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January 7, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Western Samoa - Staff Report for the 1984 Article IV Consultation  
and Review Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Western Samoa and a review of its stand-by arrangement. Draft decisions appear on pages 19 and 20.

It is proposed to bring this subject to the agenda for discussion on Monday, February 4, 1985.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Saito, ext. 7614.

Att: (1)

INTERNATIONAL MONETARY FUND

WESTERN SAMOA

Staff Report for the 1984 Article IV Consultation and  
Review Under the Stand-by Arrangement

Prepared by the Staff Representatives for the 1984  
Article IV Consultation with Western Samoa

Approved by Douglas A. Scott and Eduard H. Brau

January 7, 1985

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## I. Introduction

The 1984 Article IV consultation discussions with Western Samoa were held in Apia during October 16-28, 1984. The staff team <sup>1/</sup> also reviewed Western Samoa's performance under the stand-by arrangement and discussed the policies to be carried out during the remaining period of the arrangement. Meetings were held with Mr. Tuilaepa Sailele, Minister of Finance; Mr. Kolone Vaai, Financial Secretary; Mr. W. Kiel, Chairman of the Central Bank's Board of Directors; and officials of the Departments of Treasury, Economic Development, Customs, Inland Revenue, Agriculture, Statistics, the Central Bank of Samoa, and the public enterprises. Western Samoa continues to avail itself of the transitional arrangements of Article XIV.

The current stand-by arrangement is in an amount of SDR 3.375 million (56 percent of quota) and was approved by the Executive Board on July 8, 1984. Western Samoa has observed all performance criteria through September 1984, and has made three purchases totalling SDR 1,688 million (Table 1). The next purchase of SDR 0.844 million is contingent upon the successful completion of the mid-term review and the observance of performance criteria for December 1984. The final purchase of SDR 0.843 million is subject to the observance of performance criteria for March 1985. The policy program for 1985 is described in the attached letter from the Minister of Finance dated January 4, 1985.

As of November 30, 1984, Western Samoa's use of Fund credit stood at 138 percent of quota, or 94 percent excluding purchases under the compensatory financing facility. Full purchases under the current stand-by arrangement, net of scheduled repurchases, would raise Western Samoa's use of Fund credit to 149 percent of quota, or 117 percent excluding the CF purchases.

## II. Background

### 1. Events leading to the recent economic adjustments

Western Samoa's economy stagnated during the 1960s and 1970s. Output of its traditional crops--coconut and cocoa--declined, while diversification into other crops and products was slow. Export growth was sluggish, and as imports rose rapidly, dependence on external financing increased. By the mid-1970s, exports covered only about one

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<sup>1/</sup> The staff team consisted of Messrs. Saito (Head, ASD), Huh (ETR), Banerjee (ASD), Felman (ASD), and Miss Rosario (ASD, secretary); Mr. Karlik (TRE), who is expected to take up the post of Resident Representative in Western Samoa, and Mr. Yusuf (IBRD) also joined the team.

Table 1. Western Samoa: Fund Position During Period of Arrangement, June 1984-July 1985

(In millions of SDRs)

	Actuals		Estimates	
	June 30 1984	July-Nov. 1984	Dec. 1984- March 1985	Apr.-July 8 1985
Transactions under tranche policies (net)	...	1.502	0.751	0.658
Purchases	...	1.688	0.844	0.844
Ordinary resources	...	(0.844)	(0.422)	(0.422)
Enlarged access resources	...	(0.844)	(0.422)	(0.422)
Repurchases	...	-0.186	-0.093	-0.186
Ordinary resources	...	(-0.186)	(-0.093)	(-0.186)
Enlarged access resources	...	(--)	(--)	(--)
Transactions under special facilities <u>1/</u>	...	-0.500	-0.250	-0.500
Purchases	...	--	--	--
Repurchases	...	-0.500	-0.250	-0.500
Total Fund credit outstanding (end-of-period)	7.268	8.270	8.771	8.928
Under tranche policies	4.118	5.620	6.371	7.028
Under special facilities <u>1/</u>	3.150	2.650	2.400	1.900
(In percent of quota)				
Total Fund credit outstanding (end-of-period)	121.1	137.8	146.2	148.8
Under tranche policies	68.6	93.6	106.2	117.1
Under special facilities <u>1/</u>	52.5	44.2	40.0	31.7

Source: International Monetary Fund, Treasurer's Department.

1/ Compensatory Financing Facility.

third of imports, while external grants and loans each financed more than one fourth. The remainder was covered by private remittances from abroad, which had risen rapidly as economic stagnation was accompanied by a large increase in emigration.

In the late 1970s the authorities attempted to vitalize the economy by undertaking an ambitious investment program to develop both infrastructure and industry. Government and public enterprise development expenditure was raised sharply. This strategy, combined with favorable terms of trade developments, stimulated economic activity. At the same time, however, the policy resulted in a sharp rise in both budgetary and external deficits. Financing of these deficits caused rapid monetary expansion, mounting inflationary pressures, and increased external indebtedness.

The economic situation worsened during 1980-82. The terms of trade deteriorated sharply as export prices of copra and cocoa fell, while the prices of oil and other imports rose. The growth of government revenue declined and, although the investment program was cut back, the budgetary deficit rose further. The expansion of total domestic credit and liquidity accelerated, exacerbating inflationary pressures. Interest rates were allowed to turn negative in real terms, and the tala to appreciate substantially in real effective terms. During the three-year period 1980-82, output declined every year, inflation averaged over 20 percent, and although import controls were tightened, a large deficit persisted in the external current account. International reserves declined to a critically low level at the end of 1982, while external debt rose to SDR 70 million (72 percent of GDP), including SDR 13 million in payments arrears.

## 2. Economic adjustments in 1983

In 1983, the authorities adopted a stabilization program, which was supported by a stand-by arrangement with the Fund. <sup>1/</sup> The stabilization measures included: (a) a substantial reduction in the budgetary deficit through discretionary tax increases and expenditure restraint, including a cutback in public sector employment and domestically financed development expenditure; (b) a slowdown in credit and monetary expansion through strict implementation of credit ceilings and 4-6 percentage point increases in interest rates (in February 1983); and (c) a 17 percent devaluation of the tala in nominal effective terms (during February-May 1983). These measures were effectively implemented. The economy also benefited from a sharp improvement in the terms of trade and large inflows of official transfers and concessional loans.

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<sup>1/</sup> The 1983 program is described in "Request for Stand-by Arrangement" (EBS/83/105, 5/25/83). The performance under the arrangement is reviewed in "Staff Report for the 1983 Article IV Consultation and Review under the Stand-by Arrangement" (EBS/83/271, 12/21/83) and (continued)

All performance criteria under the 1983 arrangement were observed, and the macroeconomic targets were largely achieved. Real economic growth resumed, inflation moderated, and the external current account deficit declined. The overall balance of payments swung into a large surplus; international reserves rose substantially, while external payments arrears were reduced (Chart 1 and Table 2).

### 3. The last consultation

During the last consultation held a year ago, the Executive Directors commended the authorities for the considerable progress that had been made in economic stabilization during 1983. However, they noted that despite this progress, demand pressures continued to be strong and the economy remained structurally weak. They therefore considered it necessary that the adjustment process be continued in 1984. In that context, a number of Directors encouraged the authorities to continue their efforts to broaden the tax base, rationalize the operations of public enterprises, strengthen monetary policy through the then-envisioned establishment of a central bank, and follow flexible interest rate and exchange rate policies.

## III. Review Under the Stand-By Arrangement and Policy Discussions

### 1. Performance under the 1984 program

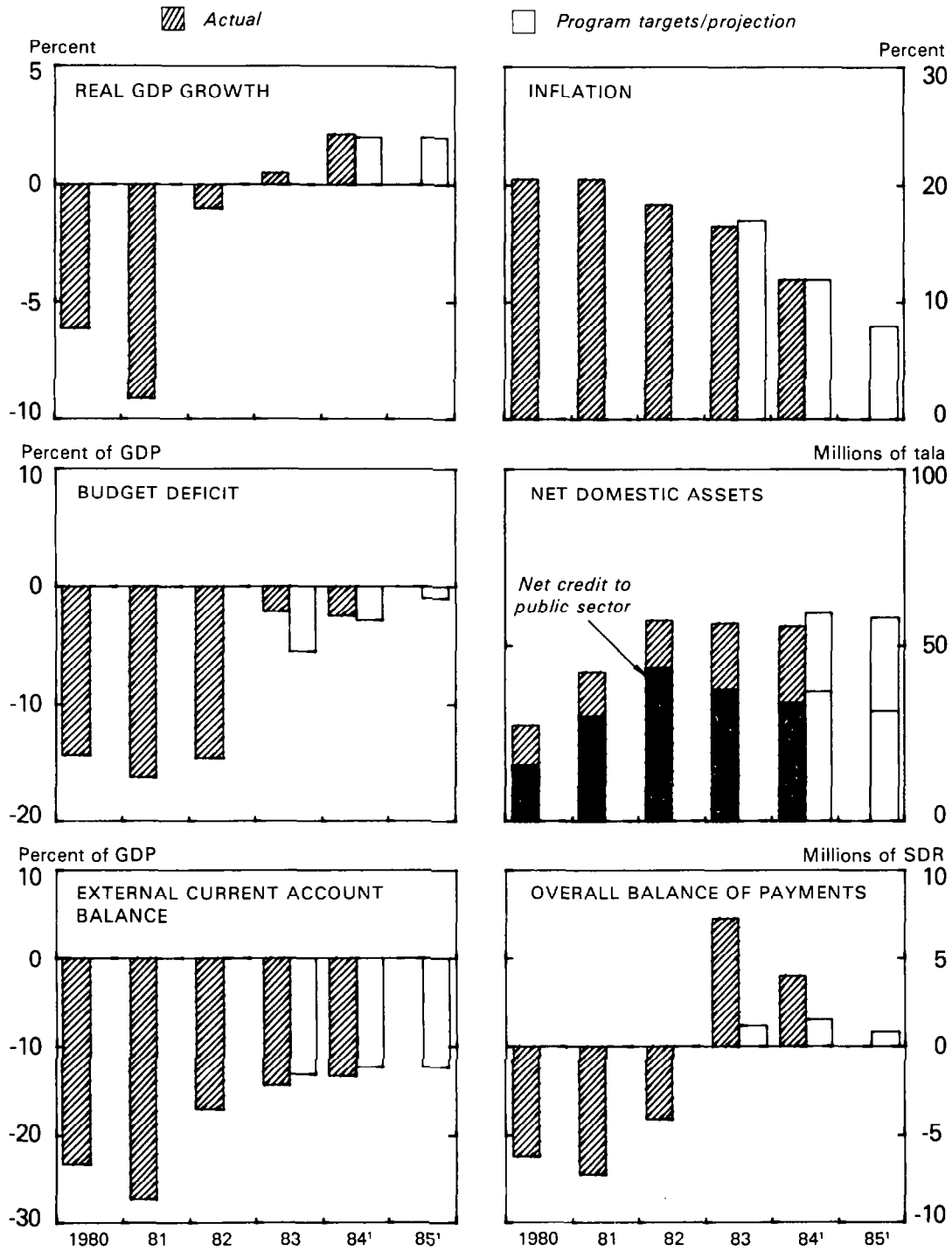
Against this background, the authorities have implemented the economic and financial program for 1984, which has been supported by the current stand-by arrangement. <sup>1/</sup> The major objectives of this program are to consolidate the gains made in 1983 in attaining economic and financial stability and to make further progress in correcting the structural weaknesses of the economy. The principal program targets are to maintain 2 percent growth in real GDP, lower the annual average rate of inflation to 12 percent, and reduce the external current account deficit to 12 percent of GDP, while maintaining a small overall surplus. Toward these ends, the authorities have continued their cautious budgetary and monetary policies, with the implementation of the latter being increasingly handled by the central bank, which was established in May 1984. In addition, the authorities have: (a) introduced a reform of import duties and excise taxes to provide a more uniform rate of protection to producers and to strengthen the tax base (since February); (b) devalued the tala by a total of 12 percent in nominal effective terms (during May-July); and (c) dismantled the foreign exchange allocation system except for a few selected items (since July).

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"Request for Stand-by Arrangement" (EBS/84/130, 5/7/84).

<sup>1/</sup> The 1984 program is described in "Request for Stand-by Arrangement" (EBS/84/130, 5/7/84).

CHART 1  
WESTERN SAMOA  
SELECTED ECONOMIC INDICATORS, 1980-85



Sources: Data provided by the Western Samoan authorities; and staff estimates.  
<sup>1</sup> Estimates.





Table 2. Western Samoa: Selected Economic and Financial Indicators, 1982-85

	1982	1983	1984		1985
			Prog.	Est.	Proj.
(Annual percentage changes unless otherwise specified)					
Output and prices					
GDP at constant prices	-1.0	0.5	2.0	2.1	2.0
Consumer prices	18.4	16.5	12.0	12.0	8.0
External sector					
Exports, f.o.b. (mn. SDRs)	11.9	16.6	20.0	17.1	17.6
Imports, c.i.f. (mn. SDRs)	45.0	48.4	50.6	49.3	50.5
Of which: non-oil imports	(39.9)	(41.2)	(...)	(42.3)	(43.5)
Export volume	19.3	4.2	5.7	-15.3	2.6
Import volume	-9.9	8.5	2.6	-1.1	-0.5
Terms of trade (deterioration -)	0.8	31.2	11.7	18.5	-2.9
Effective exchange rate <sup>1/</sup>					
Nominal	-2.2	-17.9	...	-12.4	...
Real	0.9	-2.5	...	-12.5	...
Government budget					
Total revenue (excluding grants) <sup>2/</sup>	16.5	44.2	26.0	35.5	15.2
Total expenditure <sup>2/</sup>	8.6	10.2	13.2	16.5	10.7
Money and credit					
Net domestic assets	35.3	-1.7	5.0 <sup>3/</sup>	-1.1 <sup>3/</sup>	4.6 <sup>3/</sup>
Public sector (net)	(46.0)	(-14.9)	(-1.0) <sup>3/</sup>	(-9.7) <sup>3/</sup>	(-6.3) <sup>3/</sup>
Private sector	(18.2)	(12.5)	(18.0)	(20.0)	(18.3)
Total liquidity	35.4	16.6	15.0	17.9	10.4
Velocity ((GDP/M2) ratio)	4.2	4.2	4.3	4.3	4.3
Interest rate (annual rate on one-year time deposit)	11	17	17	17	17
(In percent of GDP)					
Budget deficit (commitment basis)					
Excluding grants	-25.6	-17.6	-14.1	-13.0	-11.9
Including grants	-14.6	-2.2	-2.9	-2.5	-1.0
Domestic bank financing <sup>4/</sup>	5.5	-2.8	0.6	-2.3	0.2
Foreign financing <sup>5/</sup>	3.0	3.9	1.9	5.2	2.7
External current account	-17.1	-14.3	-12.4	-14.1	-12.8
External debt (end of period)	71.5	79.4	69.3	79.5	78.0
(In percent of exports of goods and services)					
Debt service ratio					
Excluding IMF	32.0	50.5	34.1	54.7	33.0
Including IMF	37.7	56.6 <sup>b/</sup>	39.0	61.0 <sup>b/</sup>	42.3
Interest payments (including IMF)	11.4	9.7	7.6	11.7	9.3
(In millions of SDRs)					
Overall balance of payments	-4.0	7.3	1.5	4.1	0.9
Gross international reserves	3.2	6.9	6.6	9.5	9.0
(In months of imports, end-of-period)	(0.9)	(1.7)	(1.6)	(2.3)	(2.1)
External payments arrears (end-of-period)	13.1	2.6	1.5	1.7	0.9

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

<sup>1/</sup> Change in the trade-weighted index between fourth quarters, except for 1984 which is the change during 12-month period ended October. Negative sign indicates depreciation.

<sup>2/</sup> Including the effects on revenue and expenditure of government payment of import duties beginning in 1984.

<sup>3/</sup> Based on figures net of valuation adjustments arising from exchange rate changes since December 28, 1983.

<sup>4/</sup> Excluding net change in the counterentry to government external arrears and rescheduled government arrears.

<sup>5/</sup> The figures for 1983-85 exclude amounts corresponding to reductions in arrears.

<sup>6/</sup> If private remittances are included in the denominator, the debt service ratio is only 28.8 percent in 1983, 30.9 percent in 1984, and 21.7 percent in 1985.

The economy has performed well under the 1984 program, and preliminary data for the first nine months of the year indicate that most program targets will be achieved (Chart 1 and Table 2). This favorable performance is largely attributable to the adjustment measures implemented over the last two years, which have brought demand under control, stimulated production of import substitutes that require little additional investment, and helped restore the confidence of foreign creditors. The economy also benefited from the continued improvement in the terms of trade and sustained large net inflows of external loans.

The growth of real GDP is expected to reach the program target of 2 percent in 1984. While the production of copra and cocoa has declined owing to the lagged effects of the 1982-83 drought, output of other foods (taro, vegetables, tropical fruit) and some manufactured products (e.g., fruit drinks and canned meat) has expanded considerably. Demand for domestic products and incentives for their production have risen as a result of the currency devaluations and the increases in import duties. Output of forestry products and hydroelectric power, as well as construction activity, has continued to rise at a relatively rapid rate (Appendix Table 4).

The annual average rate of inflation is projected to decline from 17 percent in 1983 to 12 percent as targeted in the program. The price index rose little during the first half of 1984, largely reflecting the increased food supply and tight credit and monetary conditions. <sup>1/</sup> In the second half, some price increase is likely because of the lagged effects of the May-July currency devaluations and the increases in import and excise duties. These effects are expected to be considerably less this year than in 1983, largely because of tighter financial policies and increased competition among importers following the dismantling of the foreign exchange allocation system (Chart 2).

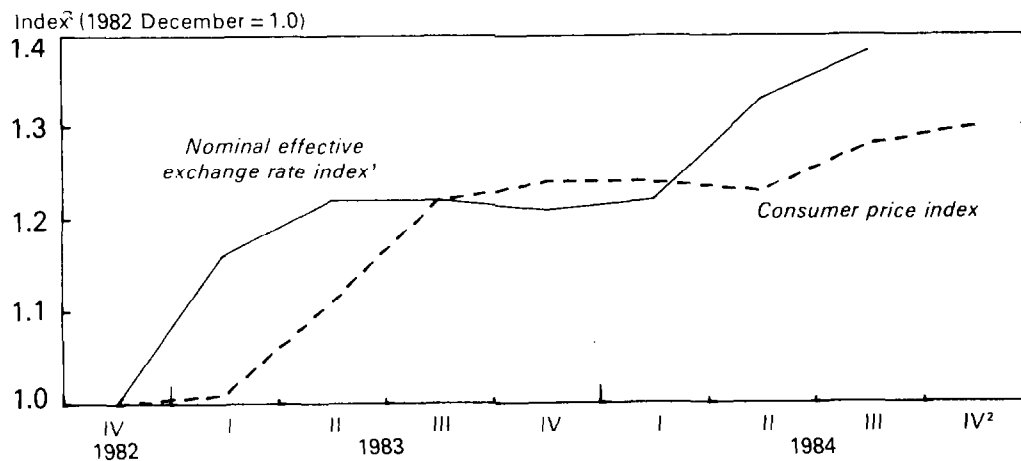
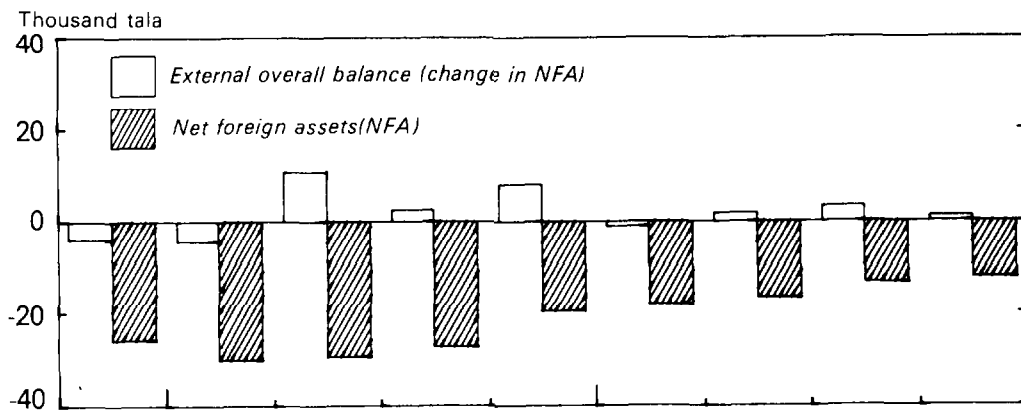
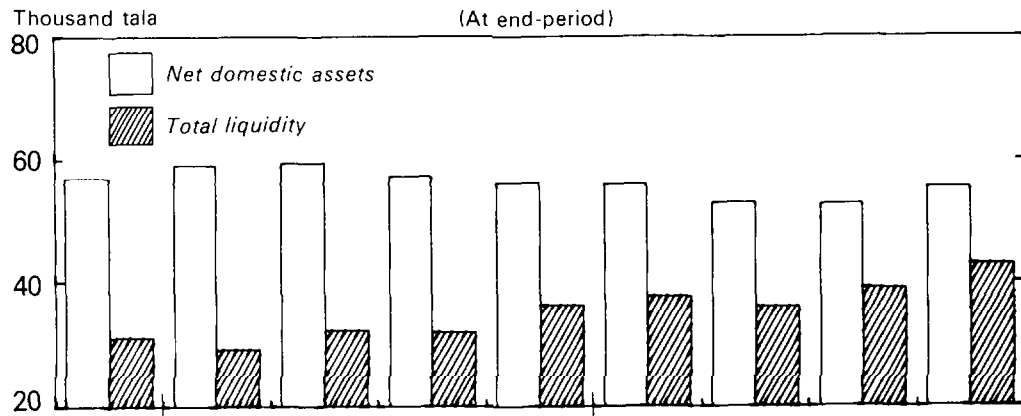
The budgetary performance has been better than anticipated in the program. The overall deficit for 1984 is now estimated to be 2.5 percent of GDP, less than the program target of 2.9 percent. The growth of total revenue and grants is currently expected to be 16 percent (substantially higher than the 11 percent programmed), despite a fall in external grants from the high level reached in 1983. This largely reflects the tax measures <sup>2/</sup> and the currency devaluations, which have

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<sup>1/</sup> As a result, the year-on-year rate of inflation declined from over 20 percent in late 1983 to 13 percent in June and to 9 percent in September; the rate is expected to be about 8 percent in December 1984.

<sup>2/</sup> In 1983, import duties were changed from a specific to an ad valorem basis. In 1984, excise taxes were introduced on a number of luxury goods; the duty structure was revised to provide a uniform effective rate protection of about 60-80 percent; and all exemptions from import duty were ended, including the Government's. The resultant import duty payments by government departments are reflected in a substantial increase in both revenue and expenditure in 1984.

CHART 2  
WESTERN SAMOA  
ECONOMIC ADJUSTMENTS, 1983-84  
SELECTED INDICATORS



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

<sup>1</sup>An increase indicates a depreciation.

<sup>2</sup>Estimates.



helped double tax revenue during the last two years. However, expenditure growth, which is now estimated to be 17 percent, is also likely to exceed the program projection (13 percent). Current expenditure has been contained to a level below the program target, but there have been cost overruns in the airport extension and other development projects, partly owing to the currency adjustments (Appendix Table 5).

The performance of public enterprises has been mixed. On the one hand, the overall deficits of the Special Projects Development Corporation (which is engaged in the airport and other government projects) and the Western Samoa Trust Estates Corporation (which suffers from organizational weaknesses) have further increased during 1984. The deficit of the Electric Power Corporation has also increased; while its operating deficit remains small, large investment funds are needed to finance its hydropower plant construction program. On the other hand, high international prices have enabled the Copra Board and, to a lesser extent, the Cocoa Board to increase their reserve funds while raising procurement prices. Overall, the combined deficit of public enterprises is likely to fall slightly, while domestic bank borrowing is likely to rise somewhat (Appendix Table 6).

The growth of total liquidity is estimated to be about 18 percent in 1984, slightly faster than in 1983 and the program target (15 percent). This faster increase has been associated with a continued improvement in the balance of payments, which is now expected to show an overall surplus almost three times larger than the program estimate. In contrast, net domestic assets of the banking system are expected to decline slightly for the second year in a row and so remain well below the program ceilings (Table 3). Net credit to the public sector is expected to decline considerably as the budgetary position has been strong. The growth of credit to the private sector is estimated to be slightly higher than in 1983 and the program target for 1984. Nominal interest rates have been kept unchanged; both lending rates (ranging between 14-20 percent per annum) and time deposit rates (12-17 percent) are higher than the estimated 12 percent average annual rate of inflation for 1984 (Appendix Tables 7 and 8).

Lending by the Development Bank and the Provident Fund (the two largest nonbank financial institutions in Western Samoa) to the private sector has risen sharply in recent years; the amount outstanding reached one and a half times the level of private credit extended by the banking system at end-August 1984. <sup>1/</sup> This rapid increase primarily reflects

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<sup>1/</sup> Total outstanding loans of the Development Bank were as large as the commercial banks loans to the private sector, and lending by the Provident Fund to the private sector was half as large. The Development Bank's primary function is to onlend external funds (mostly from the Asian Development Bank) for agricultural and industrial development. The Provident Fund is allowed to invest its members' contributions in government securities and provide loans mainly for nonresidential construction.

Table 3. Western Samoa: Domestic Credit and External Debt--  
Developments and Ceilings under the 1984 Stand-By Arrangement

	1983	1984			1985		
	Dec. 28	June 27	Sept. 26	Dec. 26	March 27	June 26	Dec. 26
(In thousands of tala)							
Net domestic assets <u>1/2/</u>							
Ceiling		59,700	59,100	59,000	56,700	57,400	<u>4/58,050 5/</u>
Actual <u>1/</u>	56,095	52,943	52,623	55,500 <u>5/</u>			
Credit to the public sector <u>2/3/</u>							
Ceiling		40,500	38,900	36,950	34,100	33,300	<u>4/31,500 5/</u>
Actual	37,188	33,231	31,562	33,600 <u>5/</u>			
(In millions of U.S. dollars)							
Contracting of government and government-guaranteed external debt with maturity of:							
Up to and including 12 years							
Ceiling	...	5.5	5.5	5.5	2.0	3.0	<u>4/6.0 5/</u>
Actual	...	2.0	3.6				
Of which:							
Up to and including 5 years							
Ceiling	...	3.0	3.0	3.0	1.0	1.5	<u>4/3.0 5/</u>
Actual	...	2.0	2.6				

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

1/ Defined as total liquidity less net foreign assets.

2/ Measured net of valuation adjustments arising from exchange rate changes since December 28, 1983.

3/ Defined as net credit to the Government and gross credit to public enterprises.

4/ Indicative ceiling.

5/ Projection.

increased access to external funds (in the case of the Development Bank) and a decline in lending to the Government (in the case of the National Provident Fund). However, as lending rose sharply, these institutions' weaknesses in assessing loan applications and subsequent monitoring have become more apparent. Some of the loans extended at preferential interest rates have been used to finance consumption, rather than for the production and construction purposes for which they were designed. Also, the loan recovery problem has become more acute, especially for the Development Bank. To alleviate these problems, the authorities have recently tightened administrative procedures for processing loan applications and begun enforcing greater supervision over the lending of the two institutions. Lending rates of the institutions have also been raised to a range of 10-19 percent, narrowing the differential with commercial banks' lending rates (Appendix Table 8).

The external overall surplus is now estimated to be SDR 4.1 million in 1984 (compared with a programmed surplus of SDR 1.5 million), and gross international reserves are expected to rise to nearly SDR 10 million, equivalent to 2.3 month of imports by the end of 1984. Net capital inflows are now estimated to be more than programmed, and the current account deficit to be less (SDR 12.7 million, compared with the earlier projected deficit of SDR 13.2 million). <sup>1/</sup> Export earnings are likely to fall short of program estimates since the continued strength in export prices (especially of coconut oil and cocoa) has only partly offset an unanticipated 15 percent fall in export volume; the output and export volume of coconut oil and cocoa have declined sharply reflecting the lagged effects of 1982-83 drought. However, receipts of private remittances are estimated to rise more than anticipated. Furthermore, imports have been kept to below the program target through tight financial policies and exchange rate and tax adjustments (Chart 3 and Appendix Table 9).

During the first nine months of 1984, the authorities have reduced external payments arrears from SDR 2.6 million to SDR 1.7 million; in addition, repayments of arrears rescheduled in 1983 totalled SDR 3.2 million, leaving only SDR 0.9 million outstanding. Partly reflecting these repayments, external debt service payments are expected to remain high at about 61 percent of exports of goods and services, or about 31 percent of these exports and private remittance receipts. The authorities have also rescheduled some of the outstanding loans and refinanced those falling due. However, contracting of external loans, including these reschedulings and refinancings, is expected to remain within the program ceilings (Table 3). Outstanding external debt (including arrears and IMF credit) is estimated to rise slightly during

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<sup>1/</sup> As a ratio to GDP, however, the current account deficit is estimated to be 14.1 percent, higher than the 12.4 percent originally programmed. This difference is largely due to the devaluation of the tala. If the ratio is calculated using the same exchange rate as in the original program, it would be 11.9 percent.



1984 to about SDR 75 million, or about 80 percent of GDP (Appendix Table 11).

2. Economic policies and outlook for 1985

a. General policy stance and outlook

The authorities consider the 1984 program the second phase of their efforts to reduce inflation and attain a viable external position and so sustain growth over the medium term. They intend to continue these efforts in 1985, placing greater emphasis on the promotion of economic activity in the private sector. Accordingly, the authorities plan to reduce the budgetary deficit, which should help achieve stabilization objectives and simultaneously provide greater resources to the private sector. Efforts to streamline the operations of public enterprises will be continued, and flexible exchange rate and interest rate policies will be maintained. These efforts will take place in a less favorable external environment in 1985. The terms of trade, which improved substantially in both 1983 and 1984, are likely to deteriorate slightly, since the export prices of coconut oil and cocoa are forecast to weaken moderately.

For 1985, the target growth of real GDP is set at 2 percent. Barring unusual weather, output of copra and cocoa is projected to recover modestly, accompanied by a continued but less rapid growth in other sectors. Inflation is to slow to 8 percent through continued cautious financial management; wage increases are expected to be limited to 5 percent (compared with 10 percent in 1984). Despite the assumed deterioration in the terms of trade, the external current account deficit is expected to decline to 12.8 percent of GDP. The projected weakening of export prices will be offset by a modest increase in volume, especially of coconut oil and cocoa. Furthermore, import volume is expected to remain broadly at the 1984 level, reflecting the planned slowdown in project-related imports, relatively tight credit conditions, and the ongoing substitution of domestic food for imported products. Net capital inflows are also expected to decline in line with the reduction in project-related imports, and receipts of private remittances and official grants are likely to rise less rapidly. In all, a small overall surplus is projected and gross reserves are likely to remain above the equivalent of two months' imports (Table 2 and Appendix Table 9).

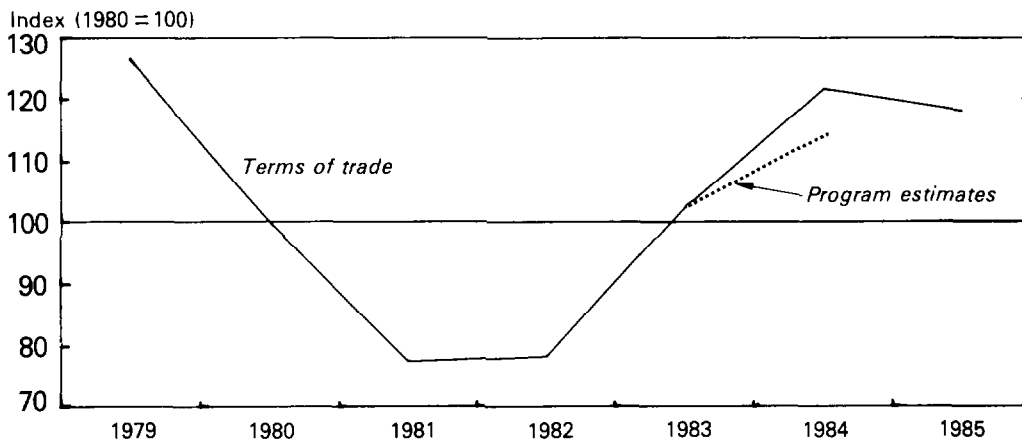
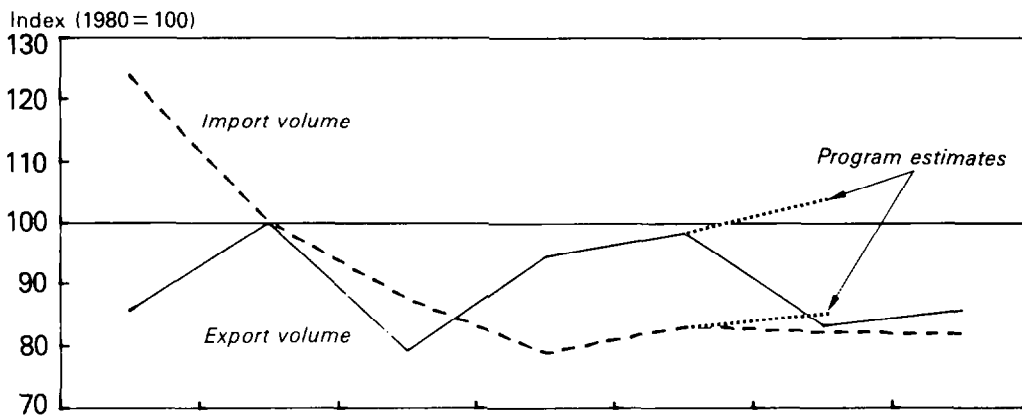
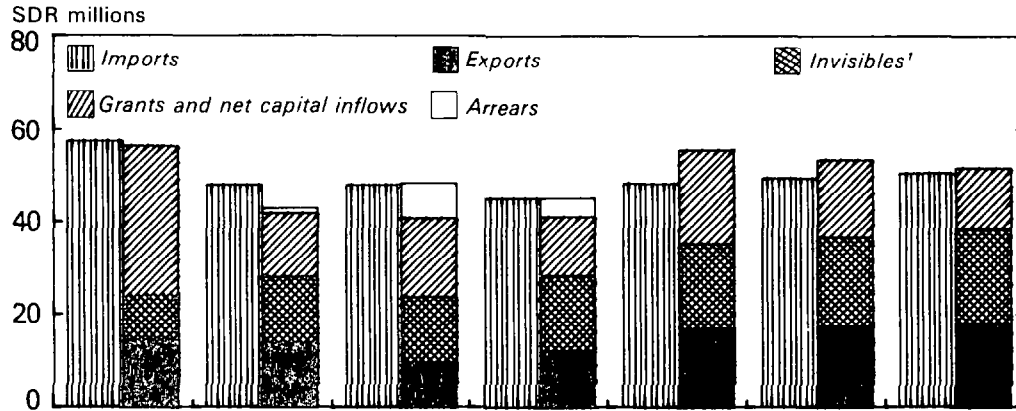
b. Budgetary policies

The 1985 budget, which was presented to Parliament in mid-October 1984, seeks to reduce the deficit to about 1 percent of GDP. <sup>1/</sup> The

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<sup>1/</sup> The budgetary deficit excluding grants will fall to 12 percent of GDP. External grants represent about one quarter of government receipts.

CHART 3  
WESTERN SAMOA  
SELECTED EXTERNAL TRADE INDICATORS, 1979-85



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

<sup>1</sup> Consist almost exclusively of private remittance receipts; net service balance is very small and, for most years, negative.



bulk of the deficit will continue to be financed by external loans and the borrowing from the banking system is likely to be minimal (Appendix Table 5).

Total revenue is projected to grow by about 15 percent, with both domestic revenue and grants expanding at about the same rate. About half of the projected increase in domestic revenue will come from higher nontax revenue, which mainly reflects increases in telephone and other user charges. The increase in tax revenue partly reflects the reforms implemented during the past two years and the net effect of the proposed measures for 1985. The new measures, estimated to account for 7 percent of the increase in total domestic revenue, include a 5 percent tax imposed on the sale of copra to the crushing mill, which replaces a previous export tax on copra. The budget also proposes reductions in tariff rates on certain inexpensive meats, as well as a few other consumer goods. The staff team noted that these reductions partially reverse the earlier reform of the tariff structure which sought to lessen the bias against the production of food and other necessities and in favor of the production of luxuries. Accordingly, the staff team suggested that the matter be examined as part of the ongoing review of the tax system. This review is currently focusing on the rationalization and broadening of the income tax system, including improved taxation on agricultural income through levies on a variety of export crops.

Total government expenditure is budgeted to increase by 11 percent in 1985, less than the estimated growth in revenue. Wage increases will be limited to 5 percent and employment will be contained by continuing the policy of filling only essential vacancies. This will allow the Government to increase educational assistance to private and village primary schools, as well as to allocate small amounts for the establishment of a national university and an office in Belgium to strengthen economic relations with the EEC. While current expenditure is expected to grow by 14 percent, development expenditure is budgeted to rise by only 5 percent, a decline in real terms. The development program is being scaled down, with the only major project in 1985 being the airport extension. To reduce cost overruns and accelerate the pace of work, the Government has increased the role of private contractors and sharply reduced the role of the Special Projects Development Corporation.

The Government is also planning to reorganize the other non-financial public enterprises, reducing the scope of their operations to improve their profitability. The nonplantation interests of the Western Samoa Trust Estates Corporation (WSTEC) will continue to be sold off, and some of the functions of the Copra and Cocoa Boards may be shifted to the private sector. Despite these efforts to strengthen public enterprises, their combined deficit is estimated to remain relatively large in 1985 (Appendix Table 6).

c. Monetary policies

Monetary policy in 1985 will aim at realizing a further moderation in inflation and promoting continued external adjustment, while supporting increased economic activity in the private sector. Consistent with these objectives, and assuming broadly stable income velocity, total liquidity is projected to increase by about 10 percent, compared with an estimated 18 percent increase in 1984. This projected liquidity growth and the targeted improvement in net foreign assets of the banking system indicate that the growth of net domestic assets will have to be limited to about 5 percent. Net credit to the public sector is expected to decline further, as the budgetary position improves. Credit to the private sector may be allowed to rise by 18 percent, less than the estimated 20 percent increase in 1984. The share of private credit in total domestic credit, which fell sharply from 42 percent in 1980 to 25 percent in 1982 but rose to an estimated 33 percent in 1984, is projected to increase further to 38 percent in 1985 (Appendix Table 7).

The authorities expressed the view that a faster growth in private credit than projected above may be required to achieve their overall economic objectives for 1985, because of two important changes in the financial system. First, the newly required use of import letters of credit (see section (d)) may raise demand for credit from domestic commercial banks. Second, the recent increase in the lending rates of the two nonbank financial institutions may generate greater demand for bank credit. Also, in the authorities' view, there is still a need for increased credit to enterprises to replenish their real working balances, which had been depleted by inflation as well as by the tight credit supply in the last few years. While recognizing the possible need for faster credit growth, the staff team suggested that, in light of the uncertainty involved in private sector responses to the institutional changes, the credit program should be managed cautiously. The staff team also indicated that more scope for private credit could be created by strengthening the public sector's financial position, especially that of the public enterprises.

The authorities have been reviewing interest rate policy, with a view to narrowing the spread in commercial banks' interest rates. They are concerned that within the context of strong overall credit demand, the interest rates at the higher end are discouraging productive investments of smaller businesses to which the rates apply while credit extended at the lower preferential rates is often being improperly used to finance consumption. The authorities therefore consider it necessary to reduce interest rates at the higher end and desirable to raise them at the lower end; as noted earlier, preferential interest rates of major nonbank financial institutions have already been raised. While generally agreeing with the authorities' analysis, the staff team stressed the importance of the timing of interest rate adjustments and suggested that interest rates be reduced only when there are clear signs of a continuing decline in inflation. The staff team also indicated

that a relatively small initial reduction could be followed by further reductions, if and when the situation warrants.

The system of overall credit and monetary control is being strengthened. As already mentioned, the lending operations of the key nonbank financial institutions are being monitored more closely. Also, the letter of credit requirement will enable the authorities to monitor trade financing more effectively. Furthermore, the newly established Central Bank of Samoa is assuming an increasing role in the country's credit and monetary management; transfers of relevant functions from the Treasury (and the now dismantled Monetary Board) and a commercial bank are expected to be completed during 1985. The staff team noted that monetary survey data should reflect central bank operations and suggested that the authorities begin to prepare this revision.

d. Exchange rate and external policies

The authorities remain committed to a flexible exchange rate policy and continue to keep exchange rate and relevant relative price movements under close review. They consider that the substantial adjustments made over the last two years have brought the exchange rate to an appropriate level. The tala was devalued by a total of 17 percent in nominal effective terms during February-May 1983. As the gains from these devaluations were partly eroded by subsequent price increases, the currency was further devalued by 12 percent in effective terms during May-July 1984. <sup>1/</sup> These adjustments undertaken during May-July this year have more than offset the real effective appreciation that occurred in the second half of 1983 and have brought the real effective exchange rate index to its lowest level since early 1980 (Chart 4). The exchange rate changes, supported by increased taxes on imports and relatively tight credit policies, have initiated import substitution and brought import demand under control; the effects on exports are expected to emerge gradually. The staff team stressed the importance of maintaining this momentum, noting that the structure of the current account still remains weak, with exports financing only a small portion of imports. Exchange rate policy could be used over the medium term to bring about a fundamental improvement in this structure.

The dismantling of the foreign exchange allocation system for private imports, a key element of the 1984 program, has been completed with a few exceptions. Imports of the exempted items remain subject to a case-by-case approval by the Central Bank, <sup>2/</sup> which the authorities consider necessary to monitor investment activity and to regulate luxury

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1/ See EBD/84/147 (5/21/84), EBD/84/163 (6/5/84), and EBD/84/207 (7/27/84) on Western Samoa's Exchange Arrangements.

2/ Exceptions are capital equipment in excess of dutiable values of WS\$10,000, motor vehicles, and a few other manufactured products. The Central Bank's approval serves as an import license; there is no separate import licensing system.

imports. Although it is too early to assess its full impact, the dismantling has not so far caused an upsurge of imports, largely because of the strength of supporting policies. However, the dismantling has apparently encouraged a greater number of businesses to engage in imports and has generated greater price competition among them. Also, the proportion of imports effected under letters of credit is rising gradually; since July, the use of such letters has been required for imports in excess of WS\$10,000 (except for oil imports), and imports through open account arrangements with overseas suppliers have been discouraged. These developments have helped the authorities to monitor private imports and related private external borrowing more closely; the open account arrangements make it difficult to collect information on prospective import developments.

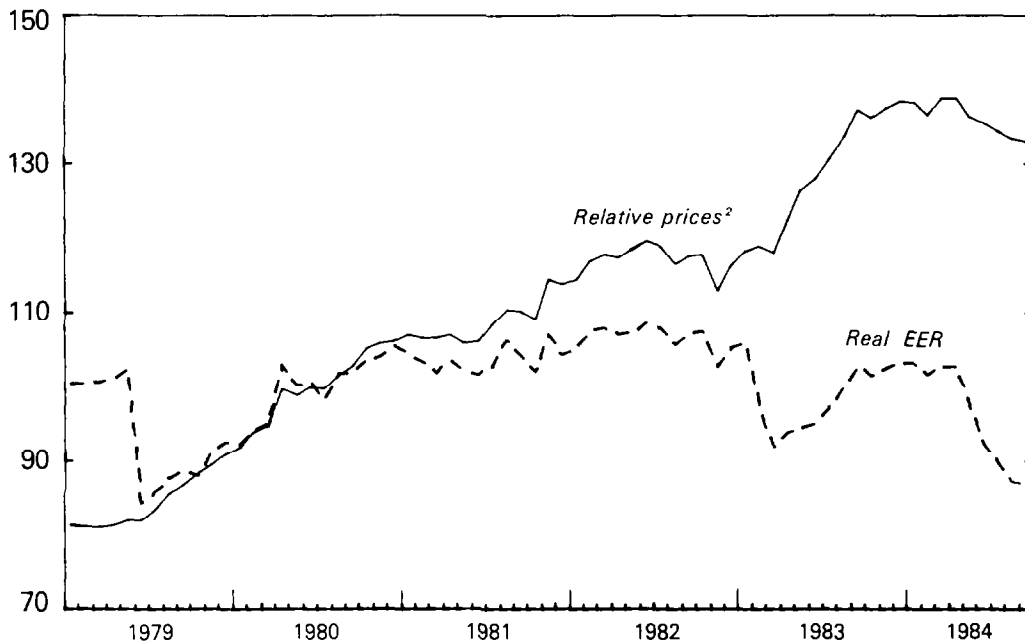
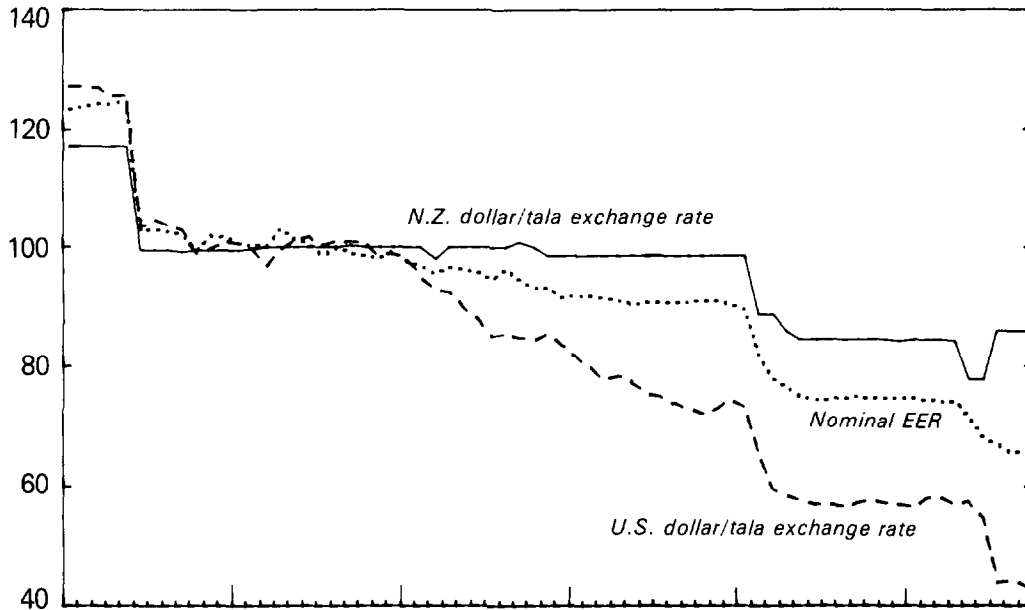
The authorities plan to tailor their external borrowing to the country's absorptive capacity (thus the Government's only major project in 1985 will be the airport extension) and to that available on concessional terms. Borrowing on commercial terms is to be limited to that required to finance certain ongoing projects (e.g., development of forest industries), for which neither concessional financing nor appropriate foreign investors have been found. It is also the authorities' policy to refinance and reschedule some of the debts incurred in the late 1970s and early 1980s, insofar as they can negotiate better terms in light of the country's improved economic performance. In all, the authorities intend to limit in 1985 the contracting and guaranteeing of both concessional and nonconcessional loans with maturities of up to 12 years to US\$6 million (compared with the US\$5.5 million ceiling for 1984), and with maturities of up to 5 years to US\$3 million (US\$2.5 million ceiling for 1984). The latter limit will include a short-term line of credit of the central bank, not exceeding NZ\$1 million, when the arrangements are finalized. The authorities consider this line of credit necessary to protect official reserves from excessive fluctuations that may occur as a result of the dismantling of the foreign exchange allocation system.

Considerable progress has been made in reducing external payment arrears; the only remaining arrears are in respect of loans from the Government of a non-Fund member. With the elimination of arrears arising from commercial transactions, Western Samoa no longer maintains restrictions on payments and transfers for current international transactions that require Fund approval under Article VIII, Section 2(a). As for the remaining arrears, the authorities indicated that they are prepared to settle them as soon as possible, but the creditor government prefers to convert them into investment in Western Samoa; negotiations are in progress but are expected to take some time.

e. Performance criteria

Under the current stand-by arrangement, a mid-term review of economic and financial policies, in particular exchange rate and interest rate policies, is required. Western Samoa is also required to

CHART 4  
WESTERN SAMOA  
EXCHANGE RATE DEVELOPMENTS, 1979-84  
(Index 1980 = 100)<sup>1</sup>



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

<sup>1</sup>An increase represents an appreciation.

<sup>2</sup>Domestic prices / Partner countries' prices.





reach understandings with the Fund at the time of the mid-term review on the performance criteria for the second half of the program period. Accordingly, within the framework of the financial program for 1985 described above, and after taking into account seasonal and other prospective developments, ceilings have been established for end-March and end-June 1985 on the outstanding level of the banking system's net domestic assets, net bank credit to the public sector, and the contracting and guaranteeing by the Government of external loans in the maturity ranges of up to 5 years and up to 12 years (Table 3). The ceilings for March constitute performance criteria, and those for June indicative targets. In addition to these quantitative performance criteria, the usual performance criteria relating to multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements with Fund members, and import restrictions for balance of payments reasons will apply.

### 3. Economic policies and outlook for the medium term

The staff team discussed with the authorities a medium-term scenario based on two key policy assumptions. First, cautious financial policies will be continued over the medium term to keep demand under control. Second, current efforts to strengthen production sectors will be sustained, so as to increase the supply of domestic products. In particular, production of traditional crops will be promoted under the coconut tree replanting scheme and the "suspensory loan scheme" for cocoa planting; 1/ output of nontraditional products will be expanded mainly by preserving the improved incentives introduced through recent tax and exchange rate adjustments. The recent improvement in domestic energy supply 2/ and the expected completion of the airport runway extension in mid-1985 should also help production and export efforts. In addition to these policies, the scenario also assumes that the inflows of foreign grants will continue at about the present level. The terms of trade are assumed to remain broadly stable over the medium term, with both export and import prices rising by 2-3 percent per annum.

Based on these assumptions, the scenario indicates that Western Samoa can sustain real economic growth with a stronger external position over the medium term. The overall balance of payments is estimated to register a small surplus over the period through 1989, which will allow

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1/ The coconut tree replanting program (using high-yielding varieties) is currently limited to WSTEC plantations but will soon be applied to smallholders. The "suspensory loan" scheme, under which 75 percent of each loan can be converted into a grant after 4-5 years, is being widely applied to finance planting of cocoa by smallholders.

2/ Hydroelectric power generation is expected to quadruple during 1981-85; the share of import oil in electricity generation is estimated to decline from 80 percent in 1980 to 20 percent in 1985.

for repayments of remaining arrears, repurchases from the Fund, and a modest increase in reserves. The current account deficit is estimated to decline from about 14 percent of GDP in 1984 to about 10 percent in 1989; the annual growth of import volume is projected to be 1-2 percent (slightly lower than the average increase during 1978-83) and that of export volume to be 2-3 percent (slightly higher than the 1978-83 average). The projected reduction in the current account deficit and the assumed relatively large inflows of external grants imply that new external borrowing could be limited broadly to that available on concessional terms. Consequently, the debt service ratio is projected to decline from 42 percent (22 percent if private remittances are included in the denominator) in 1985 to 20 percent (11 percent) in 1989. These projections are particularly sensitive to import developments, as imports are almost three times larger than exports (Appendix Tables 10 and 11). For example, if import volume rises twice as fast as envisaged, the current account deficit as a percentage of GDP would not fall over the medium term; external borrowing requirements and debt servicing would be considerably higher.

This scenario depends critically on its policy assumptions. Effective domestic demand management and successful efforts to strengthen productive sectors are crucial in both containing import demand and expanding exports as projected. The successful implementation of these policies is also important in ensuring the envisaged inflows of external grants and concessional loans. Even with a reduced current deficit through continued policy efforts, Western Samoa will have to rely heavily on these funds over the medium term.

#### IV. Staff Appraisal

Western Samoa has performed well under the current stand-by arrangement. Economic adjustments initiated under the 1983 program have been continued successfully and most program targets have been achieved. Economic growth has gained momentum, while inflation has been lowered and the external current account deficit reduced. These results have been attained despite a sharp fall in the output and exports of traditional crops resulting from the lagged effect of the 1982-83 drought. Much of the credit for the favorable outcome should be given to the authorities, whose effective implementation of adjustment policies has brought aggregate demand under control and helped increase domestically produced supply. The sustained strength in the terms of trade and continued large inflows of external grants and concessional loans have also contributed.

In 1985, the authorities intend to continue their efforts to reduce inflation and strengthen the external balance, while allowing greater economic activity in the private sector. Their macroeconomic targets are to maintain 2 percent growth in real GDP, lower inflation to 8 percent, and contain the current account deficit at 13 percent of GDP. These objectives represent a major policy challenge, as the

economy still remains structurally weak and the terms of trade are expected to weaken. Therefore, the successful pursuit of these economic objectives will require the maintenance of cautious financial policies and continued efforts to strengthen production sectors.

The staff believes that the 1985 budget is appropriate for the twin objectives of enhancing economic stability and promoting private economic activity. The budget aims at reducing the overall deficit to 1 percent of GDP and curtailing the Government's domestic bank borrowing. This would enable the authorities to contain total domestic credit and liquidity at levels consistent with stabilization objectives, while providing room for a relatively rapid growth in credit to the private sector.

The expected reduction of the budgetary deficit comes largely from the Government's continuing efforts to restrain expenditure growth. In particular, the increase in wages and salaries of public sector employees is to be limited to 5 percent, and no increase in the number of these employees is planned. Development expenditure is budgeted to decline in real terms, as the number of major development projects will be reduced and more private contractors will be utilized to avoid the cost overruns encountered in 1984. The transfer of some of the functions of other public enterprises to the private sector is also being considered in order to improve the overall financial performance of the public sector. On the revenue side, the authorities have successfully implemented a reform of import and excise duties, which has helped double tax revenue in the last two years. They are now focusing their tax review on the rationalization and broadening of the income tax system, including improved taxation on agricultural income.

The planned promotion of private sector economic activity requires a careful management of overall credit flows to that sector, lest such a policy result in excessive demand. Not only must an appropriate credit program be implemented effectively, but funds made available outside this program also need to be closely watched. Toward the latter end, the authorities have recently begun requiring the use of letters of credit for a large portion of imports and discouraging traditional open account arrangements which are difficult to monitor. They have also strengthened their supervision of the lending activities of key nonbank financial institutions and raised the lending rates of these institutions. These measures will improve the control over the magnitude and direction of overall credit flows, but could generate additional demand for credit from commercial banks. However, the staff believes that, in light of uncertainties about the response to the recent measures, it is better to err on the side of caution and maintain an appropriately tight rein on bank credit to the private sector.

The positive real interest rate policy remains an integral part of the authorities' efforts to lower inflation and promote external adjustments. However, as the commercial banks' interest rates have been kept unchanged, the lending rates at the upper end now substantially exceed

the inflation rate. These higher rates appear to be discouraging productive investments by smaller economic entities to which the rates apply. This problem has occurred while overall private credit demand has remained strong, particularly for credit extended at lower interest rates. In these circumstances, lowering the rates at the higher end and raising them at the lower end would not seem inappropriate. However, the staff believes that any such adjustments should be implemented gradually and only when a continuing decline in inflation is evident and there is little risk of rekindling inflationary expectations.

Notwithstanding the recent progress, much remains to be done to strengthen production in various sectors. In particular, the recent trend toward import substitution needs to be sustained, while export promotion efforts must be intensified. Toward these ends, continued efforts are required to diversify output and improve productivity through reorganization of the public enterprises, introduction of new skills and techniques, and most important, preservation of the production incentives introduced in the recent tax reforms and exchange rate adjustments. The exchange rate adjustments undertaken over the last two years, in combination with the tax reform and demand restraint measures, have already initiated the import substitution process and are expected to stimulate export production in due course. It is essential for Western Samoa to sustain this momentum over the medium term by actively using exchange rate policy.

The staff notes that the authorities have made considerable progress in managing the country's external debt. They have eliminated commercial arrears within a commendably short period and plan to eliminate the remaining arrears on official debt as soon as possible. The policy of scaling down the development program to within the country's absorptive capacity is expected to reduce external borrowing requirements to a level broadly in line with resources available on concessional terms. The staff emphasizes the importance of strictly implementing this policy and minimizing external commercial borrowing in view of the country's high debt service ratio.

Western Samoa's economic progress in the last two years has been substantial, and the authorities remain committed to continuing economic adjustments in 1985. The current policy stance will be maintained and additional measures will be introduced as required. This perseverance in implementing appropriate policies should ensure the achievement of adjustment goals.

The coverage and quality of data provided by Western Samoa have improved in recent years, but further work is still needed. In particular, when the full balance sheet of the central bank becomes available on a regular basis, it should be reflected in monetary survey data.

It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

## V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

### 1984 Consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Western Samoa, in the light of the 1984 Article IV consultation with Western Samoa conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
2. The existing restrictions on payments and transfers for current international transactions are maintained by Western Samoa in accordance with Article XIV. The Fund welcomes the substantial liberalization of the foreign exchange allocation system and the elimination of exchange restrictions evidenced by external arrears vis-a-vis other members of the Fund, and encourages the authorities to liberalize remaining exchange restrictions as Western Samoa's balance of payments position improves.

### Stand-By Arrangement

1. Western Samoa has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Western Samoa (EBS/84/130, Supplement 1) and paragraph 4 of the letter dated June 5, 1984 from the Minister of Finance of Western Samoa, in order to reach understandings with the Fund regarding policies and measures and to establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated January 4, 1985 from the Minister of Finance of Western Samoa shall be attached to the stand-by arrangement for Western Samoa, and the letter dated June 5, 1984 from the Minister of Finance and the memorandum annexed thereto shall be read as supplemented by the letter dated January 4, 1985.

3. Western Samoa will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Western Samoa's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota during any period in which the data at the end of the preceding period indicate that:

a. the ceiling on net credit to the public sector from the banking system described in paragraph 13 of the letter of January 4, 1985; or

b. the ceiling on net domestic assets of the banking system described in paragraph 13 of the letter of January 4, 1985; or

c. the ceilings on external debt described in paragraph 9 of the letter of January 4, 1985, have not been observed.

4. The Fund decides, pursuant to paragraph 4(c) of the stand-by arrangement for Western Samoa, that the review provided for in that paragraph, including the specification of certain performance criteria for the remaining period of the stand-by arrangement, is completed.

Table 4. Western Samoa: Indicators of Agricultural and Industrial Production, 1980-85

	Volume of Major Crops (in thousands of longtons)					
	Copra <u>1/</u>	Cocoa <u>1/</u>	Bananas <u>1/</u>	Taro <u>1/</u>	Tropical fruits	
1980	30.1 (23.3)	0.88 (0.85)	12.3 (2.4)	13.91 (2.8)	0.29	
1981	23.1 (16.5)	0.81 (0.78)	11.8 (1.8)	16.66 (5.6)	0.39	
1982	31.1 (24.1)	1.18 (1.15)	10.3 (1.3)	15.16 (4.5)	0.71	
1983	29.8 (22.6)	1.32 (1.29)	9.4 (1.4)	15.18 (3.1)	1.45	
1984 <u>2/</u>	28.5 (20.0)	0.83 (0.80)	9.7 (0.7)	16.18 (5.1)	2.33	
1985 <u>2/</u>	29.6 (22.0)	1.03 (1.00)	10.0 (1.4)	16.50 (5.5)	3.65	

	Volume of Industria Output							
	Copra Meal (MT)	Coconut Oil (MT)	Timber <u>3/</u> ('000 bd ft)	Beer ('000 hl)	Cigarettes (millions)	Matches (cartons)	Soap (MT)	Electricity (mn. kw. hour) Total (Hydro)
1980	--	--	8,984	45.7	141.9	2,604	898	31.6 (6.7)
1981	--	--	8,198	42.5	131.3	1,967	807	30.5 (7.3)
1982	4,577	8,679	8,667	50.6	157.0	4,477	923	30.7 (12.2)
1983	5,574	12,252	9,068	43.2	129.6	3,251	713	31.9 (12.1)
1984 <u>2/</u>	5,550	11,120	10,700	38.0	153.0	3,800	729	33.9 (20.2)
1985 <u>2/</u>	8,150	16,200	11,300	40.0	160.0	4,000	995	36.4 (29.1)

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

1/ Figures in parentheses show purchases by respective Marketing Boards for exports or for further processing (i.e. into coconut oil and other products, in the case of copra).

2/ Estimates.

3/ Including veneer.



Table 5. Western Samoa: Financial Operations of the Central Government, 1981-85

	1981	1982	1983 Prov.	1984 Prog.	Rev. Est.	1985 Budget
(In millions of tala)						
Total revenue and grants	39.2	42.6	64.6	71.7	74.7	85.7
Total revenue	24.3	28.3	40.8	51.4	55.3	63.7
External grants	14.9	14.3	23.8	20.3	19.4	22.0
Total expenditure, commitment basis	56.8	61.7	68.0	77.0	79.2	87.7
Current expenditure	25.1	31.7	30.6	33.5	32.7	37.4
Development expenditure	26.9	27.2	36.3	41.7	45.5	47.8
Of which: domestically financed	(8.3)	(8.9)	(6.9)	(13.8)	(17.2)	(18.3)
Net Treasury advances	0.4	1.4	1.1	1.8	0.7	1.5
Capital accounts <u>1/</u>	4.3	1.4	--	--	0.3	1.0
Overall deficit, commitment basis	-17.6	-19.1	-3.4	-5.3	-4.5	-2.0
Net change in arrears	1.7	4.3	-1.8	-1.9	-0.8	-1.6
Overall deficit, cash basis	-15.9	-14.8	-5.2	-7.2	-5.3	-3.6
External financing (net)	6.2	3.9	9.1	5.4	9.5	5.4
Domestic financing (net)	9.7	10.9	-3.9	1.8	-4.2	-1.8
Banking system <u>2/</u>	(8.6)	(7.2)	(-4.4)	(1.1)	(-4.1)	(0.4)
Other	(1.1)	(3.7)	(0.5)	(0.7)	(-0.1)	(-2.6)
(In percent of GDP)						
Total revenue	22.3	21.7	26.4	28.4	31.2	31.5
Total expenditure	52.1	47.3	44.0	42.5	43.2	43.4
Overall deficit, commitment basis						
Excluding grants	-29.8	-25.6	-17.6	-14.1	-13.0	-11.9
Including grants	-16.2	-14.6	-2.2	-2.9	-2.5	-1.0

Sources: Treasury Department of Western Samoa; and staff estimates.

1/ The ending of the Government's exemption from import duty in 1984 substantially raised tax revenue and development expenditure.

2/ Acquisition of shares by the Government.

3/ Excludes changes in the counter-entry to government arrears and rescheduled government arrears and therefore differs from the monetary survey.

Table 6. Western Samoa: Selected Financial Indicators  
of the Public Enterprises, 1981-85

(In millions of tala)

	1981	1982	1983 Prov.	1984 Projections	1985
Electric Power Corporation <sup>1/</sup>					
Overall surplus/deficit (-)	-3.6	-1.7	-4.1	-4.8	-5.0
Bank borrowing	-0.5	0.1	0.4	0.4	0.2
Western Samoan Trust Estate Corporation					
Overall surplus/deficit (-)	-3.4	-3.3	0.2	-1.3	--
Bank borrowing	2.0	0.8	-1.1	0.6	--
Special Project Development Corporation					
Overall surplus/deficit (-)	-1.1	-0.4	-0.1	-1.1	-1.0
Bank borrowing	0.2	-0.2	-0.1	0.8	0.8
Copra Board					
Overall surplus/deficit (-)	-0.9	-1.5	1.1	3.3	1.0
Bank borrowing	0.3	0.9	-1.0	-1.2	-0.2
Cocoa Board					
Overall surplus/deficit (-)	-0.2	-0.6	0.1	0.6	0.6
Bank borrowing	0.3	0.9	-1.0	--	-0.2
Other					
Overall surplus/deficit (-)	-0.1	1.0	-0.6	--	--
Bank borrowing	0.8	-1.2	0.7	0.6	0.6
Total					
Overall surplus/deficit (-)	-9.3	-6.5	-3.4	-3.3	-4.4
Bank borrowing	3.8	2.2	-2.1	1.2	1.2

(In percent of GDP)

Memorandum items:

Total					
Overall deficit	-8.5	-5.0	-2.2	-1.8	-2.2
Bank borrowing	3.5	1.7	-1.4	0.7	0.6

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

<sup>1/</sup> The large deficits of the EPC largely reflect its investment expenditure on power plant construction; the operating deficit is small.

Table 7. Western Samoa: Monetary Survey, 1981-85

(In thousands of tala)

	1981 Dec.	1982 Dec.	1983 Dec.	1984 <u>1/</u> Dec.	1985 <u>1/</u> Dec.
				Program	Estimated Actual
Net foreign assets	-19,109	-25,850	-19,712	-17,200	-12,600
Net domestic assets	42,168	57,067	56,095	59,000	55,500
Credit to the public sector (net) <u>2/</u>	29,945	43,722	37,188	36,950	33,600
Government (net) <u>2/</u>	19,896	31,470	27,061	25,900	22,300
Public enterprises	10,049	12,252	10,127	11,050	11,300
Credit to the private sector	11,986	14,166	15,938	18,800	19,100
Other assets (net)	237	-821	2,969	3,250	2,800
Total liquidity	23,059	32,217	36,383	41,800	42,900

## (Annual percentage changes)

Net domestic assets	55	35	-2	5	-1
Credit to the public sector (net)	90	46	-15	-1	-10
Government (net)	108	58	-14	-4	-18
Public enterprises	62	22	-17	9	12
Credit to the private sector	6	18	13	18	20
Total liquidity	26	35	17	15	18

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

1/ Figures for 1984 and 1985 are net of valuation adjustments arising from exchange rate changes since December 28, 1983.2/ Includes counterentries to government external arrears and rescheduled government arrears which are excluded in the budget definition of bank credit to the Government.

Table 8. Western Samoa: Interest Rates, 1981-84

(Percent per annum, end of period)

	1981	1982	1983	1984 Oct.
Commercial banks				
Savings deposits	5.0	6.0	8.0	8.0
Time deposits (3 months-2 years)	8.5-10.5	9.0-11.5	14.0-17.0	14.0-17.0
Lending rates	9.0-15.0	12.0-16.0	14.0-20.0	14.0-20.0
Development Bank				
lending rates				
Agricultural loans	8.0	8.0	8.0	10.0
Industrial and other loans	12.0-14.0	12.0-14.0	12.0-17.0	14.0-19.0
National Provident Fund				
Interest rate on contributions	4.0	5.5	6.5	6.5
Lending rates	8.0-11.0	8.0-12.0	8.0-14.0	10.0-15.0
Memorandum item:				
Inflation (annual averages)	20.5	18.4	16.5	12.0 <u>1/</u>

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

1/ Estimate.

Table 9. Western Samoa: Summary Balance of Payments, 1982-85

(In millions of SDRs)

	1982	1983	1984		1985
			Program	Revised Proj.	Proj.
Exports, f.o.b.	11.9	16.6	20.0	17.1	17.6
Of which: Copra and products	(5.3)	(7.9)	(11.2)	(8.6)	(10.7)
Cocoa	(0.6)	(2.5)	(1.9)	(1.1)	(2.1)
Imports, c.i.f.	-45.0	-48.4	-50.6	-49.3	-50.5
Of which: Oil	(-6.8)	(-7.2)	(...)	(-7.0)	(-7.0)
Trade balance	-33.1	-31.8	-30.6	-32.2	-32.9
Services (net)	-0.5	-0.4	-0.6	-0.5	0.2
Of which: Interest payments	(-1.9)	(-1.9)	(-1.9)	(-2.4)	(-2.0)
Private transfers (net)	16.9	19.0	18.0	20.0	20.5
Current account balance	-16.7	-13.2	-13.2	-12.7	-12.2
Official transfers	10.7	14.3	11.3	9.5	10.0
Nonmonetary capital (net)	2.0	6.2	3.4	7.3	3.1
Government (net)	0.8	3.7	1.6	3.0	0.3
Other <u>1/</u>	1.2	2.5	1.8	4.3	2.8
Overall balance	-4.0	7.3	1.5	4.1	0.9
Monetary movements	4.0	-7.3	-1.5	-4.1	-0.9
Foreign assets (increase-)	-0.4	-3.5	0.3	-1.5	0.5
Foreign liabilities (increase +)	4.4	-3.8	-1.8	-2.6	-1.4
Of which:					
Use of Fund resources (net)	(-0.7)	(1.9)	(2.6)	(2.6)	(0.3)
Arrears (net)	(4.2)	(-10.5)	(-1.1)	(-0.9)	(-0.8)
Rescheduled arrears (net) <u>2/</u>	(--)	(4.1)	(-3.2)	(-3.2)	(-0.9)
Memorandum items:					
Current account deficit/GDP (percent)	-17.1	-14.3	-12.4	-14.1 <u>3/</u>	-12.8
Gross international reserves (end of period):					
In millions of SDRs	3.2	6.9	6.6	9.5	9.0
In months of imports	(0.9)	(1.7)	(1.6)	(2.3)	(2.1)

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

1/ Includes private capital flows, errors and omissions, and counterentry to valuation changes in foreign assets and liabilities.

2/ Payments arrears rescheduled in 1983.

3/ The ratio is 11.9 percent if calculated by the exchange rate used at the time of the program formulation.

Table 10. Western Samoa: A Medium-Term  
Balance of Payments Scenario, 1985-89

(In millions of SDRs)

	1985	1986	1987	1988	1989
Trade balance	-32.9	-34.0	-35.2	-36.4	-37.7
Exports, f.o.b.	17.6	18.5	19.4	20.4	21.4
Imports, c.i.f.	-50.5	-52.5	-54.6	-56.8	-59.1
Services (net) <u>1/</u>	0.2	0.6	1.0	1.3	2.0
Of which: Interest payments <u>1/</u>	-2.0	-2.2	-2.1	-2.1	-2.0
Private transfers (net)	20.5	20.8	21.3	21.8	22.3
Current account balance	-12.2	-12.6	-12.9	-13.3	-13.4
Official transfers	10.0	10.0	10.3	10.5	11.0
Nonmonetary capital (net)	3.1	4.2	5.6	6.1	7.0
Government	0.3	1.2	2.6	2.8	3.4
Disbursement	(4.3)	(5.0)	(5.0)	(5.3)	(6.0)
Amortization	(-4.0)	(-3.8)	(-2.4)	(-2.5)	(-2.6)
Other	2.8	3.0	3.0	3.3	3.6
Overall balance	0.9	1.6	3.0	3.3	4.6
Financing	-1.4	-2.2	-2.1	-2.7	-1.4
Use of Fund resources <u>2/</u>	0.3	-1.3	-2.1	-2.7	-1.4
Purchases	(1.7)	(...)	(...)	(...)	(...)
Repurchases	(-1.4)	(-1.3)	(-2.1)	(-2.7)	(-1.4)
Reduction in payments arrears <u>3/</u>	-1.7	-0.9	--	--	--
Change in reserves	-0.5	-0.6	0.9	0.6	3.2
Memorandum items:					
Gross reserves in months of imports <u>4/</u>	2.1	1.8	2.0	2.0	...
Current account deficit (as percent of GDP) <u>5/</u>	-12.8	-12.3	-11.6	-11.1	-10.4

Sources: Western Samoan authorities; and staff estimates.

1/ Includes estimated interest payments on projected new borrowings.

2/ Assumes full purchase under the current stand-by arrangement.

3/ Includes reductions of payments arrears rescheduled in 1983.

4/ In terms of following year's imports.

5/ Nominal GDP is assumed to grow at 10 percent in 1985 and at 8 percent during 1986-89.

Table 11. Western Samoa: A Medium-Term External Debt and Debt Service Payments Scenario, 1983-89

	1983	Projections					
		1984	1985	1986	1987	1988	1989
(In millions of SDRs)							
External debt outstanding <u>1/</u>	73.8	75.3	74.2	73.2	73.7	73.8	75.8
Of which: IMF <u>2/</u>	(5.7)	(8.3)	(8.6)	(7.3)	(5.2)	(2.5)	(1.1)
Arrears	(2.6)	(1.7)	(0.9)	(--)	(--)	(--)	(--)
Rescheduled arrears <u>3/</u>	(4.1)	(0.9)	(--)	(--)	(--)	(--)	(--)
Loan disbursements	8.4	11.6 <u>4/</u>	6.0	5.0	5.0	5.3	6.0
Of which: IMF	(2.8)	(3.4)	(1.7)	(--)	(--)	(--)	(--)
Amortization <u>5/</u>	9.2	12.6 <u>4/</u>	7.1	5.1	4.5	5.2	4.0
Of which: IMF	(0.9)	(0.8)	(1.4)	(1.3)	(2.1)	(2.7)	(1.4)
Interest payments	1.9	2.4	2.0	2.2	2.1	2.1	2.0
Of which: IMF	(0.3)	(0.5)	(0.6)	(0.6)	(0.5)	(0.4)	(0.2)
(In percent)							
External debt outstanding (as percent of GDP) <u>6/</u>	79.4	79.5 <u>4/</u>	78.0	71.2	66.5	61.6	58.6
Of which: IMF	(6.1)	(8.8)	(9.0)	(7.1)	(4.7)	(2.1)	(0.8)
Arrears	(2.8)	(1.8)	(0.9)	(--)	(--)	(--)	(--)
Rescheduled arrears	(4.4)	(0.9)	(--)	(--)	(--)	(--)	(--)
Debt service payments as percent of exports of goods and services	56.6	61.0 <u>7/</u>	42.3	31.7	26.4	26.5	19.7
Of which: IMF	(6.1)	(6.3)	(9.3)	(8.3)	(10.4)	(11.3)	(5.2)
Arrears, including rescheduled	(32.6)	(20.0)	(7.9)	(3.9)	(--)	(--)	(--)
Debt service payments as percent of exports of goods, services and private remittances	28.8	30.9 <u>7/</u>	21.7	16.7	14.3	14.8	11.4

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

1/ Government and government-guaranteed external debt, use of Fund credit, and external payments arrears, including rescheduled amounts; end of period.

2/ Use of Fund credit outstanding at end-period; no drawings from the Fund are assumed for the period 1985-89 beyond purchases under the current stand-by arrangement.

3/ Payments arrears scheduled in 1983.

4/ Includes refinancing of a Eurodollar loan in June 1984 (SDR 2 million) and a New Zealand loan in August 1984 (SDR 0.5 million).

5/ Including repayments of external payments arrears and arrears rescheduled in 1983 during 1984-86.

6/ Nominal GDP is assumed to grow at 10 percent in 1985 and at 8 percent during 1986-89.

7/ Excludes refinancing mentioned in footnote 4/ above; if it is included, the ratio would be 73.2 percent (exports of goods and services) and 37.0 percent (exports of goods, services and private remittances).

Western Samoa ~ Fund Relations  
(As of November 30, 1984)

I. Membership Status

- (a) Date of Membership: December 28, 1971
- (b) Status: Article XIV

(A) Financial Relations

II. General Department (General Resources Account)

- (a) Quota: SDR 6.0 million (previously SDR 4.5 million)
- (b) Total Fund holdings of currency:
  - SDR 14.270 million (237.8 percent of quota)
  - Fund credit: SDR 8.269 million (137.8 percent of quota)
  - Of which:
    - CFF: SDR 2.650 million (44.2 percent)
    - Credit tranche: SDR 4.775 million (79.6 percent)
    - EAR: SDR 0.844 million (14.1 percent)
- (d) Reserve tranche position: None
- (e) Current Operational Budget: Not included
- (f) Lending to the Fund: None

III. Current Stand-by or Extended Arrangement and Special Facilities

- (a) Current stand-by
  - (i) Duration: July 9, 1984-July 8, 1985
  - (ii) Amount: SDR 3.375 million
  - (iii) Utilization: SDR 1.688 million
  - (iv) Undrawn balance: SDR 1.687 million
- (b) Stand-by and extended arrangements in last 10 years:
  - Stand-by 1975 November SDR 0.5 million (25 percent of quota)
  - Stand-by 1977 January SDR 0.59 million (29.5 percent)
  - Stand-by 1978 February SDR 0.725 million (36.25 percent)
  - Stand-by 1979 August SDR 0.75 million (25 percent)
  - Stand-by 1983 June SDR 3.375 million (75 percent)
  - First tranche: 1981 March SDR 0.745 million (16.56 percent)
- (c) Special facilities in the past two years
  - CFF: 1983 May, SDR 1.15 million (25 percent)



IV. SDR Department

- (a) Net cumulative allocations: SDR 1.14 million
- (b) Holdings: SDR 151,098 (13.3 percent of net cumulative allocation)
- (c) Current Designation Plan: Not included

V Administered Accounts

- (a) Trust Fund Loans
  - (i) Disbursed SDR 1.955 million
  - (ii) Outstanding SDR 1.70 million
- (b) SFF Subsidy Account: None

VI. Overdue Obligations to the Fund None

B. Nonfinancial Relations

VII. Exchange rate arrangement

The exchange rate of tala in terms of New Zealand dollar is determined by reference to a basket of currencies. Exchange rates for other currencies are set on the basis of the rate vis-a-vis the New Zealand dollar and the daily cross rates between these currencies and the New Zealand dollar. As of end-August 1984, the exchange rate was WS\$2.08 = US\$1, and WS\$1.04 = NZ\$1.

VIII. Last Article IV consultation

Staff discussions were held in October 1983. The Executive Board discussed the Staff Report (EBS/83/271, 12/21/83) on January 18, 1984. The Executive Board approved Western Samoa's request for a stand-by arrangement EBS/84/130, 6/7/84) on July 9, 1984.

IX. Technical Assistance:

- (a) CBD: Advisory mission on general banking legislation (November 1983). The Fund currently provides three CBD panel experts as General Manager, Advisor to the Foreign Department, and Manager of the Research Department of the new Central Bank.
- (b) Fiscal: Mission on Tax reform (June 1981)
- (c) Legal: Staff visits in November 1983, July and November 1984 to help the authorities draft and revise tax legislation.
- (d) Bureau of Statistics: Mission to review money and banking statistics (March 1983).

X. Resident Representative/Advisor: None since 1980.

A staff member is expected to take up this post in January 1985.

World Bank Operations in Western Samoa

Since 1975, the World Bank Group has had three operations in Western Samoa, all financed through IDA credit. The first in March 1975 was a \$4.40 million credit for highway construction. This has now been fully disbursed. Two subsequent credits, one in 1979 and other in 1980, provided a total of \$10 million for agricultural development. As of October 31, 1984, some \$4.53 million remained undisbursed. The Bank continues to be involved in the implementation of these credits and, since some of the funds are earmarked for WSTEC's operations, it is closely monitoring the Government's efforts at restructuring the corporation along the lines suggested by a Bank-financed study. Currently the Bank is reviewing the possibility of cofinancing an agro-industrial project with AsDB to the Development Bank of Western Samoa. The Bank, through IDA, could be providing \$2-2.5 million out of a total of \$6 million. For the subsequent years the Bank Group would be working with AsDB to support two more agricultural projects with about \$4.5 million of IDA funds.

During 1984 Bank staff participated in the AsDB Agricultural Sector Mission and on the Fund Article IV consultation mission. For 1985, the Bank is considering a mission, possibly in conjunction with the AsDB, to prepare the ground for the next lending operation. In the latter half of the year, an economic mission is planned which will produce a report on selected aspects of agricultural production and agro-processing activities.

Western Samoa--Statistical Issues

1. Coverage, currentness, and reporting of data in IFS

		<u>Latest Data in November 1984 IFS</u>
Real Sector	- National Accounts	n.a.
	- Prices (consumer)	March 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Central Bank	n.a.
	- Deposit Money Banks	n.a.
	- Monetary Survey	August 1984
	- Other Financial Institutions	Q3 1983
External Sector	- Merchandise Trade: Values	March 1984
	- Merchandise Trade: Prices	Q2 1983
	- Balance of Payments	1982
	- International Reserves	July 1984
	- Exchange Rates	September 1984

2. Outstanding statistical issues

a. Monetary Accounts

Present IFS international liquidity data and Monetary Survey are based on the financial system that was in effect before the Central Bank was established. Revisions will be made once the Central Bank publishes its own balance sheet.

b. Merchandise trade--prices

There are no statistics on import prices and there is a long time lag in the reporting of data on export volume and value (which form the basis for calculation of the export unit value indices for publication in IFS).

c. Government Finance

The 1983 GFS Yearbook only contains information on the institutional framework of government and no data are published.

WESTERN SAMOA

Basic Data

Area:	1,075 square miles
Population (1984):	159,000
Population growth rate (1968-83)	0.9 percent annually
GDP per capita (1984 estimate)	SDR 601
	1981      1982      1983      1984 Estimate

	<u>(Annual percentage change)</u>			
<u>Selected economic indicators</u>				
GDP at constant prices	-9.1	-1.0	0.5	2.1
Consumer price index	20.5	18.4	16.5	12.0
Government revenue (excluding grants)	-2.4	16.5	44.2	35.5
Government expenditure	8.2	8.6	10.2	16.5
Net domestic assets	54.9	35.3	-1.7	1.1
Total liquidity	26.4	35.4	16.6	17.9
Merchandise exports, f.o.b.	-29.6	25.3	39.5	3.0
Merchandise imports, c.i.f.	0.2	-6.0	7.6	1.9
Export volume	-20.8	19.3	4.2	-15.3
Import volume	-12.5	-9.9	8.5	-1.1
Terms of trade (deterioration ~)	-22.4	0.8	31.2	18.5
Effective exchange rate index (depreciation ~) <u>1/</u>				
Nominal	-6.0	-2.2	-17.9	-12.5
Real	-0.2	0.9	-2.5	-15.2

	<u>(In percent of GDP)</u>			
<u>Selected financial ratios</u>				
Government revenue	22.3	21.7	26.4	31.2
Tax revenue	18.6	18.3	22.1	26.4
Government expenditure (commitment basis)	52.1	47.3	44.0	43.2
Budget deficit (commitment basis)	-16.2	-14.6	-2.2	-2.5
Domestic bank financing <u>2/</u>	7.9	5.5	-2.8	--
Foreign financing	5.7	3.0	3.9 <u>3/</u>	5.2 <u>3/</u>
Total liquidity	21.2	24.0	23.6	23.4
External current account deficit	-27.2	-17.1	-14.3	-14.1
Imports (c.i.f.)	53.7	46.0	52.1	55.3
Oil imports (percent of total imports)	21.4	15.1	14.9	...
External debt <u>4/</u>				
Including IMF	71.1	71.5	79.4	79.5
Excluding IMF	68.1	67.6	73.2	70.7

WESTERN SAMOABasic Data (Concluded)

	1981	1982	1983	1984 Estimate
	(In percent of exports of <u>goods and services</u> )			
<u>External debt service ratios 5/</u>				
Debt service, including IMF	34.4	37.7	56.6	61.3
Debt service, excluding IMF	27.5	32.0	50.5	54.7
Interest payments, including IMF	14.3	11.4	9.7	11.7
Interest payments, excluding IMF	12.9	9.6	8.1	9.3
	(In millions of SDRs)			
<u>External payments data</u>				
Overall balance of payments (deficit -)	-7.2	-4.1	7.3	4.1
Gross international reserves (end of period)	2.8	3.2	6.9	9.5
In months of imports	(0.7)	(0.9)	(1.7)	(2.3)
External payments arrears (end of period)	8.8	13.1	2.6	1.7

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

1/ Change between fourth quarters, except for 1984 which is the change in the 12-month period ended September. Negative sign indicates depreciation.

2/ Excluding net changes in the counterentries to external government arrears and rescheduled government arrears.

3/ Excludes amounts corresponding to reductions in arrears largely due to rescheduling and investment in Western Samoa.

4/ Including external payments arrears. The estimate for 1984 includes refinancing of Eurodollar loan in June 1984 and New Zealand loan in August 1984.

5/ Including repayments of external payments arrears and rescheduled arrears in 1983-84. The estimate for 1984 excludes refinancing mentioned in footnote 4.

Apia  
Western Samoa  
January 4, 1985

Mr. J. de Larosiere  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. The principal objectives of Western Samoa's stabilization program for 1984 that is supported by the stand-by arrangement from the Fund approved on July 9, 1984 are to achieve a real GDP growth of 2 percent, to bring about a reduction in the annual average rate of inflation to 12 percent, to limit the Central Government's budget deficit (including grants) to below 3 percent of GDP (14 percent of GDP excluding grants), and to reduce the external current account deficit to 12 percent of GDP. An overall balance of payments surplus of SDR 1.5 million has been envisaged.

2. To achieve these objectives, we have implemented a financial program for 1984 that aims at limiting the growth in net domestic assets of the banking system to 5 percent, with a small improvement in the public sector's net position with the banking system, and at containing the growth of total liquidity to 15 percent. The maintenance of positive real interest rates has also been an important monetary policy objective. We wish to reaffirm our commitment to implement the financial measures under the program.

3. We have continued to pursue a flexible exchange rate policy, adjusting the exchange rate of the tala on three occasions since the beginning of 1984. Against the New Zealand dollar, which has been used as the intervention currency for some years, the exchange rate was depreciated by 4.3 percent on May 7 and by 3.9 percent on May 31. In addition, when the New Zealand dollar was devalued by 20 percent against the U.S. dollar in July, the tala was appreciated by only 10.8 percent against the New Zealand dollar. These adjustments brought about a 12 percent depreciation in the real effective exchange rate of the tala during the first nine months of 1984; over this period, the tala depreciated by 24 percent against the U.S. dollar. We believe that the present level of the exchange rate is appropriate, but remain committed to a flexible exchange rate policy so as to avoid any major change in the real effective exchange rate of the tala.

4. Domestic economic developments during the first ten months of 1984 have been generally satisfactory, and we expect the recent trends to continue during the remainder of 1984. Although the output of copra and cocoa declined, food production recovered from the drought-affected level of 1983. Industrial production also increased appreciably. The

favorable food supply, combined with financial restraint, contributed to a slowdown in inflation so far in 1984. On the basis of these developments, we now expect that the program targets of achieving a 2 percent growth in real GDP and of limiting inflation to an annual average rate of 12 percent will be realized.

5. The export performance to date has been weaker than anticipated in the program, mainly due to the declines in export volume of copra products and cocoa, which account for over one half of Western Samoa's total exports. Total export earnings (in SDR terms) are now expected to be 15 percent lower than the program projection, implying a marginal growth over 1983. On the other hand, import payments (in SDR terms) are likely to be 3 percent less than earlier envisaged, while private remittances are projected to be higher. If these developments continue, the current account deficit may turn out to be 14 percent of GDP, compared with the target ratio of 12 percent and the 14.3 percent ratio realized in 1983. However, partly as a result of larger than earlier projected inflows of official capital, the balance of payments surplus (as measured by movements in net foreign assets) is expected to be larger than programmed.

6. In the course of 1984 the import system has been liberalized substantially. In April, the upper limits on the allocation of foreign exchange for certain basic food items and construction materials were lifted. Effective July 1, the foreign exchange allocation system was dismantled and imports can now be made freely, except with respect to motor vehicles, capital equipment in excess of dutiable values of WS\$10,000 and a few domestically manufactured items. As from July 1, all payments for imports in excess of WS\$10,000, with the exception of petroleum products, must be made under letters of credit to ensure that import payments will be effected in an orderly manner.

7. By the end of March 1984 all external payments arrears on commercial debt had been eliminated through cash payments and rescheduling. External payments arrears on government and government-guaranteed debt, which amounted to SDR 2.6 million at the end of 1983 and covered debt owed to the Government of a non-Fund member, were reduced during January-August 1984 to SDR 1.7 million through cash payment and investment in Western Samoa by the Government concerned. In addition, rescheduled payments arrears, which amounted to SDR 4.2 million at the end of 1983, were reduced to SDR 0.9 million by end-September 1984 through cash payments. It is our intention to eliminate rescheduled arrears, and to reduce the remaining amount of arrears owed to the non-Fund member government.

8. With a view to reducing the external debt service burden, the contracting and guaranteeing by the Government of external loans with original maturities of up to and including five years was subjected, during the economic program period corresponding to calendar 1984, to a limit of US\$3 million, and those with original maturities of up to and

including 12 years, to a limit of US\$5.5 million. During January-September, external loans with maturities of up to 12 years contracted by the Government amounted to US\$3.6 million; of these US\$2.6 million carried maturities of up to 5 years, all of which represent rescheduling and rollover of commercial debt. These reschedulings and rollovers were intended to spread the debt service burden more evenly over the next few years. The Government has not guaranteed any external loans during 1984.

9. During 1985 the Government will continue to pursue a prudent external debt policy. Thus, the contracting and guaranteeing of external loans with maturities of up to and including 12 years will be limited to US\$6 million, and with maturities of up to and including 5 years to US\$3 million. In accordance with this plan, during the first quarter of 1985, the Government will limit the contracting and guaranteeing of external loans with maturities of up to and including 12 years to US\$2 million, and those with maturities of up to and including 5 years, to US\$1 million. The latter limit would include a short-term stand-by line of credit not exceeding NZ\$1 million if arrangements under review by the Central Bank of Samoa are finalized.

10. The fiscal reforms introduced in February 1984 have produced many positive results. To further improve the tax system, we are continuing the tax review, focusing on the rationalization and broadening of the income tax including measures to tax agricultural income. At the same time, the Government has been pursuing a cautious fiscal policy. In the revised 1984 budget, total tax revenue is estimated to be 42 percent higher and total revenue and grants to be 16 percent greater than in 1983. Current expenditure is estimated to be only 7 percent larger than in 1983. Development expenditure is expected to increase by 25 percent, mainly on account of the airport extension and hydroelectric projects. The overall deficit (on a commitment basis including grants) in 1984 is now estimated at WS\$4.5 million, equivalent to 2.5 percent of GDP, which is less than targeted under the program. The ceiling on net credit to the Government for end-September has been met, and we are confident that the ceiling for end-December 1984 will also be observed.

11. In the 1985 budget, the cautious fiscal policy stance will be continued. Total revenue and grants are budgeted to increase by 15 percent and the increase in tax revenue is expected to contribute slightly over one third of this increase. Total expenditure is planned to increase by only 11 percent. A 14 percent growth in current expenditure is planned, as spending on health and education will be raised significantly, while development expenditure is budgeted to increase by only 5 percent. The overall deficit (on a commitment basis including grants) is projected to decline to 1 percent of GDP in 1985. Net borrowing of the Government from the banking system is expected to be very small.



12. At the end of September net domestic assets of the banking system were 11 percent below the ceiling due to a further decline in net credit to the public sector. On the other hand, the growth in credit to the private sector has been somewhat higher than envisaged, partly as a result of increased demand for domestic bank credit resulting from the newly required use of letters of credit for most imports. During 1984, credit to the private sector is now projected to grow by 20 percent, compared with 18 percent envisaged under the program. However, as a result of the improvement in the net position of the Government with the banking system, net domestic assets are projected to be slightly lower than the level at the end of 1983, or 6 percent below the ceiling for end-December. The net foreign assets position is expected to improve substantially more than programmed. Total liquidity is now projected to grow by 18 percent in 1984, compared with the program projection of 15 percent. We will monitor closely the developments in credit to the private sector.

13. Monetary policy in 1985 will aim at lowering inflation further to 8 percent, reducing the current account deficit to 13 percent of GDP, and maintaining real growth rate at 2 percent. Consistent with these objectives, total liquidity is envisaged to grow by 10.4 percent in 1985. Taking into account the projected balance of payments surplus of WS\$1.9 million, net domestic assets of the banking system are programmed to increase by 4.6 percent. Net credit to the public sector is projected to decline by 6.3 percent while credit to the private sector is expected to increase by 18.3 percent. After considering the anticipated credit conditions during the first quarter of 1985, we have established targets for net domestic assets and net credit to the public sector for end-March 1985. Thus, net domestic assets of the banking system, which are projected to be WS\$55.5 million at the end of December 1984, will not exceed WS\$56.7 million on March 29, 1985, and net bank credit to the public sector, which is projected to be WS\$33.6 million at the end of December 1984, will not exceed WS\$34.1 million. These ceilings are defined to exclude valuation adjustments. Policies will also be directed to ensure that there is no appreciable change in the growth of these credit aggregates through the first half of 1985. Thus, we will aim to limit the level of net domestic assets at the end of June 1985 to no more than WS\$57.4 million, and the level of net bank credit to the public sector to no more than WS\$33.3 million.

14. We believe that positive real interest rates are essential for mobilization of savings, efficient use of resources, and control of demand for credit. Interest rates in Western Samoa have been kept unchanged since February 1983, while those in some overseas financial markets have eased recently. As the rate of inflation declined in Western Samoa, real interest rates are now positive and they are expected to rise during the remainder of 1984. However, partly because of the effect of recent exchange rate actions, price developments in the coming months remain uncertain. Also, the demand for private credit, including that for imports, has been strong, and to partially counter this, the lending rates of nonbank financial institutions have been

raised recently. This adjustment has also narrowed the differentials between the lending rates of commercial banks and nonbank financial institutions. In light of these developments, we are currently reviewing the appropriateness of the level and structure of interest rates, bearing in mind the ultimate objectives of positive real interest rate policy and the need to pursue both exchange rate and interest rate policies in a flexible manner.

15. We expect the overall external position to remain in surplus in 1985, although the surplus is not expected to be as large as in 1984. The current account deficit is projected to decline to 13 percent of GDP. The improvement in the current account position is expected to result partly from a modest recovery in export volume and growth in private remittances from abroad. The current account projection assumes no increase in import volume and a moderate increase in import prices. We have discussed the medium-term balance of payments outlook prepared by the mission. We consider that a modest accumulation of reserves assumed in the balance of payments projections for 1987-89 is reasonable. Given the openness of the Western Samoan economy and the vulnerability of the economy to external developments, we consider it necessary to maintain a relatively high level of international reserves.

16. Western Samoa's stand-by arrangement from the Fund provides for a mid-term review discussion of the progress under the program to be held in Apia before October 31. The purchase based on the observance of end-December 1984 ceilings is subject to the satisfactory conclusion of the mid-term review. We have set forth the above economic and financial policies that the Government of Western Samoa intends to pursue during the remaining period of the stand-by arrangement. The Government believes that these policies and measures set forth in this letter are adequate to achieve the objectives of the program, but will take any further measures that may become necessary for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultation.

Sincerely yours,

Tuilaepa Sailele Malielegaoi  
Minister of Finance

