GOVERNMENT OF SAMOA

FISCAL STRATEGY STATEMENT
BUDGET 2016/17

MINISTRY OF FINANCE

MAY 2016

TABLE OF CONTENTS

FISCAL STRATEGY STATEMENT
BUDGET 2016/17 – 2018/19

I. REPORTING REQUIREMENTS

The Public Finance Management Act 2001 stipulates the principles of responsible fiscal management as well as the reporting requirements associated with the presentation of the budget. The reporting requirements include, under Section 18, the budget address, and a statement of the projected estimated revenues and expenditures for the budget year and the two forward years which is referred to as forward estimates. The reporting requirements also include, under Section 19, the Fiscal Strategy Statement to be submitted to the Legislative Assembly as part of the budget address.

The Fiscal Strategy Statement includes an assessment of the extent to which the budget statement is consistent with the "Strategy for the Development of Samoa" (SDS), an explanation of the reasons for any significant differences between the current economic and financial situation and the targets set out in the SDS.

The SDS must be published no later than the end of the current financial year and must be effective by the beginning of the new financial year which is 2016/17. At present, the SDS is for a period of four years and the new SDS will cover the period from 2016/17 to 2019/20.

II. REVIEW OF FISCAL AND ECONOMIC PERFORMANCE IN THE LAST 5 YEARS, 2011/12 TO 2015/16

Economic Performance

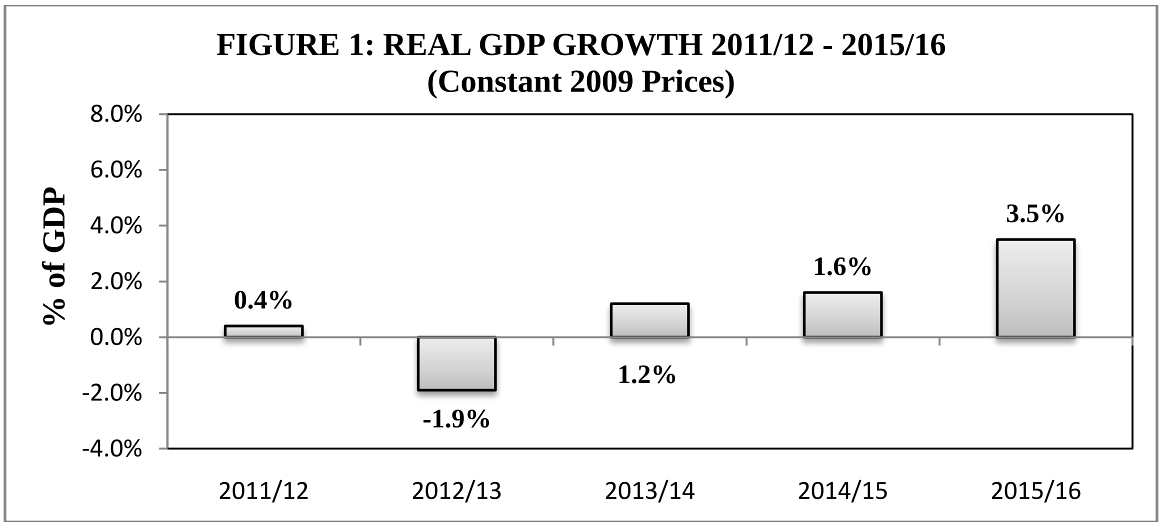
Samoa's economy grew marginally in FY2011/12 registering a 0.4% growth rate. This was largely due to the reconstruction work in response to the Tsunami that affected Samoa in 2009. Economic growth fell by 1.9% in FY2012/2013 as a direct result of the devastating Cyclone Evan which struck Samoa in December 2012.

The economy rebounded in 2013/14 growing by 1.2%. The main factors contributing to this include: the reconstruction work following Cyclone Evan, preparations for the UN Small Island Developing States (SIDS) Conference and the construction of some major hotels such as Return to Paradise Resort, Lamana Hotel, Aggie Greys Resort and the Aggie Greys Hotel in Apia.

The economy grew by 1.6% in the FY 2014/15. This was a sign that the economy was recovering from Cyclone Evan and assisted by the SIDS Conference as well as positive growth in tourism, commerce, transport, communication, electricity and water sectors. Preparations for the Commonwealth Youth Games and the historical All Blacks rugby match also contributed favorably to this positive growth. The SACEP project operating under the Ministry of Agriculture and Fisheries helped improve the performance of the Agriculture industry which also contributed positively to the overall positive growth rate.

After strong growth in the first two consecutive quarters growth projection has been revised from 1.9% to 3.5% for FY2015/16. This is due largely to continuous improvement in the Fishing industry as a result of the newly established Yu Yao Company Ltd. Growth is expected to continue next year as a result two major hotels opening for operations in 2016/17: Aggie Grey's and Taumeasina Island Resort.

Figure 1 below further illustrates the real GDP growth rates after the rebasing (2009 prices) of the National Accounts estimates which was formally revised by the Samoa Bureau of Statistics in 2014. The rebasing exercise is an internationally accepted exercise to update the baseline of the GDP to fully realize the level of growth.



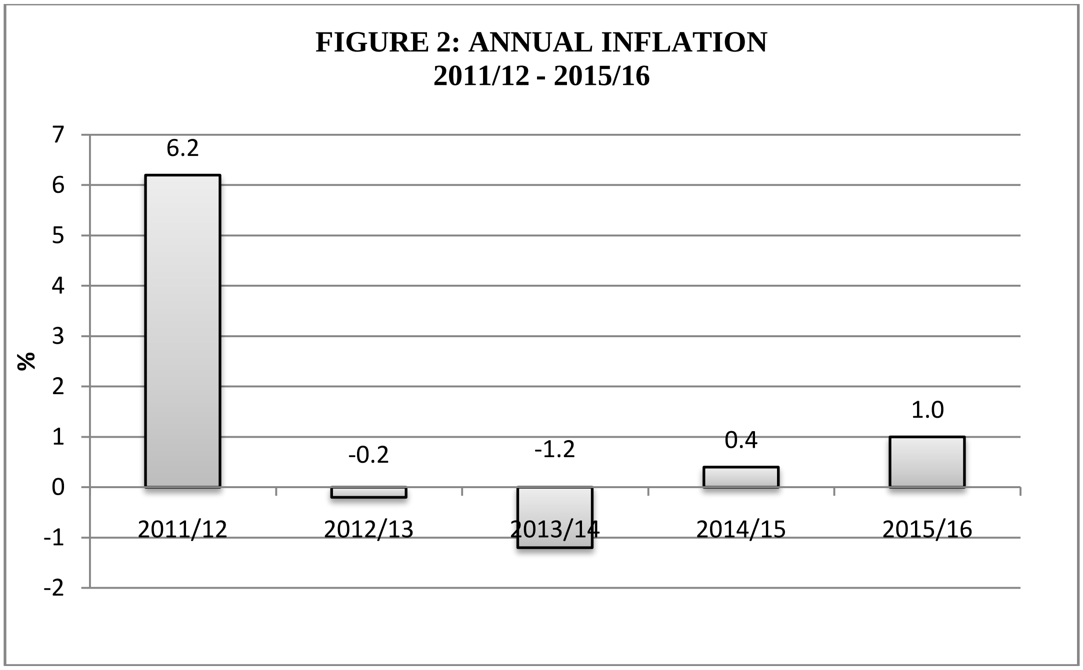
Source: Ministry of Finance and Samoa Bureau of Statistics

<u>Inflation</u>

Figure 2 below shows the fluctuation of the annual average inflation rate trend from 2011/12 to 2015/16. It portrays a downward trend from a high of 6.2% in 2011/12 to a low of -0.2% in 2012/13. This downfall was a result of a decrease in international food and oil prices which consequently led to a decline in the prices of food and non-alcoholic beverages as well as prices on housing, water, electricity, gas and other fuels.

The annual average inflation rate continued to drop in 2013/14 to a negative 1.2% as international oil prices continued to decrease. The recovery from tropical cyclone Evan in December 2012 saw a decrease in the prices of local produce as the supply slowly increased.

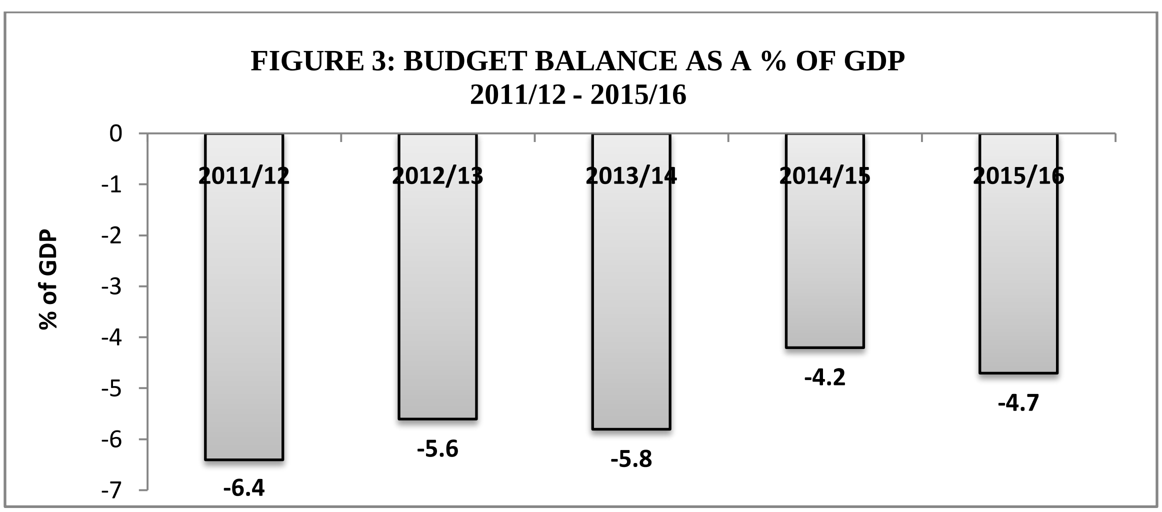
Inflation gradually picked up in the following financial year (2014/15) to 0.4%. This was largely driven by an increase in the prices of health products, restaurants, hotels, clothing and footwear.
This trend continued in the first nine months of the current financial year (2015/16) standing at 0.5% in the March quarter. This was due mainly to the increase in the international prices of food and oil. Inflation rate is forecasted to be at 1.0% in 2015/16.



Source: Ministry of Finance and Samoa Bureau of Statistics

Budget Balance

The overall budget balance is expected to exceed the target deficit in fiscal year 2015/16. The improvement in deficit from a negative 6.4% in 2010/11 to 4.2% in 2014/15 as per Figure 3 below, reflecting the winding down and eventual completion of rehabilitation and reconstruction works linked to the Tsunami of 2009 and the cyclone of 2012. In 2015/16 the deficit is forecasted to be -4.7% of GDP. This is mainly due to the commitment made by the government on spending for the Commonwealth Youth Games and other huge projects in the pipeline such as road constructions and the new airport terminal development that are ongoing.

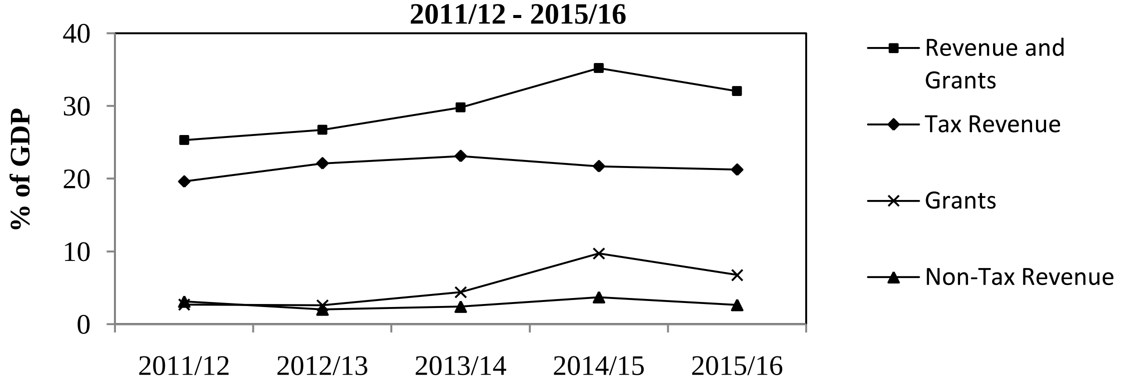


Source: Ministry of Finance and Samoa Bureau of Statistics

Revenue and Grants

Tax Revenue is expected to remain in 2015/16 from 2014/15, following a gradual drop from 2013/14. **Other Revenue** decreased three years consecutively from FY2011/12 to FY2013/14 and then it picked up with a slight increase in FY2014/15 to stand at 3.7% of GDP. For the current period 2015/16, it is assumed that other revenue collections will be slightly lower than the previous period to stand at 2.7% of GDP. **External Grants** as a percentage of GDP showed an upward trend from 2.7% in FY2011/12 to 9.7% of GDP in FY2014/15. A slightly drop to grant is expected in 2015/16 of 6.7% of GDP as a result of Samoa's Debt risk status revised from high to moderate which means Samoa is now receiving less grants. Overall the total of revenue and grants for the current fiscal year is expected to drop following the decline in grants as shown by the below Figure 4.

FIGURE 4: REVENUE AND GRANT AS A % OF GDP 2011/12 - 2015/16

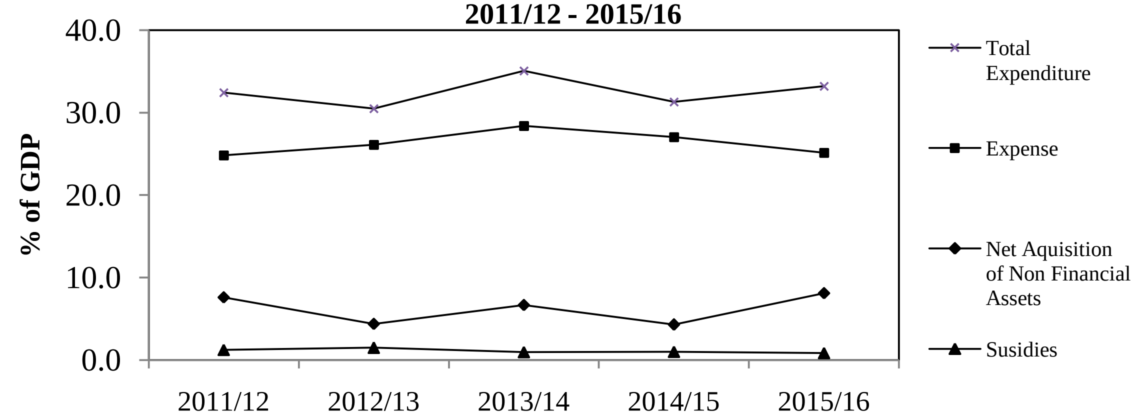


Source: Ministry of Finance and Samoa Bureau of Statistics

<u>Expenditures</u>

Government expenses (current expenditure) as percentage of GDP showed a decline in 2014/15 compared to 2013/14 shown in Figure 5 below. This decline is expected to continue gradually in 2015/16 and it will be a consequence of the government's strategy to tighten expenditure. In terms of Net Acquisition of Nonfinancial Assets, the trend showed a decline from 2011/12 to 2012/13 as a result of the completion of the tsunami reconstruction. The reconstruction programme for the cyclone devastation resulted in development expenditure increasing in 2013/14. This was also boosted by expenditure on the developments for the SIDS meeting that was held in 2014. The fiscal year period of 2014/15 outturn for net acquisition of non financial assets showed a lower expenditure as most of the rehabilitation works for the Cyclone were completed plus the preparation development for the SIDS were not continued to 2014/15. For the period 2015/16, it is projected to increase as a result of some of the major government projects that are ongoing such as the road resilience construction and the new airport terminal development. All these projects as well as other investments by the government will contribute greatly to the increase in Total Expenditure in 2015/16.

FIGURE 5: TOTAL EXPENDITURE AS A % OF GDP
2011/12 - 2015/16

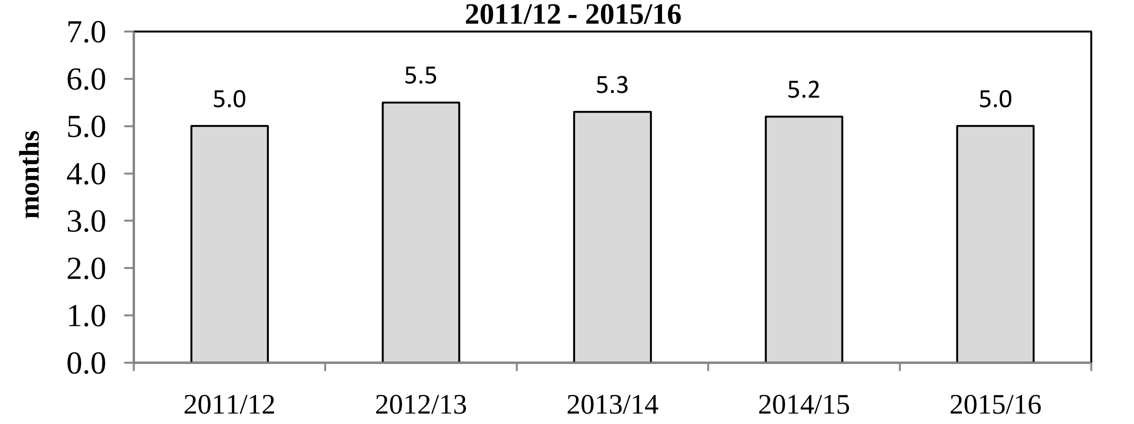


Source: Ministry of Finance and Samoa Bureau of Statistics

Reserves

Official foreign reserves recorded a 5.0 months of import cover in 2011/12 and then increases in the forward years. This increase level of reserves was largely driven by an increasing amount of grants and loans on concessional terms to support tropical cyclone rehabilitation and preparation developments for the hosting of the SIDS meeting in September 2014. Import cover was generally maintained within the target range of between 4-6 months from 2011/12 to 2015/16.

FIGURE 6: MONTHS OF IMPORTS COVER
2011/12 - 2015/16



Source: Ministry of Finance and Samoa Bureau of Statistics

Public Debt

Total public debt continued to increase from 2011/12 to 2014/15 exceeding the threshold of 50% in 2012/13. This was largely the result of new borrowings to finance development projects in the energy sector, namely the power sector expansion project and the petroleum tank rehabilitation project, health sector management program and new medical centre facilities, education sector program, national broadband project in communication sector; plus the reconstruction work for the Cyclone devastation. It is anticipated that total public debt in 2015/16 will remain at 58% of GDP mainly as a result of a number of major development projects coming to an end.

Table 1: Official Public Debts

Years	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**
Official Public Debts (million tala)	909.4	990.4	1,015.5	1,126.1	1,149.5
Total Debt Servicing (million tala)	38.3	40.4	46.2	54.0	66.7
Official Public Debts as % of GDP	49%	54%	54%	58%	58%

III. ECONOMIC OBJECTIVES

Fiscal Policy

To ensure macroeconomic stability is achieved in the medium to long term, Government will continue to maintain the following fiscal targets and objectives:

a) Aggregate current expenditure to be maintained within a range of 35 – 38% of GDP over the forward estimate cycle, to ensure liquidity in the economy is sufficient to foster private sector growth and employment;
b) Public Debt outstanding to be reduced to less than 50% of GDP in the medium term;
c) Personnel costs as a percentage of total current expenditure to be constrained to a range of 40 - 45% so as to reflect government’s commitment to improve service delivery associated with the implementation of performance budgeting;
d) Budget Deficit to be maintained at a rate not below -3.5% of GDP;
e) Improve performance of SOE’s to avoid extra burden on Government budget through default loans;
f) Improve compliance in revenue collection.

In maintaining economic growth at a positive level, the government will continue to put in place sound macroeconomic policy measures that will underpin macroeconomic stability. These measures will have the dual impact of cushioning the economy from future exogenous shocks and injecting additional spending into various sectors to trigger economic activity. Government will also reprioritize expenditures to areas that generate high returns and more employment. Emphasis will also be given to improve the efficiency and cost-effectiveness of public services delivered through government agencies.

The fiscal consolidation direction for the next 2 to 3 years will be to tighten expenditure and to impose quality spending on priority areas. In the Medium Term Debt Strategy, the focus is now “*to ensure that the financing needs of the State are always met on a timely basis and that its borrowing costs are as low as possible over the medium term.* In light of the debt objective, the government aims to ensure that the debt ratio will decline in the medium term towards the threshold of 50% of GDP.

It is important to revisit and review policies and reforms to build a solid foundation for sustainable development going forward. Furthermore, agricultural policies and reforms will be geared towards reinvigorating agricultural production, agri-processing and boosting the linkage to tourism which are critical to employment creation and broadening the revenue base, which in turn, will help achieve the medium-term fiscal objectives.

Monetary Policy

Fiscal consolidation will be supported by maintaining an accommodative monetary policy stance. This policy mix is consistent at this time with the low inflation environment and more upbeat prospects for growth. In addition, this balances the desire to support economic activity while rebuilding buffers to handle external shocks and natural disasters. While the current level of the exchange rate is broadly in line with current economic conditions, the main challenge is to maintain reserves in the short to medium term to a comfortable level (**4.0 – 6.0 months of imports**), especially taking into account the risk of natural disasters. A growth-friendly fiscal consolidation will help support sustainability of the exchange rate while at the same time rebuilding fiscal buffers.

On financial stability, the banking system's liquidity has increased during the year, and is expected to remain high. Non-performing loans are declining. Private sector credit picked-up recently, owing largely to one-off increases in domestic loans to the hotels and restaurants sector. Foreign currency loans are becoming a feature of the financial system despite its inherent risks that the Central Bank is closely monitoring.

IV. ECONOMIC AND FISCAL OUTLOOK

According to the latest International Monetary Fund (IMF) World Economic Outlook (WEO) edition released in January 2016, global growth estimates stood at 3.1% in 2015, which is 0.3% lower than the same period in 2014. This figure is projected to be 3.4% in 2016 and 3.6% in 2017. It is stated that this projected increase over the next two years will be influenced by forecasts of gradual improvement of growth rates in countries currently in economic distress, particularly Brazil, Russia and a few countries in the Middle East.

It is envisaged that Samoa's GDP growth rate will be around 3.0% in FY2016/17. This positive growth will be driven by the new development projects namely new Prison facility, Parliament House, Airport Terminal, Matautu Wharf, the Leone road and bridge development, ongoing improvement of road infrastructure (west coast and cross island road), and the new submarine cable under Samoa Connectivity project.

The closure of the Yazaki Company Ltd is expected to shock the economy and therefore lower growth of 2.7% in **FY2017/18**. Despite this setback, **FY2018/19** is anticipated to rebound with a growth of 3.2% as the economy starts to yield results from previous development initiatives that will be implemented by both public and private sector. Moreover, major ongoing projects will continue to contribute to the expected growth.

The macroeconomic target rates and its implications are as follows:

1) A budget deficit of 3.5% of GDP has been projected for 2016/17. This is a huge shift from the deficit of 4.7% of GDP in the current fiscal year (2015/16). The Government will continue with fiscal consolidation through tightening of government spending and imposing quality as well as raising revenues through health taxes i.e. excises on sugar items, salt products; increase in excise duty on tobacco and alcohol products. Improvement in revenue compliance will contribute positive to that to achieving the fiscal target.

2) It is anticipated that total current expenditure as percentage of GDP will be maintained below the target due to fiscal consolidation initiatives by the government. These include the introduction of a 10% productivity dividend across all ministries and corporations and 3% for education and health agencies.

3) Personnel cost as percentage of total current expenditure is projected to be above the target range over the forecast period. This is driven by the upward adjustment to public service wages and salaries as well as the introduction of the productivity dividend.

4) Though total public debt level as a percentage of GDP is projected to remain above the target rate of 50.0% of GDP, it is anticipated to decline over the medium term.

5) Greater efficiencies in revenue collection will be enforced through broad ranging review of revenue, covering all tax and non-tax revenue. Strengthening of compliance measures to ensure everyone is paying their fair share of tax will help keep tax burden as low as possible.

6) Continued efforts to privatize state owned enterprises, strong governance and ensuring that SOE’s which generate revenue and earn profits pay appropriate dividends are some of the measures being put into place to help improve SOE’s performances. The target is to avoid extra burden on the Government budget through default loans.

Table 2: Macroeconomic Framework 2015/16-2018/19

	Target	**2015/16**	**2016/17**	**2017/18**	**2018/19**
Real GDP (% change)	3.0%-4.0%	3.5%	3.0%	2.7%	3.2%
Budget Balance (% of GDP)	Deficit: Not more than 3.5% of GDP	-4.7%	-3.5%	-4.5%	-3.6%
Total Current Expenditure (% of GDP)	35%-38%	25.3%	25.1%	22.9%	21.2%

Personnel Costs (% of total current expenditure)	40% - 45%	46.9%	48.1%	48.1%	47.2%
Disbursed Outstanding Debt (% of GDP)	Less than 50%	58.0%	58.0%	56.2%	52.9%
Nominal GDP ($ billion tala)		2.03	2.14	2.25	2.38

Source: Ministry of Finance

1. This debt consists largely of concessional loans;
2. Personnel costs and Total Current Expenditures are GFS estimates from Budget Division.

V. PUBLIC DEBT - LONG TERM PROJECTIONS

The total public debt comprises of external and domestic debt, about 96% of total debt is external debt 4% domestic debt. Total Government's contingent liabilities i.e. Government guarantees is about 8.9% of GDP and Government on lending outstanding is about 10% of GDP.

The Government aims to achieve and maintaining the target of 50% of debt to GDP through fiscal consolidation. The Government continues to tighten expenditure, provide quality spending program and to improve on revenue compliance in tax collection as prescribed in some of the previous sections. As a consequence, the fiscal stance will be to broaden the revenue base in order to offset any financing requirement but also to lessen the expenditure on developments that provide a lesser contribution to economic activities and less impact to growth.

The government will continue to implement structural reforms to make the public service more cost-effective and a sector wide approach has been in place to ensure the efficient allocation of resources to address issues within sectors. A Public Expenditure Review has been implemented for the purpose of reprioritizing spending to essential areas of the economy.

The new Medium Term Debt Strategy (MTDS) 2016-2020 seeks to ensure that Government debt management objectives are achieved over the medium term, prioritizing concessional external borrowings. The MTDS is consistent with the fiscal strategy and its targets