Fiji Sun
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Saturday April 19, 2014

IMF on Samoa's Debt

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"When a dog bites a man that is not news, but when a man bites a dog that is news".

Whether or not the credit for this quote goes to the British press baron Lord Northcliffe or the American editorial staff of New York Sun in the 1920s, one thing is certain: in this electronic age, things tend to get blown out of proportion.

A routine statement by the International Monetary Fund (IMF) mission chief at the end of his visit to Samoa two weeks ago would have eventually got buried in the archives. But an agitated reaction, rather than an articulated response, made the news.

The reaction came from no less than Samoa's Prime Minister: "We have brains too! We don't have to just swallow (whatever advice) is given".

That was sufficient. The Samoan press and opposition seized it.

Those, who do not read IMF's routine statements, are now reading the mission chief's statement. Some of them asked me to throw more light.

Health checks

Under Article IV of the Charter, the IMF holds annual bilateral discussions with its 188 member governments. A staff team visits the country for collecting economic and financial information and for holding discussions with officials. Before the formal two to three-week Mission, a short visit takes place. Accordingly, an IMF team concluded its short mission to Samoa in early April. The full fledged Mission for annual economic health check is now scheduled for late September.

Samoa's growth was halted by cyclones, including cyclone Evan in 2013. External aid in terms of free grants and loans has put the economy back on the growth path. Much of the recovery is coming from rise in agricultural output and reconstruction activities. These include one-off preparations for the September 2014 United Nations Third International Conference on Small Island Developing States. The negative growth rate of the fiscal year 2012/13 is expected to be followed by positive growth rates: 1.5 percent in 2013/14 and 2.5 percent next year.

IMF concerns

Sustaining the growth in the medium term is the major concern. The IMF has identified the downside risks: protracted slow global growth affecting Samoa's agricultural exports; and diminished prospects for the manufacturing export sector.

Although low inflation is due to improved agricultural output, uncertainties in agriculture would prove a hurdle. Further, any deterioration in external conditions would also depreciate the exchange rate, raising import costs of rice, flour and fuel.

Concerns continue to centre around rising public debt. Increasing debt servicing would absorb greater proportion of public revenue, leaving less resources for addressing future disasters. IMF has again stressed the need for fiscal consolidation.

External Debt

Samoa's debt as a ratio of country's domestic output rose from 34 per cent in 2007/08 to 62 per cent in 2012/13. It might hit 65 percent soon.

Since domestic borrowing is negligible, the debt is mainly owed to foreigners. That involves servicing debt and repayment in foreign exchange. Foreign exchange earnings are more critical not only for debt servicing but also for meeting rising import needs relating to consumption and investment. One suggestion is Samoa should seek only grant assistance in future, rather than overseas loans. For conserving foreign exchange, Central Bank of Samoa recently announced some exchange control measures.

Debt service ratio

Samoa's Prime Minister in his reaction stressed the importance of debt servicing capacity. It is not the size of debt which matters for a developing country which has a high growth potential for exports and tourism earnings. If a country has borrowed for investment in growth enhancing areas of the economy with sizeable export earning capacities, rising debt is not a major risk.

The Asian Development Bank's ***Development Outlook 2014*** report says debt service ratios (as proportion of export earnings) are coming down in the Pacific. While Fiji's debt service ratio in percent decreased over last five years from 2 in 2009 to 1 in 2013, Samoa's ratio was 56.9 in 2009 and 5.3 in 2012. Tonga's ratio is on the rise: from 5.2 in 2009 to 9.6 in 2013. Vanuatu is the only country, with a ratio less than 2 percent throughout the five year period.

External debt for any developing country is unavoidable. What is important is smart debt management.

The ways open are: limit future external assistance only to grants; strengthen the agriculture sector; and diversify exports by getting into manufacturing, utilizing domestic raw materials and local labour.