Current economic trends

Desh Gupta

When Papua New Guinea ran out of foreign exchange reserves in the second half of 1994 international commercial institutions were extremely reluctant to lend money to the government, forcing the devaluation of the kina. This was combined with the further tightening of fiscal policy, which had been very loose following the Bougainville crisis to the early part of 1994 and had been tightened following the March 1994 mini-Budget. There was also a tightening of monetary policy as well as wages policy. Fiscal tightening created a cash-flow problem for government departments and statutory authorities, as well as for the private sector (outside the export sector) which now faced considerable delay in the payment of outstanding government bills. Though Papua New Guinea’s current (last quarter of 1994 and first quarter of 1995) foreign exchange and cash-flow problems can be sheeted home to the early 1990s, its budgetary problems have long-standing and intractable roots.

The hard kina policy

Before independence, Papua New Guinea was part of the Australian monetary system. Independence involved among other things Papua New Guinea creating its own currency, the kina, and setting up its own monetary system, with the Bank of Papua New Guinea as its central bank. But this also created a balance of payments or foreign exchange problem which was not there before.

The question which had to be answered in 1975, especially in the context of the large share of wealth in the hands of foreign citizens, was whether or not the balance of payments problem which had emerged with independence could be resolved through kina devaluation. For a number of reasons the Papua New Guinea authorities decided to resolve the question in the negative. With a reasonably open economy and an inflexible production structure, and with the 1974 Minimum
Wages Board decision on full indexation, it was clear that a devaluation would introduce a price-wage-price spiral. Essentially this meant that expenditure-switching policies would fail. There was also the important element of creating confidence in the new currency among the wealthholders, which would have been undermined with kina devaluation.

At independence Papua New Guinea decided on an open economy policy, or on minimal controls on foreign transactions, and to pursue a ‘hard kina’ policy, maintaining the value of the kina against the world’s major currencies.

Since the rate of increase of government expenditure had ‘a strong, direct and fairly predictable impact on the balance of payments’ (Goodman et al. 1985:53), in a situation of low foreign exchange reserves, a hard kina policy required a fiscal policy stance of a cut in government expenditure, especially government recurrent expenditure. A cut in government capital (including maintenance) expenditure would have impacted adversely on the performance of the private sector by reducing improvements in infrastructure. Consequently, as foreign exchange reserves fell in 1975–76 in response to capital outflows and low commodity prices, a substantial cut of around 9 per cent in real government current expenditure was undertaken. By the end of 1977 a healthy import cover of 7.8 months was restored.

A three per cent increase in government expenditure and the pre-1986 period

There was also the policy objective of increasing government expenditure annually by 3 per cent in real terms (Holloway 1979), in the context of declining real Australian aid and therefore with the combined objective of increasing fiscal self-reliance. It may be worth observing here that the combination of declining real Australian aid flows and rising internal revenues have slowly but steadily improved the fiscal self-reliance index (which measures the proportion of government expenditure, which is financed from internal revenue) from 48 per cent in 1974–75 to 81 per cent in 1994.

Though the 3 per cent increase in government expenditure was a modest objective, given the substantial needs in education, health and infrastructure, in practice even this modest objective became unrealisable. Over the 1975–90 period, real government expenditure increased by a mere 0.5 per cent per annum. There were a few years immediately following sharply rising prices of gold and copper, such as 1980 and 1989, when government recurrent expenditure increased by 7 per cent and 8 per cent respectively, but these were followed by years of sharp cuts in real government expenditure, as the foreign exchange constraint became evident.

The government had the added objective of raising the share of the budget going on capital expenditure. In trend terms, however, the share of government capital expenditure remained unchanged, at around 13 per cent of the total budget and 4 per cent of GDP. On a year to year basis the share fluctuated from a high of 18.4 per cent in 1980 to a low of 6.7 per cent in 1985. Moreover, in the 1974–1980 period, the share of the total budget going on capital expenditure increased, while in 1980–85 it fell. The latter was a period during which the bureaucracy was subjected to ridicule and attack: ‘the bureaucracy should be on tap, not on top’ (Iambakey Okuk, Deputy Prime Minister in 1981). The 1982 Budget had the objective of ‘trimming the fat off the Public Service and trimming the overlapping and unnecessary expenditures of departments’ (Kaputin 1981:16). Cuts of 3,000 with redundancy packages were instituted in 1983, but the share going to capital expenditure did not
rise; instead it fell to 6.7 per cent in 1985. The National Public Expenditure Plan, which had been launched in 1978 with the objective of increasing the resources for capital expenditure was consequently seen to have failed by the end of 1985.

Though the bureaucracy was the target of abuse, especially when the government was forced to cut back on expenditure, it was the combined administrative and political structure that had emerged in the transition to independence and in the years immediately after independence that consumed a substantial proportion of the budget simply to run itself. Between 1963 and 1978, the size of the public service increased from around 5,700 to around 49,000, while the number of politicians increased from nothing to more than 400. The increase in the size of the bureaucracy was necessitated by the transfer of functions from Australia to Papua New Guinea as well as to service an expanding political apparatus. The high preference for leisure, reinforced by the adoption of a very short working week and working year during the period of transition to independence, meant that larger numbers of bureaucrats were needed to service the needs of politicians.

In the early post-independence period, the salaries and other emolument of the public service consumed 38 per cent of the total budget (Kaputin 1980) and with the addition of 400 politicians, it is likely that 40 per cent of the total budget went to cover the salaries and other emoluments of the bureaucrats and politicians. But increasingly travel, *per diem* allowances and other discretionary expenditures took up a larger and larger proportion of the budget, even as the share of the budget on salaries declined somewhat. Consequently, despite the large bureaucracy or because of it, implementation of projects was slow and cumbersome. In this context, Dahanayake (in Sawyer 1984) has argued that the slow drawdown (considerably below that available) of concessional loans from international donor agencies, in particular from Japan, was inappropriate aid policy. In some ways though, the lack of drawdown of Japanese aid was fortunate for Papua New Guinea because of the substantial appreciation of the Japanese yen, especially in the post-1985 period, has meant that countries which have had concessional loans from Japan have faced a sharp rise in debt—soft Japanese loans have become hard loans! But the slow drawdown has also meant that infrastructure improvement has remained slow and in some cases regressed. In practice, despite the objective of increasing capital expenditure (including maintenance expenditure), it has often been easier to cut capital expenditure than recurrent expenditure.

In general, in the first post-independence decade there was a determination to continue the hard kina policy, even if it necessitated restraint in expenditure. Moreover, monitoring of expenditure was much tighter. For instance, following the realisation of over-spending of the 1980 Budget, there was a substantial recruitment of accountants and an increase in penalties for breach of government financial regulations to ensure much tighter budgetary controls.

In only one year up to 1986 is there evidence of expenditure exceeding the budgeted amount. In 1980 budgetary policy was framed in an optimistic environment following the lift in prices for gold and copper, but it was also a year in which the share of capital expenditure in the total budget hit 18.4 per cent, its highest level in Papua New Guinea’s post-colonial history. Subsequently, there was an almost immediate tightening of expenditure procedures and over-expenditure was contained. The level of import cover had declined to 4.8 months in 1980 and 1981 and was set to decline further in 1982 which sounded the warning bells for the tightening of the budget in 1982. Import cover rose in 1983, 1984 and 1985 from 4
months at the end of 1982 to 6.4 months at
the end of 1985. But the fiscal tightening
involved fell more heavily on capital
expenditure than on recurrent expenditure.
In 1985 for instance, actual capital
expenditure exceeded the planned amount
(Chan 1986). In addition, it became
apparent that the 13 million kina
retrenchment exercise in 1983 had failed—
there were as many public servants
employed at the end of it as there were at
the beginning. (There was a ‘revolving
door’: retrenched public servants were
rehired after taking the package.)

In summing up the pre-1986 period, it
is clear that the hard kina policy was
pursued and there was success in
containing expenditure below the budgeted
amount. But in practice the policy led to
severe constraints on the expansion of
government capital and maintenance
expenditure.

The post-1985 period and the
breakdown of fiscal discipline

From 1986 fiscal discipline began to break
down. This followed frustration with the
virtual stagnation in real government
expenditure. In addition, improvements in
social indicators were imperceptibly slow.
More importantly, the functions of Finance
and National Planning, which existed as
separate departments before 1986, were
merged into a mega-department of Finance
and Planning. The National Public
Expenditure Plan through which public

Table 1  **Central government fiscal operations budgeted and actual, 1986–95** (million kina)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total receipts</th>
<th>Total expenditure</th>
<th>Total investment</th>
<th>Total deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986 budgeted</td>
<td>794</td>
<td>845</td>
<td>142</td>
<td>50</td>
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<tr>
<td>1986 actual</td>
<td>745</td>
<td>837</td>
<td>137</td>
<td>93</td>
</tr>
<tr>
<td>1987 budgeted</td>
<td>844</td>
<td>866</td>
<td>144</td>
<td>21</td>
</tr>
<tr>
<td>1987 actual</td>
<td>82</td>
<td>870</td>
<td>124</td>
<td>45</td>
</tr>
<tr>
<td>1988 budgeted</td>
<td>883</td>
<td>90</td>
<td>181</td>
<td>23</td>
</tr>
<tr>
<td>1988 actual</td>
<td>884</td>
<td>914</td>
<td>140</td>
<td>30</td>
</tr>
<tr>
<td>1989 budgeted</td>
<td>1008</td>
<td>1016</td>
<td>187</td>
<td>8</td>
</tr>
<tr>
<td>1989 actual</td>
<td>997</td>
<td>032</td>
<td>121</td>
<td>35</td>
</tr>
<tr>
<td>1990 budgeted</td>
<td>1046</td>
<td>1082</td>
<td>155</td>
<td>3</td>
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<tr>
<td>1990 actual</td>
<td>989</td>
<td>1089</td>
<td>13</td>
<td>100</td>
</tr>
<tr>
<td>1991 budgeted</td>
<td>1080</td>
<td>1140</td>
<td>160</td>
<td>60</td>
</tr>
<tr>
<td>1991 actual</td>
<td>1026</td>
<td>1188</td>
<td>153</td>
<td>162</td>
</tr>
<tr>
<td>1992 budgeted</td>
<td>1195</td>
<td>1245</td>
<td>172</td>
<td>51</td>
</tr>
<tr>
<td>1992 actual</td>
<td>1126</td>
<td>1358</td>
<td>166</td>
<td>233</td>
</tr>
<tr>
<td>1993 budgeted</td>
<td>1331</td>
<td>1491</td>
<td>202</td>
<td>160</td>
</tr>
<tr>
<td>1993 actual</td>
<td>1309</td>
<td>1605</td>
<td>213</td>
<td>296</td>
</tr>
<tr>
<td>1994 budgeted</td>
<td>1390</td>
<td>1633</td>
<td>181</td>
<td>243</td>
</tr>
<tr>
<td>1994 actual(^b)</td>
<td>1448</td>
<td>1582</td>
<td>127</td>
<td>135</td>
</tr>
<tr>
<td>1995 budgeted</td>
<td>1572</td>
<td>1630</td>
<td>229</td>
<td>8</td>
</tr>
</tbody>
</table>

\(^a\) Capital plus maintenance plus net lending and investment
\(^b\) Preliminary

investment programs were conducted had been abandoned in 1985. The nine strategic objectives which were used to allocate investment funds under the National Public Expenditure Plan were seen as rather fuzzy. More importantly, it was felt that too many of the country’s scarce skilled human resources were being devoted to setting priorities for a small and declining amount of capital outlay.

The 1986 Budget announced a decision to examine total government outlays in order to shift government resources from low priority to high priority areas and to increase the share of resources going to capital and maintenance expenditure (Chan 1986). Funds outside those transferred to the provincial governments were allocated across five broad sectors: economic, infrastructure, social services, law and order, and administration. Despite the objective of containing outlays on administration, however, the share of resources going to administration rose from 16.6 per cent in 1986 to 17.6 per cent in 1989. Resources going to infrastructure were cut back, with its share dropping from 27.7 per cent to 24.5 per cent over the same period.

At the same time the actual deficits began to exceed budgeted deficits (Table 1). There were a number of reasons for this. (We ignore for the time being the data in Table 1 relating to 1994, in which an extremely tight budgetary policy was brought into play, especially in the second half of the year.) There was inadequate factoring of the adverse impact of the closure of the BCL mine and the related national recession in 1990. In addition, the international economic environment was much less benign over those three years, as is reflected in the falling terms of trade for Papua New Guinea. In 1986, 1987 and 1990, the actual deficits turned out to be larger than the budgeted ones mainly because of revenue shortfalls. In 1989 and 1991 both revenue shortfalls and expenditure over-runs contributed in about equal measure to the larger actual deficits. In 1992, the expenditure over-runs contributed more than the revenue shortfalls to the larger actual deficit, but revenue shortfalls were also quite substantial. In 1993, expenditure over-runs were the main culprit.

**Government recurrent expenditure blowout**

Since actual total capital expenditure came in under budget in all years except 1993, this meant that it was the inability to control government recurrent expenditure that was at the heart of the budgetary problems on the expenditure side during this period. Though attempts have been made following budgetary blowouts and crisis to control public service wages through redundancy packages as in 1983 and 1990, once the sense of crisis is over, the expansion of the bureaucracy resumes again. In 1983, at the time the first retrenchment exercise began, there were an estimated 52,000 public servants, while at the beginning of 1995 the number was reported at around 60,000. In 1992, the year during which the expenditure over-run hit 113 million kina (the second worst in Papua New Guinea’s post-colonial history and exceeded only by that of 1993), actual expenditure on national departments was 604 million kina compared to the budget figure of 512 million kina and the actual 1991 figure of 525 million kina. Most of the expansion in the national departments’ expenditure occurred in the goods and services budget (by 56 million kina out of a total increase of 79 million kina), though there was also an increase in the wages bill. Expansion of travel by both administrative personnel and politicians occurred, as did the installation of new computer facilities.

In 1993, the expenditure over-run hit 14 million kina, spread over several items. The main reasons for this over-run were connected with the substantially increased
support for the commodity stabilisation fund (up to 91 million kina) and the expansion of the non-departmental miscellaneous budget, mostly comprised of education subsidies, the village services program and the Electoral Development Fund (commonly known as the ‘slush fund’). 1993 was also a year in which the capital expenditure came in just above budget at 213.3 million kina. It could be argued that capital expenditure was protected. But because of the expenditure blowout, the share of capital expenditure in total outlays came to 13.3 per cent, instead of the planned 14 per cent.

Budget deficits and import cover

The excess of actual budget deficit over planned budget deficit in all years since 1986 (except 1994) is shown in Table 2. The table shows that between 1986 and 1988 (inclusive) there was improvement in the actual budgetary deficits situation with the deficits falling from 4.3 per cent of GDP to less than 1 per cent of GDP. But from 1989 to 1993 (inclusive) the budgetary deficits deteriorated, hitting 5.9 per cent of GDP in 1993. At the same time, foreign exchange reserves as measured by import cover deteriorated. There was a small recovery in import cover in 1990 with the injection of a structural adjustment loan and the deflationary policies induced by the 10 per cent devaluation of the kina. But by 1991 the import cover had fallen to less than three months, which is regarded as the minimum safe import cover (Table 2).

Despite this, and in contrast with the Papua New Guinea government’s past behaviour, budgetary policy remained lax—the budget deficit rose to more than 5.6 per cent of GDP in 1992, from 4.6 per cent in 1991. The former was mainly due to large increase in departmental outlays.

Despite (or because of) the 1992 outcome, a year in which 70 million to 100 million kina of the government’s bills were unpaid in November 1992, the 1993 Budget assumed a high-risk strategy. Import cover was low but despite this there was the assumption in the 1993 Budget (and foreshadowed for the 1994 Budget) that the foreign exchange constraint had become non-operational. This notion was based on the assumption of large increases stemming from oil and mineral exports and that construction for the Lihir gold project would commence in the first half of 1994 with production starting two years later. It was also assumed that the South Gobe Oil construction would commence towards the end of 1994. Moreover, for the 1993 Budget oil prices were assumed at US$20 per barrel.

At the end of 1992, the government virtually lifted the foreign exchange controls, putting in place a reformed tax structure to be implemented over the 1993 and 1994 tax years and aimed at attracting private sector investment. These tax changes were aimed at returning to individuals and businesses tax revenues amounting to 100 million kina. Such tax changes on their own did not create the subsequent budgetary problems, although given the infrastructure constraints and poor maintenance of such infrastructure and low productivity of capital, it was unclear how such tax reductions were going to stimulate private sector investment.

The 1993 Budget attempted to offset such tax reductions by raising more revenue from the mining and petroleum sector through the phased introduction of the Advanced Payments System. Under this system the mining and petroleum sector became liable to tax in the year in which such income was earned. Phased introduction meant that the government receipts from mining and petroleum taxes increased for 1993, 1994 and 1995 by roughly 160 per cent, 120 per cent and 120 per cent respectively. But the oil assumption proved to be optimistic for 1993 coming in at US$18.10 per barrel. There was a revenue shortfall of 22 million kina (Table 1), though the main culprit for
Table 2  **Budget deficit as a percentage of GDP and end year import cover, 1986–95**

<table>
<thead>
<tr>
<th>Year</th>
<th>Planned (per cent of GDP)</th>
<th>Actual</th>
<th>End year import cover (Months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>2.3</td>
<td>4.3</td>
<td>6.1</td>
</tr>
<tr>
<td>1987</td>
<td>0.7</td>
<td>1.6</td>
<td>5.3</td>
</tr>
<tr>
<td>1988</td>
<td>0.7</td>
<td>0.9</td>
<td>3.9</td>
</tr>
<tr>
<td>1989</td>
<td>0.3</td>
<td>1.1</td>
<td>3.6</td>
</tr>
<tr>
<td>1990</td>
<td>1.2</td>
<td>3.3</td>
<td>4.3</td>
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<tr>
<td>1991</td>
<td>2.5</td>
<td>4.6</td>
<td>2.4</td>
</tr>
<tr>
<td>1992</td>
<td>1.2</td>
<td>5.6</td>
<td>2.5</td>
</tr>
<tr>
<td>1993</td>
<td>3.3</td>
<td>5.9</td>
<td>1.6</td>
</tr>
<tr>
<td>1994*</td>
<td>4.7</td>
<td>2.5</td>
<td>1.0</td>
</tr>
<tr>
<td>1995b</td>
<td>1.0</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

**Note**:  a Preliminary; b Budgeted


the budget blowout was expenditure over-runs.

The 1993 Budget foreshadowed substantial increases in outlays for both 1993 and 1994. There was the introduction of free education, expansion of the education system through the top-up of provincial high schools and the transfer of Grades 7 and 8 to primary schools. The politicians’ Electoral Development Fund was raised to 100,000 kina per MP in 1993 and then to 300,000 kina in 1994. A Village Services Program was put in place. In addition, a decision was taken to support commodity prices for the main tree crops on the basis of their costs of production. There were also increases in salaries for public servants, with substantial increases for the Governor of the Bank of Papua New Guinea. The government attempted to do too much and the planned commitments were poorly costed.

The budget overshot by a substantial margin (Table 1). Moreover, this was on top of the poor fiscal turn out of the previous three years. Between 1990 and 1993, real government expenditure increased by 8.5 per cent per annum. This should be compared with the average over the 1975–90 period of 0.5 per cent per annum growth to realise the large magnitude of the increases between 1990 and 1993.

**The cash flow problem**

A cash flow problem arises when income or revenue flows are inadequate to meet expenditure needs. This can happen if expenditures have to be made before revenue inflows. In early 1994 there was a cash flow squeeze because the government made 96 million kina worth of upfront payments. These were in the form of roughly one-third each for the Electoral Development Fund, the Village Services Program and school subsidies.

Given the government’s access to credit from the central bank and its ability to raise revenue through taxation and international borrowings, a government facing a cash flow problem is reflected in a loss of confidence in the economy and the currency. There were a number of developments which had adversely affected confidence of foreign investors in the Papua New Guinea economy, particularly in the important mining sector.
For CRA, it had started with the Bougainville crisis and culminated in its withdrawal from the Mt Kare mine. In 1993, there were forced renegotiations by the government with the Porgera Joint Venture for an additional 15 per cent equity, which further reduced confidence. Then in 1994, there were contradictory moves and statements by senior government ministers about mining policy, leading to substantial delays in the commencement of the Lihir project and in the South Gobe Oil project. In May 1994, a landowner group brought to a Melbourne court a massive lawsuit against BHP.

The March 1994 mini-Budget was necessitated by the cashflow problem which was aggravated by the fall in oil prices to US$13 a barrel (against the 1994 Budget’s assumed US$18 a barrel). It reversed some tax changes introduced in the 1993 Budget and planned to increase revenue flows through an increase in export duties on logs. There were cuts in expenditure amounting to 54 million kina. But the announcement of the collateralisation of mining revenues to be paid into a Cayman Island account for a 90 million kina commercial loan reduced confidence in the Papua New Guinea economy. Such a situation, when combined with lower interest rates in Papua New Guinea in the context of rising US and Australian interest rates, falling import cover (Table 2), and the liberalised foreign exchange controls, encouraged and facilitated the flight of capital. Though there was a need to tighten monetary policy through an increase in the minimum liquid assets ratio, the Bank of Papua New Guinea failed to do so. The bunching of loan repayments by mining companies did not help the foreign exchange position. The impact of the March mini-Budget was not felt—especially on the revenue side—in the first half of 1994, and by the end of June 1994 the budget deficit had hit 10.8 per cent (on an annual basis) of GDP.

The monetisation of the deficit (as the government continued its practice of substantially funding its large deficits through borrowings from the central bank, while repaying its overseas debt) created the potential for inflation, but the liberal import regime kept inflation in check (over the first half of 1994 the Consumer Price Index even fell somewhat). By the end of August 1994, however, Papua New Guinea had run out of foreign exchange reserves and the government was forced to take drastic measures.

The end of the hard kina policy

The hard kina policy and financial independence (despite dependence on Australian grant aid) that Papua New Guinea had prided itself on had to be jettisoned. The kina was devalued by 12 per cent in September 1994 and then floated in October 1994. The combined effect was to reduce the value of the kina by around 22 per cent against the Australian dollar. A 16 month wage freeze was announced and a sharp tightening of fiscal policy. Departmental budgets were slashed and a system of queuing of payments to the private sector was introduced. The cash flow problem was felt through the length and breadth of Papua New Guinea society. Schools, particularly boarding schools, were closed early as they ran out of funds. Because the operating budgets of departments were slashed, fax, telephone, photocopying and computer facilities were affected. More seriously, there was a drying up of medicine supplies, particularly in rural areas. Private sector activities dependent on the government for payment were adversely affected as the government considerably delayed paying its bills. Everyone was affected through the inflationary kick flowing from the kina depreciation, but the effect was muted in 1994 because of the lag in import prices and was felt much more in early 1995. There was also a tightening of monetary policy with the phased lift in the
minimum liquid assets ratio from 11 per cent in September 1994 to 29 per cent in March 1995 and 32 per cent in May 1995.

On the positive side, such drastic measures (with some fortuitous developments, such as the lift in commodity prices, particularly coffee and oil), substantially improved the final 1994 budgetary outcome. Total 1994 revenue came in 58 million kina above budget, mainly because of the increase in revenue from logs (through increases in the export tax announced in the mini-Budget). Expenditure came in below budget because of cuts in the mini-Budget and across-the-board cuts in outlays from October 1994, but also because coffee and copra prices increased and therefore the demand on the public account to support them disappeared in the second half of 1994. Real outlays fell by 5.6 per cent over 1993. The deficit for 1994 was 2.5 per cent of GDP and substantially below the 4.7 per cent planned—a major turnaround from the estimated 10.8 per cent (on an annual basis) at the end of June 1994.

With cuts planned for 1995, the 1994 Budget demonstrated once again that large increases in government expenditure of the type undertaken over the 1990–93 period were unsustainable and have to be reversed in subsequent periods.

The 1995 Budget

The 1995 Budget is a highly deflationary one. In money terms total expenditure and net lending is set to increase at 3 per cent over the 1994 preliminary outcome. With inflation measured by the GDP deflator projected at 16 per cent, real outlays are planned to fall by 13 per cent and by around 15 per cent if interest payments on government debt are excluded. With the capital (including maintenance) proportion of the budget planned to increase substantially, from 8 per cent in 1994 to 14 per cent in 1995, cuts to national departments and provincial departments are severe. In real terms (including transfers to provincial and local government) they amount to more than 21 per cent. There are cuts in money terms for both salaries as well as the goods and services. Real cuts in salaries are being achieved by not filling around 1,500 vacant positions, by planning to keep wage increases within a 1.5–3 per cent band and by introducing a redundancy package for 3,000 public servants. The redundancy package will cost 45 million kina, but the government has only budgeted 12 million kina for 1995; the rest is planned to be paid in 1996 with tax concessions for accepting deferment. In addition, it is planned to improve the efficiency of the public service through restructuring. Some departments are to be abolished while others are to be merged with or taken over by other departments. Restructuring and redundancy are likely to take up scarce management resources and consequently departments will have even less time to implement projects. This development is taking place in the context of an increasing need to provide counterpart staff and funding for larger program/project aid from Australia and a much larger Public Investment Program (almost double in money terms) than in 1994.

It is quite likely, therefore, that program/project aid from Australia will be underdrawn and the Public Investment Program will be underspent. In addition, unless strict monitoring of expenditure occurs, the non-capital budget will be over-spent. For instance, there are pressures coming from the March 1995 teachers’ strike which are bound to have an impact on the Department of Education’s outlays and possibly, through comparative wage justice, on the outlays of other departments.

In 1993 and the first half of 1994 the budget blew out partly because of larger than anticipated commitments from the public accounts for price support advances

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to the commodity stabilisation funds. In 1995 the government has provided only 10 million kina in the public accounts for this purpose. Given that commodity prices are up, there is likely to be less demand on the government for these funds. Though the government has limited its liability for the commodity stabilisation funds in line with international donor concerns (it has indicated that it will phase out support from the public accounts completely from 1996), there is an expansion of the slush fund for each MP from 300,000 kina to 500,000 kina, and an additional 200,000 kina is being provided under the rural transport program. At a time when a lot of pain is being inflicted through cuts in the budget, an increase in the slush fund is not likely to go down well with the public. There are also dangers that, given its size, it will be mismanaged; though 150,000 kina per MP is being spent through the Public Investment Program and therefore is likely to be better managed.

There is an inconsistency in education policy between the policy objective of giving priority to primary education and substantial reduction in the share of resources going to primary education. The availability of materials and books is likely to be reduced, producing an adverse effect on the quality of primary education.

The budget is deflationary not only on the expenditure side but also on the revenue side through increases in taxes. The fringe benefits tax abolished in the 1993 Budget has been restored on a wide variety of items. In addition, the full effect of the increase in the top marginal personal income tax rate to 35 per cent from 28 per cent announced in the March 1994 mini-Budget will be felt in 1995. The government expects a 36.3 million kina increase in personal income tax collections. This appears somewhat optimistic given the adverse impact on employment of the tight fiscal and monetary policies which have been in place since September 1994 and are continued into 1995. The protective import duty has been lifted from 33 per cent to 40 per cent—there is a trade-off with the decision to move to tariffication from direct import controls granted for certain selected infant industries. Excise duties have been increased on a range of products by 20 per cent. Government fees and charges have been increased in line with CPI movements since the previous change. Such increases coming on top of the increases in the March 1994 mini-Budget and on top of the price rises flowing from kina devaluation/depreciation will have a negative income effect. Therefore, increases of 33.7 million kina and 42.2 million kina in import duties and non-tax revenue looks somewhat optimistic. The former may be attained though, if the announcement that in future import duties will be payable by all public sector departments, agencies and authorities is implemented. But it will either further squeeze their goods and services budget or, as is becoming apparent, they will be seeking and getting blanket exemption from import duties.

It is probable though that the government has used somewhat pessimistic assumptions for the 1995 Budget about the prices of gold, oil and copper in forecasting revenue from taxes on mining and petroleum (however forecasts for 1996 and beyond, especially for oil, are somewhat optimistic). The mining and petroleum revenues may exceed the 1995 Budget estimate by around 30 million kina. Therefore, the net effect is likely to be a slight increase in total revenue over the budgeted amount.

**Restoration of financial independence**

Gold, oil and copper prices are likely to turn out to be more than 5 per cent above those assumed in the 1995 Budget. This means that exports will be larger than projected by around 100 million kina. Given the deflationary nature of the budget, imports are likely to be lower than
projected. It is probable therefore that the foreign exchange position will continue to improve over the course of 1995. In making this forecast, it is assumed that there is no budgetary blowout of the type which occurred in the early 1990s.

Though the structural adjustment loan from the International Monetary Fund and other international donors is likely to improve confidence in the Papua New Guinea economy because it means a stamp of approval on Papua New Guinea’s budgetary policy, such a loan is not likely to be necessary to support the kina. With the 1995 Budget, Papua New Guinea is likely to have restored its financial independence. In order to secure the continuation of this independence, the government will have to continue to keep a tight rein on budgetary policy—it should not be tempted by the booming mining sector to lose its grip on budgetary policy again. Past experience suggests that given the reductions in real Australian aid flows, the increased flows from the mining (and petroleum) sector are barely enough to leave total expenditure unchanged. Attempts to shift the budget to capital (plus maintenance) expenditure, and away from recurrent expenditure evident throughout Papua New Guinea’s post-colonial history, have not so far succeeded. The 1995 Budget attempts to do so again, though only to 14 per cent of total expenditure, which is not too far out of line with the post-colonial period’s average of 13 per cent. In this context what may yield greater dividends for the Papua New Guinea economy is a greater focus on attempting to improve the efficiency of government investment, which to date has been lacking.

References

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