GOVERNMENT OF SAMOA

FISCAL STRATEGY STATEMENT
BUDGET 2017/18

MINISTRY OF FINANCE

MAY 2017

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FISCAL STRATEGY STATEMENT
BUDGET 2017/18-2019/20

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.

At present, the SDS is for a period of four years – *Strategy for the Development of Samoa, 2016/17-2019/20:* "*accelerating sustainable development and broaden opportunities for all*".

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

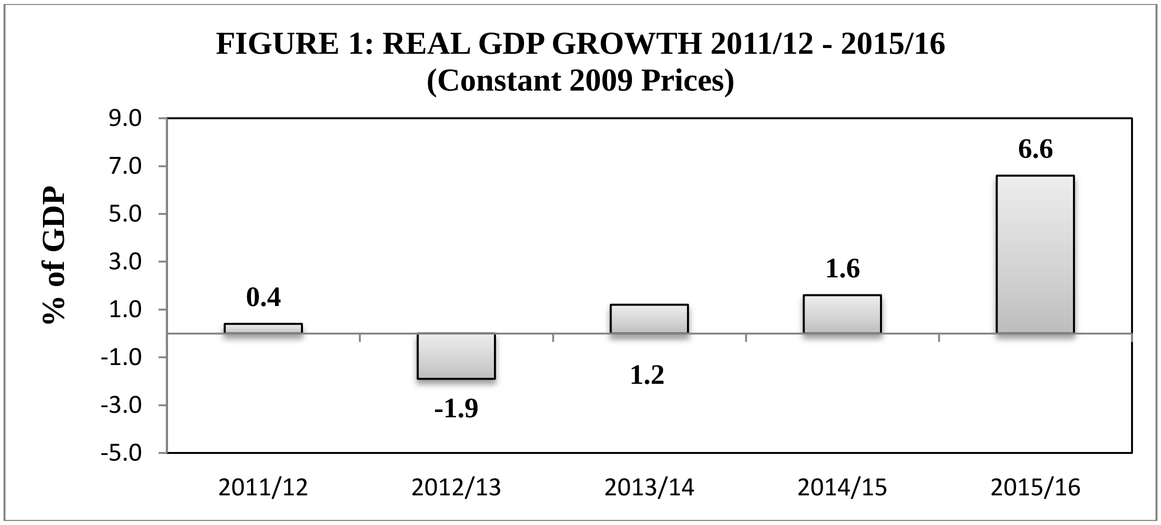
Economic Performance

Samoa's economy grew marginally in FY 2011/12 with a 0.4% growth rate compared to FY 2010/11. For FY2012/2013, growth contracted by 1.9%. This was due largely to the impacts of Cyclone Evan that devastated Samoa in December 2012. Growth rebound in FY2013/2014 registering a 1.2% increase driven largely by post Cyclone Evan reconstruction work, hosting of the UN Small Island Developing States (SIDS) Conference and the construction of a number of hotels such as the Return to Paradise Resort, Taumeasina Island Resort, Sheraton Samoa Aggie Greys Resort and Bungalows in Apia.

The economy again registered positive growth of 1.6% in FY 2014/15, driven by the continuation of the recovery process post Cyclone Evan and growth in tourism, commerce, transport, communication, electricity and water sectors. Other contributing factors included the hosting of the Commonwealth Youth Games, the historical All Blacks versus Manu Samoa match as well as the SACEP Project under the Ministry of Agriculture and Fisheries.

Strong economic growth rate of 6.6% was recorded in FY2015/16 as reported by the International Monetary Fund. This was due largely to continuous improvement in the Fishing industry as a result of the newly established Apia Deepsea Fishing Ltd which contributed to a significant increase in fish exports. Furthermore, the opening of two major tourism developments; Sheraton Samoa Aggie Grey's Hotel and Taumeasina Island Resort also contributed to this positive growth as well as ongoing government projects such as the airport terminal, enhancing and upgrading of roads and ports infrastructure.

Figure 1 below further illustrates the real GDP growth rates:



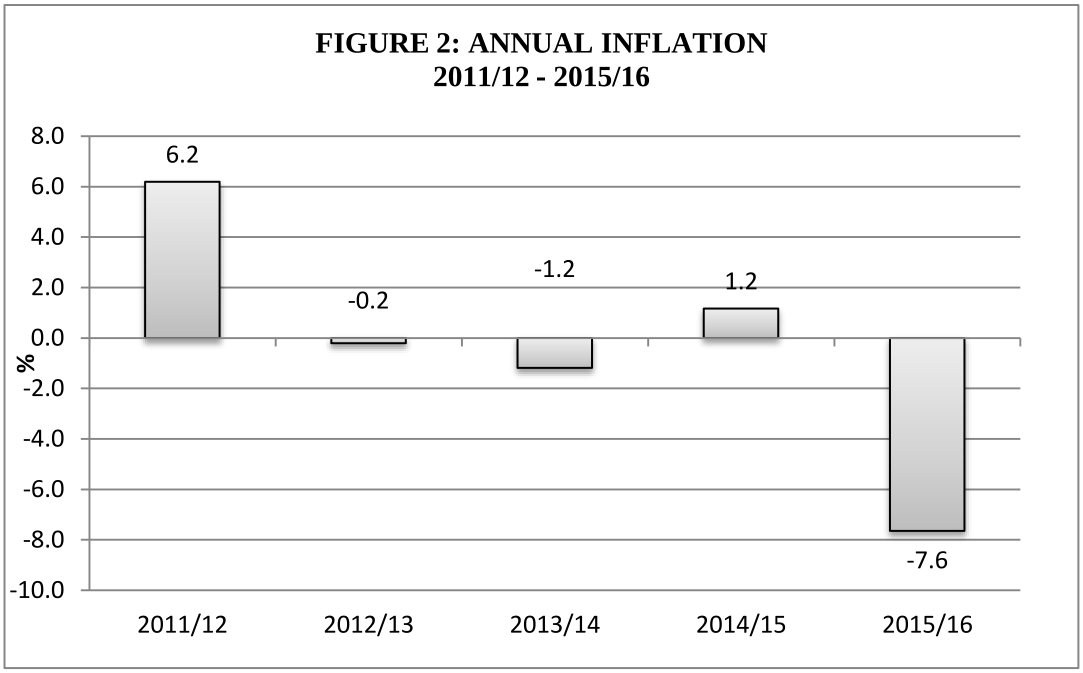
Source: Ministry of Finance and Samoa Bureau of Statistics

Inflation

The annual inflation rate from FY2011/12 to FY2015/16 is shown in Figure 2 below. In 2012/13, the inflation rate was -0.2% caused by the fall in the prices of international food and oil which consequently led to a reduction in the prices of food, non-alcoholic beverages, housing, water, electricity, gas and other fuels.

International oil prices continued to decline in FY 2013/14 and as a result domestic inflation decreased by 1.2% in the same year.

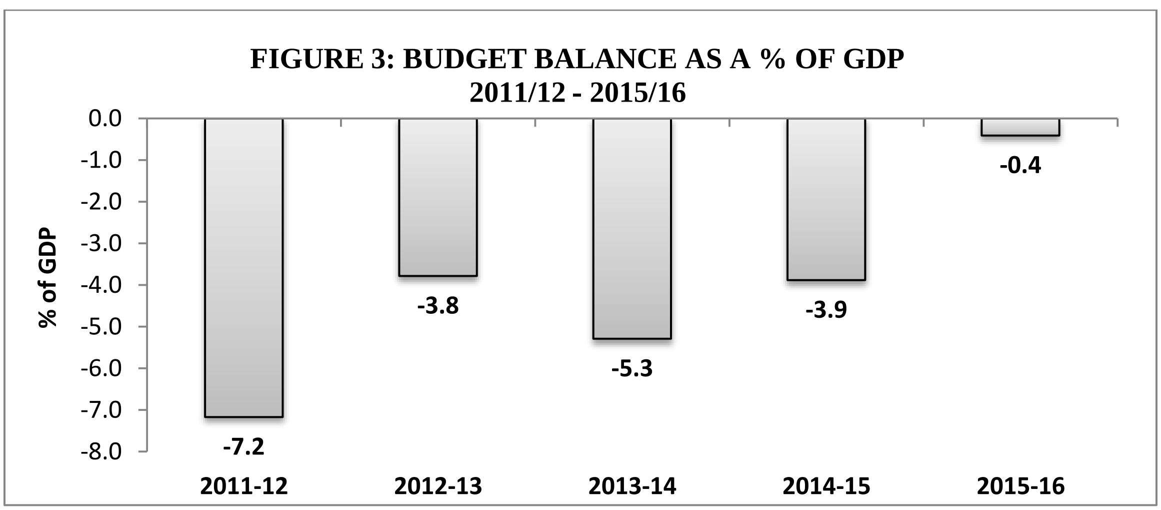
The inflation rate increased in 2014/15 to 1.2% and was driven largely by the rise in prices of health products, restaurants, hotels, clothing and footwear. Inflation dropped to -7.6% in FY2015/16 due to the consecutive monthly decreases in the international prices of food and oil.



Source: Ministry of Finance and Samoa Bureau of Statistics

Budget Balance

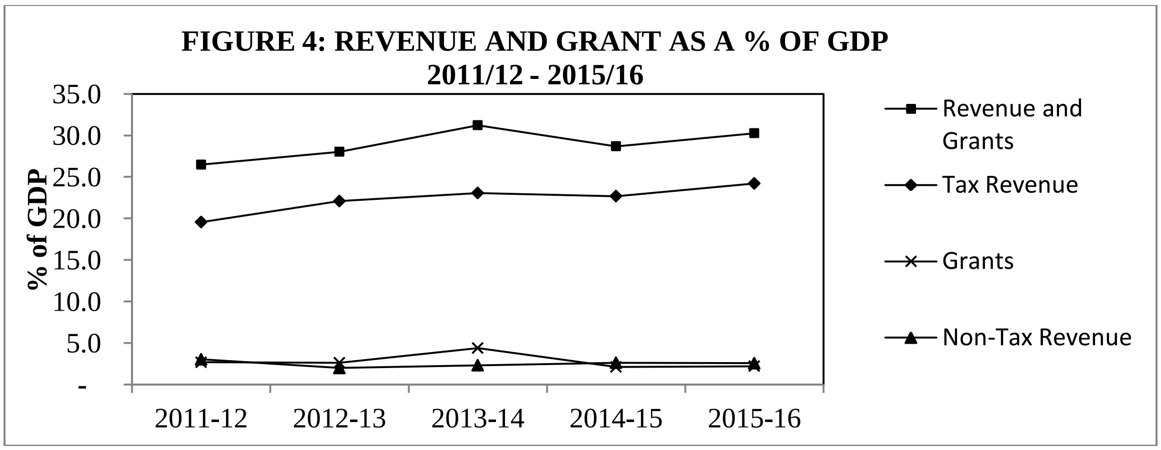
The budget deficit saw an improvement in the past five years. The deficit to GDP figures from 2011/12 to 2014/15 showed a marked improvement from a 7.2% in 2011/12 to 3.9% in 2014/15. In 2015/16, a 0.4% deficit to GDP was achieved mainly due to the commitment by the government to tighten its fiscal stance coupled with the winding down of the recovery work and improved performance on the revenue side.



Source: Ministry of Finance and Samoa Bureau of Statistics

Revenue and Grants

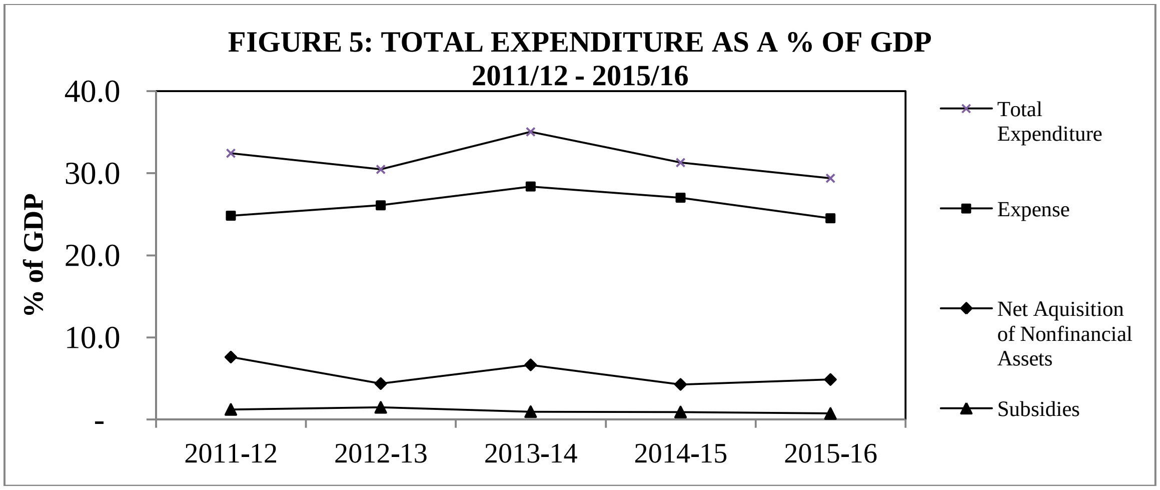
Tax Revenue as percentage of GDP recorded an average of around 23% in the past five fiscal years. In 2015/16, total Tax Revenue was 24.2% of GDP which was a steady growth over the previous fiscal year. Grants as percentage of GDP increased marginally from 2014/15 to 2015/16 with 2.1% and 2.2% growth rates respectively. This was well below the earlier years of 2013/14 which grew by 4.4%. The high grant component was the result of converting loans to grants by the ADB and World Bank due to the high debt distress the economy faced at the time. As the economy recovered and the debt distress revised from high to moderate, grants as percentage of total resources from the multilateral agencies was reduced to 50%. As a result **Revenue and Grants** dropped in 2014/15 but picked up slowly in 2015/16 due to the increases in domestic tax revenue.



Source: Ministry of Finance and Samoa Bureau of Statistics

Expenditures

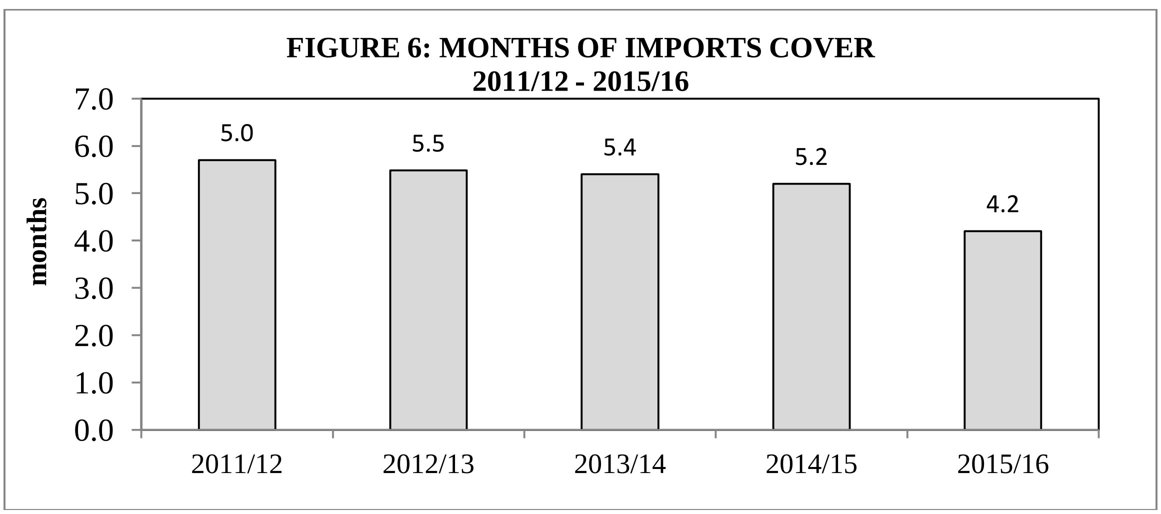
Current expenditure as percentage of GDP (as per Figure 5) declined in FY 2014/15 and FY 2015/16. This was due largely to Government control and tightening on spending by imposing a 10% productivity dividend across all ministries and corporations and 3% for education and health sectors. **Net Acquisition of Nonfinancial Assets** increased gradually from 2014/15 to 2015/16 as reflected in Figure 5 below. Both years are lower than 2013/14 attributed mainly to the preparation for the SIDS conference held in September 2014 and the rehabilitation work for Cyclone Evan that was still on-going during that period.



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 continue to remain above five months from 2012/13 to 2014/15. The strong reserves position was largely driven by the increase in the amount of grants and loans on concessional terms to support tropical cyclone rehabilitation efforts as well as preparation for the hosting of the SIDS Conference in September 2014. For 2015/16, Reserves dropped by 4.2% due to the completion of most projects mentioned already. In line with the target range, import cover remained between 4-6 months in the last five fiscal years.



Source: Ministry of Finance and Samoa Bureau of Statistics

Public Debt

Total public debt continued to increase between 2012/13 to 2014/15 and exceeded the target 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 Evan devastation. In 2015/16, debt to GDP dropped to 53%, clawing towards the threshold target of 50% of GDP. This was mainly the result of a number of major development projects coming to an end and the result of the government adhering to its Medium Debt Strategy currently in place.

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	1,080
Total Debt Servicing (million tala)	38.3	40.4	46.2	54.0	53.8
Official Public Debts as % of GDP	49%	54%	54%	58%	53%

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 and SOEs.

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 whilst rebuilding fiscal 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.

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 together with the disruptions to the remittances corridor due to de-risking/de-banking.

IV. ECONOMIC AND FISCAL OUTLOOK

According to the latest International Monetary Fund (IMF) World Economic Outlook (WEO) edition released in April 2017, it is estimated that global growth will be a positive 3.5% in 2017, which is around 0.4 percentage-point increase from the previous year (2016). The report also stated that a global growth rate of 3.6% is expected for 2018. The projections are based on assumptions of stronger economic activity and expectations of more robust global demand, coupled with agreed restrictions on oil supply. These are expected to recover from their recent troughs. Higher commodity prices are expected to provide some relief to commodity exporters and help lift global headline inflation and reduce deflationary pressures. Moreover the report stated that, financial markets are buoyant and expect continued policy support in China and fiscal expansion and deregulation in the United States. Lastly, the WEO report stated that if confidence and market sentiment remain strong, short-term growth could indeed surprise on the upside.

It is envisaged that Samoa's GDP growth rate will be around 3.0% in FY2017/18. The projected growth rate is expected to be driven by new and on-going developments that are now up and running. Such development projects namely the 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. However, the closure of the Yazaki Company Ltd is expected to affect the economy leading to a 0.3 percentage points drop in the expected growth for 2017/18 compared to a **3.3% growth in the current financial year (2016/17)**.

Notwithstanding the setback of the Yazaki Company Ltd closure, the economy is expected **to rebound in FY 2018/19 with an estimated growth of 3.4%.** Results yield from previous development initiatives that are being implemented by both public and private sector and the continuation of major ongoing projects will also contribute to the expected growth for that period.

The macroeconomic target rates and its implications are as follows:

1) A budget deficit of 3.5% of GDP has been projected for 2017/18. The Government still intends to continue with the fiscal consolidation through tightening of government spending, as well as broadening the revenue base in order to cater for government expenses and to lessen deficit and ease the burden to borrow.

2) Improving the effectiveness of revenue collection and strengthening of revenue compliance are the main key strategies to stabilize ordinary revenues. In addition the tax credit on hotels will cease, there will be increases in non tax fees and charges, increasing the duty and excise rates, an equalization charge will be imposed on EPC and lastly the introducing of the telecommunication levy. These will all contribute to broadening the revenue base.

3) It is anticipated that total current expenditure as a percentage of GDP will be maintained below the target as the government stands to maintain its fiscal consolidation initiatives set in the previous budget such as the efficiency dividend across all ministries and corporations/ agencies.

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

4) To date, the total public debt level as a percentage of GDP is just above 50% of GDP and is projected to decline below the 50% threshold over the medium term.

Table 2: Macroeconomic Framework 2016/17-2019/20

	Target	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Real GDP (% change)	3.0%-4.0%	3.3%	3.0%	3.4%	3.6%
Budget Balance (% of GDP)	Deficit: Not more than 3.5% of GDP	-3.5%	-3.5%	-4.6%	-3.8%
Total Current Expenditure (% of GDP)	35%-38%	24.1%	23.7%	21.6%	21.2%
Personnel Costs (% of total current expenditure)	40% - 45%	48.7%	47.5%	48.4%	47.6%
Disbursed Outstanding Debt (% of GDP)	Less than 50%	53.7%	53.2%	52.5%	50.5%
Nominal GDP ($ billion tala)		2.21	2.34	2.48	2.63

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 has recorded a debt to GDP ratio of 50% as per December 2016 Quarter update. This is the result of the Government taking action to tighten expenditure, provide quality spending program and to improve on revenue compliance in tax collection as described in the previous sections. In the medium term, the debt to GDP ratio is likely to fall below the target threshold given that the government will continue to broaden the revenue base through introducing additional and higher charges and fees as well as removing some of the tax concessions and incentives on hotels. In light of these measures, it will help ease the need to borrow as the increased revenue will be sufficient to cover the priority expenses and will therefore lessen the need to borrow.

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 specifically focusing on the Health and Education sectors has been implemented for the purpose of reprioritizing spending to these 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 for FY 2017/18.