described above, the decline in tourism sector revenue could take about 1.7–3.3 percent off Samoa's GDP in FY 2009/10.<sup>6</sup> At the same time, the current account deficit would widen, but not by the full amount of the projected shortfall in tourism receipts. With about 30 percent of receipts related to imported intermediated goods, the net effect would range from US\$10 to US\$20 million in FY 2009/10.

<sup>4</sup> Aside from the southern hemisphere months of June/July, the official country data also show a sharp increase in holiday-makers during December which is inconsistent with the out-of-country data from New Zealand. Much of this may be explained by classification, for example, an overseas Samoan may be leaving New Zealand for 'holiday' purposes to 'visit friends and family' in Samoa. There are also significant numbers of Samoans that reside in American Samoa that return home on 'holiday' during December.

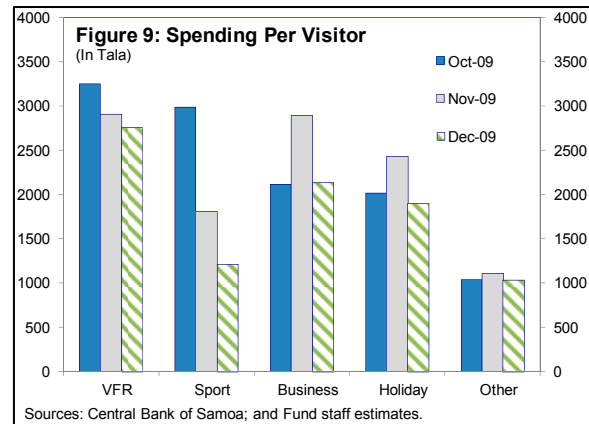
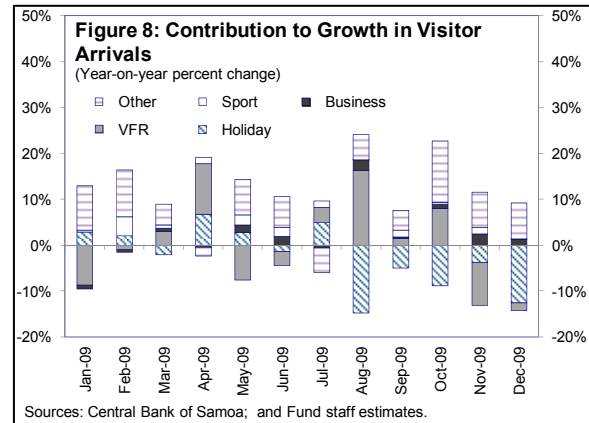
<sup>5</sup> This is consistent with the first-year tourism earnings loss of 16.5 percent on average for Indonesia, the Maldives, and Thailand.

<sup>6</sup> With around 6 percent of formal sector employment in hotels and restaurants, the tsunami is likely to result in significant economy-wide job losses that may only be partially offset by jobs generated through reconstruction activities.

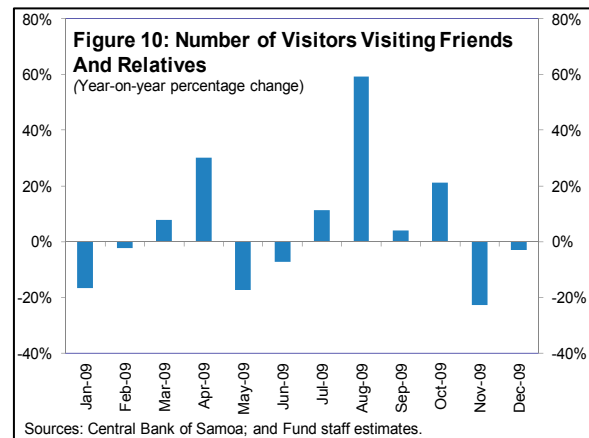
## D. What Do Recent Tourism Data Tell Us?

10. While it is still too early to assess the impact of the tsunami based on actual tourism data, the few data points available so far broadly confirm expectations.

- **Overall visitor arrivals** increased by 6.4 percent year-on-year in October and November. However, this was the result of a doubling in the number of volunteers in rescue operations and reconstruction—as classified in ‘other’ category in the purpose of visit (Figure 8). Despite a large number of volunteers contributing to a significant rise in the headcount, tourism earnings did not grow proportionately. In fact, the overall earnings declined by 8.5 percent year-on-year. This is due to lower spending per head compared to other types of visitors (Figure 9).



- **VFR visitors** appear to have shifted forward their festive-season visits in response to the tsunami. October saw a significant increase in the VFR visitors at an expense of a decline in November and December (Figure 10). The total earnings from VFR visitors between October and December were lower, however, than the working assumption in our forecasts of constant real-term spending per person.



- Arrival data for **holiday makers** continues to worsen, broadly in line with our forecasts. The number of holiday makers fell 22.4 percent year-on-year in the last quarter of 2009, which was less than the initial assessment. The decline in overall earnings from holiday makers was also lower than projected. However, preliminary data on holiday-maker arrivals in January 2010 point to an accelerating decline of 36.8 percent year-on-year. In addition, Samoa has lost significant market share of holiday makers from



New Zealand from 17.7 percent in December 2008 to 12.9 percent over the same period in 2009. This may partly reflect the impact of the tsunami on confidence.

### **E. Conclusion**

11. **The impact of the tsunami on tourism and the Samoan economy is likely to be substantial.** Despite a relatively small direct contribution of tourism in the national accounts, tourism has been an important foreign currency earner and provider of employment and income. The damage caused by the tsunami is not only in terms of the loss in capacity but also the likely change in perception of Samoa as a safe destination and the impact on local area livelihood. Nevertheless, humanitarian efforts, the reconstruction process, as well as upcoming sporting events may help alleviate the adverse impact of the tsunami to a certain extent.

## II. SAMOA: IMPEDIMENTS TO BANK INTERMEDIATION AND MONETARY TRANSMISSION<sup>1</sup>

### A. Overview

1. **This note reviews the credit channel and effectiveness of the monetary transmission mechanism in Samoa.** Since mid 2008, the Central Bank of Samoa (CBS) has pursued an aggressive accommodative monetary policy stance with limited success. Despite a large reduction in the official rate since May 2008, adjustments in commercial bank lending rates have been sluggish. In addition, interest spreads increased while credit growth continued to slow.

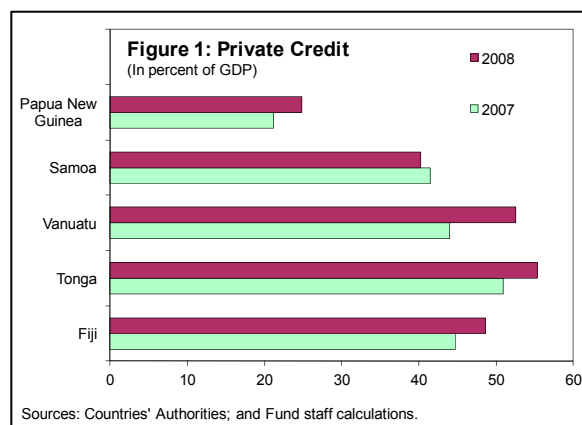
2. **Several factors can explain the weakness of the interest rate, credit, and monetary transmission mechanisms in Samoa.** An economic downturn can induce greater external financing premium, thus increasing the effective rate of lending. Fear of default may also cause a credit crunch. Moreover, structural problems such as asymmetric information, problems with bank-lending collateralization and lack of competition in the banking system likely contribute to the limited effectiveness of monetary policy.

### B. Background: Samoa's Monetary Policy and the Banking Sector

3. **The CBS has implemented monetary policy via the use of indirect instruments since 1998.** The CBS conducts monetary policy through open market operations (OMOs). As part of the monetary operations, CBS securities are issued regularly through auctions while banks can gain access to liquidity through repurchase agreements (repos) and the discount window. CBS securities are of varying maturities from 14 to 365 days. The CBS's official rate is the weighted average of interest rates on all CBS securities issued. To date, the secondary market for CBS securities and government securities has not been active.

4. **Samoa's banking system lacks depth, not unlike other Pacific Island Countries (PICs).** The domestic banking sector comprises four major commercial banks—ANZ, Westpac, National Bank of Samoa, and Samoa Commercial Bank—with the total assets of 69 percent of GDP in 2009. Nonmonetary financial institutions such as the National Providence Fund also play an important role in the Samoan financial system.

Private credit to GDP registered 40.2 percent in 2008, somewhat lower than in several

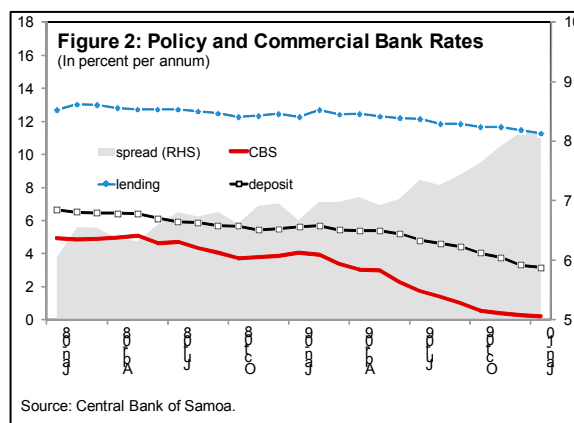


<sup>1</sup> The main contributor is Runchana Pongsaparn (APD).

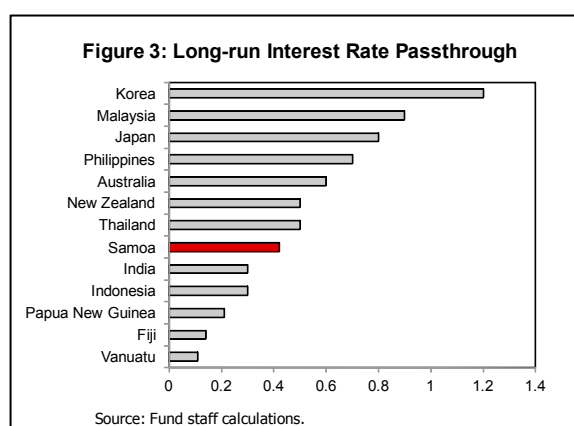
neighboring islands (Figure 1), and significantly less than the East Asia and Pacific average of 100 percent.<sup>2</sup>

### C. The Effectiveness of the Monetary Transmission Mechanism

5. **To assess the effectiveness of the monetary transmission mechanism, this note focuses on the degree of interest rate pass-through from the policy rate to commercial bank rates.** The CBS lowered the official rate by 486 bps between May 2008 and January 2010 (Figure 2). However, the degree of interest rate pass-through has been low. Average bank lending and deposit rates have been cut by merely 144 and 325 bps respectively.



6. **The degree of interest rate pass-through in Samoa appears on the low side by international standards.** Based on a simple dynamic model,<sup>3</sup> using the monthly data over the period 2005–09, the estimated long-run interest rate pass-through from the policy rates to the lending rates in East Asia ranges between 0.3–1.2.<sup>4</sup> The corresponding estimated long-run pass-through for Samoa is 0.42 (Figure 3), which is relatively high compared with its peers (average value: 0.15). However, regarding deposit rates, the long-run pass-through from the policy rate is much higher at 1.37. This large difference in interest rate pass-through helps explain the recent widening interest spread from 6.32 percent to 8.13 percent between May 2008 and January 2010.



<sup>2</sup> World Bank data (2008).

<sup>3</sup> See Espinosa-Vega and Rebucci (2003). The dynamic reduced form model postulates the relationship between the policy rate and lending (deposit) rate. The econometric specification is given by  $\text{lending}_t = \alpha_0 + \alpha_1 \text{trend} + \alpha_2 \text{policy}_t + \alpha_3 \text{lending}_{t-1} + \alpha_4 \text{policy}_{t-1} + \varepsilon_t$ . The long-run interest pass-through is measured by  $(\alpha_2 + \alpha_4)/(1 - \alpha_3)$ .

<sup>4</sup> See IMF (2009), Regional Economic Outlook: Asia and Pacific, October 2009.

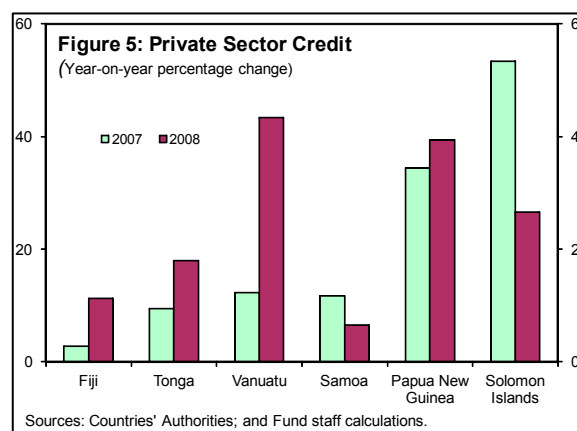
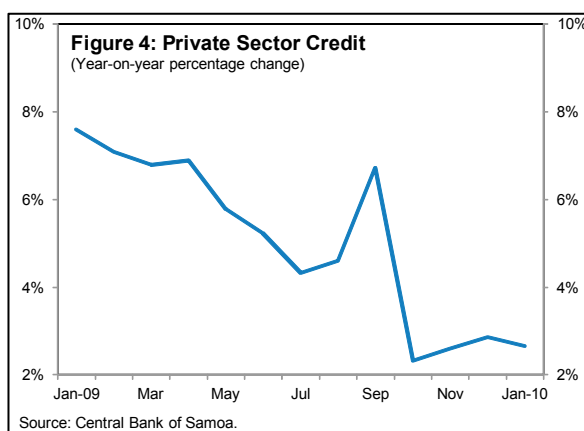
7. **However, monetary policy transmission appears to have become more effective.**

It is clear that the degree of interest rate pass-through, measured as the ratio between the change in the lending (deposit) rate and the change in the policy rate since the beginning of the cycle, was much higher during the recent easing cycle than the last tightening cycle—both on the lending and deposit rates.

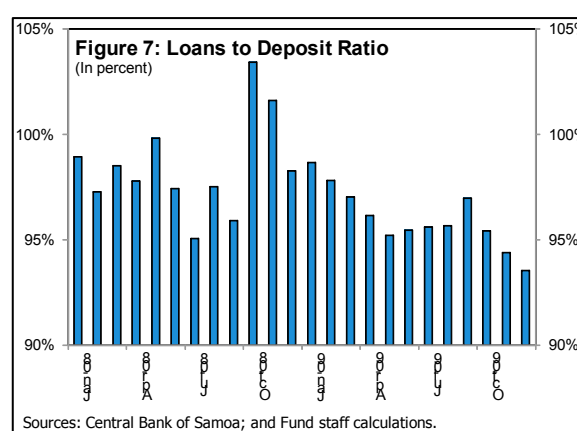
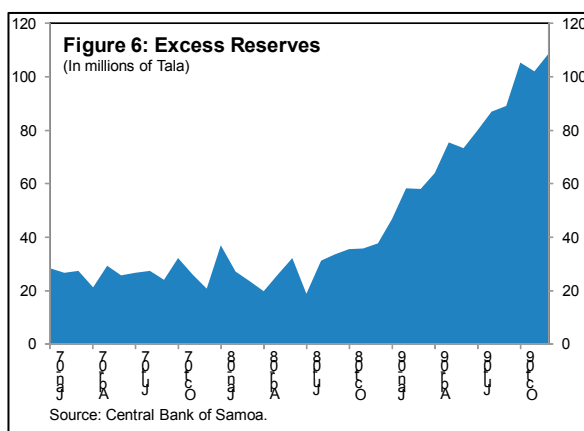
Interest rate pass-through (percent)		
	Tightening cycle (Oct 05 – Oct 06)	Easing cycle (May 08 – Jan 10)
Lending rate	9.9	29.6
Deposit rate	17.7	66.9

#### D. Constraints on Bank Lending

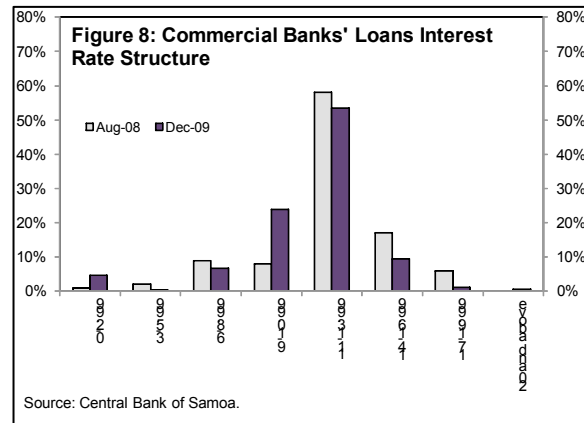
8. **Despite excess liquidity, credit growth continued to slow.** Private sector credit growth continues to decelerate registering 2.6 percent year-on-year growth in January 2010 (Figure 4) and is relatively low (Figure 5).



9. **On the other hand, there appears to be sufficient liquidity in the banking system.** This is clear from a persistent increase in excess reserves (Figure 6). Furthermore, the current loan-to-deposit ratio has been well below its historical level (Figure 7).



10. **A slowdown in credit growth could be the result of both demand and supply side factors.** On the demand side, the slowdown could be attributed to weaker economic conditions and a dearth of profitable investment opportunities. On the supply side it could reflect tighter lending standards by banks. While the average lending rate appeared to fall, the distribution of lending rates did not change significantly compared with the beginning of the easing cycle. The largest proportion of loans, over 50 percent, is still subject to high interest rate of 11–13.99 percent, a proportion comparable to last year (Figure 8). This suggests, despite a lower base interest rate, banks might impose a higher external financing premium reflecting a deteriorating and riskier economic environment, which in turn increased the effective interest rate charged on loans comparable to pre-easing level. In other words, banks may be less willing to lend for fear of increasing default risks, since the amount of non-performing loans would usually rise with worsening economic conditions. Indeed, the ratio of nonperforming loans has risen to 8 percent at end 2009, from 6 percent a year earlier.



11. **At the same time, effective strategies to mitigate default risks are not easily available in the case of Samoa.** Among the most important structural impediments are insufficient information on the credit quality of potential borrowers (in the absence of a credit bureau) and the lack of secure property rights to customary land, which accounts for around 80 percent of total land in Samoa. The problem of clear legal title to customary land and restrictions over transfer of ownership limits the use of customary land as collateral in bank lending. Without appropriate collateral and sufficient information on credit history of potential customers, it induces banks to limit credit or charge higher interest rates to cover for potential default risks.

## E. Conclusion and Policy Implications

12. **The effectiveness of monetary transmission in terms of interest rate pass-through in Samoa has improved over time, however, it is still below international standards.** In addition, the crisis has had important implications on bank lending through an increase in external financing premium and fear of loan losses. These, in effect, impaired the transmission from the change in interest rates to the extension of loans.

13. **The adverse impact of the crisis on the functioning of the banking system may be alleviated by an improvement in the financial infrastructure.** Particularly, the asymmetric information problem, which led to higher external financing premium and heightened fears of loan losses, may be resolved by an establishment of a credit bureau, which allows

information sharing on the credit history of customers. An improvement on bank-lending collateralization via further reforms in land-use rights may enhance the ability of banks to extend loans without jeopardizing their prudential status.

### III. STATE-OWNED ENTERPRISE REFORM IN SAMOA<sup>1</sup>

#### A. Background

1. **The State continues to play a substantial role in the Samoan economy, with a large range of commercial businesses which employ 10 percent of the formal sector workforce.** The government supplies most infrastructure-related public services either directly by the state or by public enterprises. The high cost and generally poor quality of public services, as well as the capacity constraints of state-owned utility companies have been obstacles to private sector development. Furthermore, the noncommercial stewardship of large parts of the public enterprise portfolio, particularly the Public Trading Bodies (PTBs), crowds out the private sector as well as exposing the government to significant risk and direct costs. It is estimated that the government's continued ownership of the PTBs, in aggregate over 10 years, has cost the Samoan taxpayer over tala 451 million, which exceeds the current level of equity in those PTBs (see AsDB, Samoa—Country Partnership Strategy, 2008).
2. **The Public Bodies (Performance and Accountability) Act 2001 and the subsequent State-Owned Enterprise (SOE) Policy, established the principles for putting SOEs on a commercial footing, and divesting nonstrategic SOEs.** This policy and SOE law followed the first period of SOE reform from 1987 to 1996 when 21 SOEs were either divested or liquidated. In the absence of a formal legal and policy framework, these divestitures were conducted on an ad-hoc basis, with mixed results. The legislative and policy framework provides a sound basis for the restructuring of SOEs, the strengthening of their corporate governance practices, and the creation of a privatization pipeline so that nonstrategic SOEs can be transferred to the private sector. However, implementation of the public enterprise framework has proven difficult and will require continued corporate governance reform support and political commitment.
3. **There are two broad categories of SOEs** (Table 1): (i) those classified as “strategic” by the government will remain in state hands; and (ii) “non-strategic” SOEs which, according to the SOE Policy, should be divested. The “strategic enterprise” group is engaged in providing essential public services (EPC, SAA, and SWA, in particular) and need comprehensive financial and operational restructuring, including corporate governance and implementation of a rigorous Community Service Obligation (CSO) framework (see below).
4. **As a whole, the SOE portfolio continues to operate inefficiently and engage both willingly and unwillingly in noncommercial or unprofitable activities.** However, with the sale of the international jet operations of Polynesian Airlines in 2005, the situation has

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<sup>1</sup> The main contributor is Dominic Mellor (AsDB).

improved markedly. Somewhat surprisingly, the nonstrategic SOEs also perform poorly, with a return on equity of just 3.3 percent for the financial year ending June 2008 (compared with the government's benchmark of 7 percent). Most of the SOEs combine commercial business activities with noncommercial ones (i.e., CSOs) for which they do not always receive compensation. In most cases, where the SOEs are engaged in commercial activities they compete directly with the private sector

Table 1: Summary Statistics for of Public Trading Bodies <sup>1/</sup>

SOE Code	SOE Name	Public Trading Bodies		Strategic	Non-Strategic	Total Assets	Total Liabilities	Net Profit After Tax	Return on Equity (ROE)	Employment at end FY2009
		Infras.	Comm.							
ASC	Agricultural Store Corporation		X		X	8.63	2.28	(0.60)	-9.5%	40
DBS	Development Bank of Samoa		X		X	120.98	73.58	(2.94)	-6.2%	114
EPC	Electric Power Corporation	X		X		205.04	45.12	1.93	1.2%	505
LTA	Land Transport Authority 2/				X					56
PAL	Polynesian Airlines Limited		X		X	20.88	28.48	2.67	-35.1%	141
PTO	Public Trust Office		X		X	4.90	5.24	(0.91)	266.7%	14
SAA	Samoa Airport Authority	X		X		63.22	27.56	0.01	0.0%	198
SBC	Samoa Broadcasting Corporation 3/	X			X	5.45	3.73	(0.63)	-36.4%	48
SHC	Samoa Housing Corporation		X		X	21.56	7.52	0.20	1.4%	26
SLC	Samoa Land Corporation		X		X	72.90	13.25	0.55	0.9%	70
SPL	Samoa Post Limited 4/			X						..
SPA	Samoa Ports Authority	X		X		128.57	88.94	0.87	2.2%	168
SSC	Samoa Shipping Corporation Limited			X		19.03	10.81	0.15	1.9%	142
SSS	Samoa Shipping Services		X		X	5.04	3.84	0.54	45.4%	126
SamTEL	Samoa Tel	X	X		X	130.58	67.39	1.21	1.9%	271
STEC	Samoa Trust Estates Corporation		X		X	53.98	5.18	7.68	15.7%	35
SWA	Samoa Water Authority	X		X		92.02	2.54	(2.27)	-2.5%	152
Strategic SOE's						507.89	174.98	0.70	0.2%	1165
Privatizable SOE's						444.90	210.49	7.77	3.3%	941
All Trading SOE's						952.79	385.47	8.47	1.5%	2106

Source: State-Owned Enterprise Monitoring Unit.

1/ Financial statistics are for the year end FY 2007/08.

2/ Land Transport Authority was added to the list of Public Bodies in FY 2008/2009.

3/ Samoa Broadcasting Corporation was privatized in FY2008/09.

4/ Samoa Post Limited was created after a decision by Cabinet to separate the post mailing services from SamoaTel in FY 2008/09.

## B. Community Service Obligations and Tariff Structure

5. **Many of the SOEs are required to provide subsidized or free services to communities through CSOs.** In the past, they were expected to defray these expenses by raising charges to paying customers—a process generally known as cross-subsidization or to carry the cost themselves. The Public Bodies Act now enables SOEs to claim reimbursement from the government for the cost of providing CSOs that have been approved. But those approval provisions have not been enforced which has led to conflicting interpretations of what constitutes a CSO. As a result, SOEs request CSO payments for services that they are under no explicit obligation to provide or simply cannot provide at a price that meets a reasonable commercial return. Similarly, there appear to be cases where SOEs fulfill CSOs that do not qualify for direct compensation. Poor CSO management depresses SOEs' profitability, contributes to inefficient resource allocation, and impairs the government's ability to assess whether or not the CSOs provide value for money.



6. **In 2007, the Cabinet approved a revised CSO policy paper to clarify the government's goals for CSO delivery and simplify its implementation.** This policy effectively limits CSOs to projects that are consistent with the goals identified in the Samoa's Development Strategy, subject to the availability of funds. The new policy also includes a streamlined CSO identification, prioritization, approval, and compensation process. If strictly applied, this new CSO policy should result in SOEs discontinuing activities that they consider to be CSOs, but for which no further compensation will be received from the government. The new policy might thus provide further incentives for SOEs to restructure loss-making activities.

7. **However, even if rigorously implemented, the performance of the infrastructure service SOEs would still probably provide returns far below their cost of capital.** AsDB estimates suggest that, even if the Electric Power Corporation's (EPC) CSOs had been fully funded, its ROE would have been only 3.5 percent in FY 2004/05 and 6.2 percent in FY 2005/06. The corporation would still have been unable to meet the government's ROE target of 7 percent or the private sector's benchmark of 10–15 percent.

8. **Successful CSO restructuring will therefore also require tariff adjustments that allow for full cost recovery.** For example, a revised tariff structure for water supplied by the Samoa Water Authority (SWA) was approved by the Cabinet in the third quarter of 2008 and implemented shortly afterward. The revised structure follows recommendations of an EU-sponsored review of SWA's financial sustainability aimed at full cost recovery through a progressive tariff blocks for domestic and nondomestic customers and government subsidies in the form of CSOs. SWA's revenue now exceeds operations and maintenance costs by 57 percent. However, accumulated losses continue to be of concern and amounted to approximately 33 percent of the SWA total asset value at the end of FY 2007/08. As for electricity, the price setting has been adjusted to include a fluctuating fuel surcharge which shields EPC to some degree from impacts of varying imported diesel costs.<sup>2</sup> However, there is still a certain level of user dissatisfaction with the quality of service provided.

### C. Corporate Governance Reform

9. **With the enactment of the Public Bodies Act in 2001, SOEs were given a set of guidelines and requirements to strengthen their corporate governance** practices and support a more commercial orientation. These include: (i) The process for selecting and appointing directors, (ii) the role of directors, (iii) reporting requirements, (iv) disclosures of

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<sup>2</sup> Samoa has significant hydropower resources which constitute around 50 percent of power generation, depending on water availability in the catchment area. The remainder of power generation is derived from diesel-fired power generation.

conflicts of interest, (v) the role and composition of the audit committees, and (vi) policies and procedures for contracting CSOs.

10. **While the Act is based on international best practice in SOE corporate governance, implementation has proven to be a challenge.** As of end 2006, only the reporting and disclosure requirements are being fully met by the SOEs. Of the other provisions, the relevant ministries have failed to ensure SOEs, with the exception of SamoaTel, meet the clear requirements of the Act and supporting regulations on the selection and appointment process for directors. While many SOEs now have audit committees, few of these are fully operational. In addition, members of parliament, public servants, or constitutional officers are prohibited from serving as directors of SOEs, unless Cabinet certifies that their appointment is in the national interest or that they have unique qualifications needed by the SOE. Nevertheless, there is still a large presence of ex-officio directors on SOE boards. Indeed, of the 270 positions available on SOE boards, 121 are currently held by public servants. Total board positions have recently been reduced to improve compliance with legislation.

#### **D. Status of Reform Program**

11. **Samoa's SOE reform program has slowed in recent years.** For example, the Agricultural Stores Corporation was removed from the privatization pipeline after it had received initial privatization preparation support, and there have been delays with the sale of Samoa Shipping Services. However, SamoaTel was recently restructured to allow the spin-off of postal operations into a new corporate SOE and Samoan Broadcasting Services was privatized in 2008. The privatization of SamoaTel is currently targeted to be completed before the end of 2010.

12. **To generate renewed focus on SOE reform, the Prime Minister sponsored a Cabinet paper in March 2009** directing: (i) Ministers and ex-officio board members must step down from SOE boards by June 2010, (ii) SOEs must achieve a minimum of 7 percent return or CEOs and boards face removal from office, (iii) CSO cannot be paid without prior cabinet and MoF approval, and 50 percent of net profit after tax must be paid to government as dividend. A Cabinet Submission was submitted in March 2010 that listed potential candidates that could replace ex-officio directors.

#### **E. Possible Ways Forward**

13. **If the government is to successfully execute the privatization of its remaining nonstrategic SOEs, it will need political commitment at the highest levels to overcome existing points of resistance.** SOE divestiture takes time even in the most buoyant markets. In Samoa, where the domestic market remains small, it can be more challenging still. While the smaller, more profitable SOEs should find ready buyers, others will require some pre-privatization restructuring and/or carving out of viable business lines for sale. The

government has started assessing the divestiture prospects of each SOE, which is an important step to preparing a more comprehensive SOE reform strategy going forward. International experience has demonstrated that public support for SOE divestiture can be garnered through: (i) Public disclosure of the current poor SOE financial performance showing the true cost to the economy; and (ii) Illustration of the benefits of improved services through private provision. In Samoa, the success of the Polynesian Blue transaction has clearly demonstrated the benefits of private sector participation. Further public support for the privatization program could be encouraged through the annual publication of SOE accounts in widely circulated newspapers, together with key performance indicators.

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

15. **Implementation of the new CSO policy framework should be guided by the clear separation of the government’s dual role as both the purchaser and provider of CSOs.** International experience shows that functioning purchaser-provider models are critical. The purchaser-provider model requires the formulation of a contract specifying the precise nature of the service to be provided and the mechanisms by which that service will be measured and compensated. In the case of EPC and SWA, CSO payment should be linked to specific outputs where possible. For example, SWA’s provision of electricity for boreholes could be compensated according to quantity of water pumped, thus proving an incentive to explore alternative delivery mechanisms.

16. **The capacity of the government to prepare and monitor CSO contracts needs to be strengthened.** The cost of CSO monitoring is significant and the government should consider increasing the resources available to the SOE Monitoring Division (SOEMD) to allow it to more effectively carry out its mandated functions and responsibilities.

17. **The appointment of ministers and civil servants on SOE boards should be limited further.** Their presence violates basic principles of good corporate governance and creates pressures to use SOEs as instruments of government policy, rather than as independent operating entities. Moreover, it distorts competition as ministries will have a vested interest in ensuring that SOEs can benefit from sector policy. Although performance based contracts were introduced for all SOE chief executive officers since late 2007, the performance measures often do not align with the performance goals of the SOE. An option would be to enhance the capacity of the SOEMD to monitor these contracts and the board, to ensure that they are linked to the objectives in the SCI of their respective SOEs.

18. **There are concerns that it may be difficult to replace ministers and public servants on SOE boards due to a lack of skilled directors.** To address this concern, the government requires directors of SOEs to attend training courses at the Samoa Institute of Directors, which receives assistance from the European Union and NZAID, as part of the capacity building program to strengthen the corporate governance of SOEs. In the interim, the government is also agreeable to the recruitment of expatriate directors to SOE boards.

#### **F. Conclusion**

19. **SOEs continue to play an important role in Samoa, but constitute a drag on economic growth and the government's budget.** Despite previous achievements, Samoa's SOE reform program appears to have lost momentum as evidenced in privatization delays, but the government remains committed to addressing the ongoing challenges. Regardless of ownership, the key to successful SOE reform in Samoa will be placing SOEs on a fully commercial footing, with independence from political directives, hard budget constraints, exposure to competition, and full accountability. Existing corporate governance legislation is based on international good practice but implementation has been challenging.