Booming commodity prices: an opportunity to good to miss?

PNG-Australia Update
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Bob Warner
Centre for International Economics
www.TheCIE.com.au
Content

- Recent developments
- The impacts of the current commodity price boom, and how they are being managed
- The implications for rural PNG
Recent growth – positive and broad based

- Agriculture, Forestry and Fishing: 33%
- Oil and Gas Extraction: 2%
- Mining: 1%
- Manufacturing: 4%
- Electricity, gas and water: 3%
- Construction: 25%
- Wholesale and retail trade: 10%
- Transport, storage and communication: 8%
- Community, social and personal services: 2%
- Finance and business services: 3%
- Total: 100%

Growth share:

Trend growth:

% per annum:

- Agriculture, Forestry and Fishing
- Oil and Gas Extraction
- Mining
- Manufacturing
- Electricity, gas and water
- Construction
- Wholesale and retail trade
- Transport, storage and communication
- Finance, real estate and business services
- Community, social and personal services
- Total
Soaring prices – for agriculture as well as oil and minerals
Different effects of mineral and non-mineral price surges on rural PNG

- Surging agricultural commodity prices mean increased incomes for growers, processors and traders - a direct effect on rural areas

- Surging mineral prices mean increased foreign exchange revenues for the government: so impact on rural PNG depends on what government does about the revenue surge.
Not all rural people grow export crops
Limited output response to rural commodity price surge
One reason: uncertain access to markets
Impact of mineral price increases

- Its all about the government
- Mineral revenues in 2007 were well over 5 times higher than in 2002
  - An extra K2.5 billion
  - In total about K6 billion more than if revenues had stayed at 2002 levels
- Lots of options!
Government choices

- When government gets a boost in foreign exchange revenues like this it has some interesting choices about whether to spend, and what to spend on.
  - Spend or not
    - Could save the revenues for a rainy day: explicitly or by reducing debt
  - Recurrent or investment
    - An immediate surge in local incomes, or an increase in capacity to earn income in the future
  - Local goods or imports
    - On local goods and services risk inflation and exchange rate appreciations – bad for rural exporters
    - On imports – no risk of crowding out rural exports, but no immediate local income effect
How unanticipated revenues have been dealt with

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<th>Spent</th>
<th>Paid into trust account</th>
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<td>Transport</td>
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<td>Others</td>
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<td><strong>Total</strong></td>
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<td><strong>2251.4</strong></td>
<td><strong>3810.4</strong></td>
<td><strong>100.0</strong></td>
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Exchange rates have hardly appreciated
So far so good, it seems

- The government has so far avoided some of the traps associated with a surge in its foreign exchange revenues
- But there is scope for things to come unstuck, so it is a little reassuring to see that the 2008 budget presents a strategy to replace the current ad hoc approach to mineral revenue volatility
The fiscal strategy

- Limit ongoing development and recurrent spending to “normal” mineral revenue and non-mineral revenues
  - Where “normal” mineral revenue is 4 per cent of GDP

- Additional mineral revenue will be used to benefit future generations by investment or reducing debt.
  - 40 per cent allocated to debt reduction
  - 60 per cent for public investment
  - If additional revenues do not materialise, debt prepayment will take the hit rather than investment
What does the strategy mean?

- If implemented between 2002 and 2007, about K2.1 billion would have been allocated to debt reduction, rather than the K647 million in the supplementary budgets.
- The strategy can deal with quantity as well as price fluctuations.
- Debt reduction recognises limited life of some key mineral projects, and need to bolster fiscal position to meet future challenges.
The bottom line

- The current boom has been good for significant parts of rural PNG, because they have benefited directly.
- But the real test of whether the opportunity has been taken or missed lies with the government, and how it deals with the surge in mineral revenues.
- And that is still pretty much untested: a lot hinges on what is done with those trust accounts!