PNG economic survey: Transforming good luck into policies for long-term growth

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Outline

1. Some stylized facts on PNG
2. Recent economic developments
3. Fiscal position – 2003 budget
4. Sectoral performance
5. 2004 Budget: Stabilisation with growth
6. Sum-up: there is hope!
Some of the stylized facts

1. GDP for decade to 2002 grew at an annual average rate of 1 percent while the population grew at a rate of 2.4 per cent implying per capita income fell at an average of 1.4 per cent per year over this period

2. Developmental record is poor relative to own past and countries of the region (life exp. 57yrs, GDP/capita of US$570, IMR of 79)

3. Return to positive GDP growth in 2003 due to strong recovery in agriculture and mining; a fortuitous combination of good weather and healthy improvements in price of exports (Good luck!)

4. Major risks to recovery: policy and political instability
## PNG lags behind the neighbours

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<tbody>
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<td>(million)</td>
<td>(sq. km)</td>
<td>($US)</td>
<td>(% per annum)</td>
<td>(%)</td>
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<td>Fiji</td>
<td>0.82</td>
<td>18270</td>
<td>2160</td>
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<td>Indonesia</td>
<td>212</td>
<td>1.9m</td>
<td>710</td>
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<tr>
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<td>463000</td>
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<tr>
<td>Samoa</td>
<td>0.18</td>
<td>2840</td>
<td>1420</td>
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Data sourced from *World Bank Development Economics Central Database* on 20/08/2003.
<table>
<thead>
<tr>
<th>Country</th>
<th>Life Exp (yrs)</th>
<th>Per-capita GDP ($US)</th>
<th>Infant Mortality (per 1000 births)</th>
<th>Illiteracy (15yrs+ popln) (%)</th>
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Note: IMR increased from 72 in 1980 to 82 by 1991.
Recent economic achievements

1. GDP growth for 2003 estimated at 2.4% against budget forecast of 1.8 (BPNG, 2003)
2. Annual inflation for 2003 of 8.4%, a sharp fall from the 14.8% of the previous year (stable kina)
3. Balance of payments surplus of K324m compared to deficit of K239m in 2002 with Forex as of Dec 2003, sufficient for 5.1 months of import cover
Macroeconomic reality

- Structure of production: Agriculture – 30% of GDP, 20% of exports, and 90% of employment; Mining – 21% of GDP, 75% of exports; Manufacturing – 9% of GDP and M-substitutes.

- Primary sector output dependent on weather (rain) and international commodity prices—for example, the case of vanilla.

- Annual changes in GDP, as a consequence, expected to be volatile; but stagnant per capita income over the long term due to structural impediments.

- Treasury Bill rates of all maturities went up over the year, for example, the 182-day Treasury Bill rate went up from 13.5 to 16.91%.
2003 Fiscal Position

- Budget deficit for 2003 of 1.3 (2?) per cent of GDP
- Total expenditures totaled 92 per cent of the (revised budget) appropriation — development expenditure totaled 71 per cent of appropriation
- Tax and non-tax receipts up but foreign grants down, thus total revenues amounted to 92 per cent of budget estimates
- Domestic financing of K458.9m used to fund the deficit of K152.6m together with (net) repayments on external loans of K306.3m
- Interest payments on debt alone amounted to 27 per cent of recurrent expenditures (or 70% of development budget)
Sectoral Performance

- Improvements in (weighted) average kina price of agricultural exports of 6.3%, mining of 7.8%
- Agriculture – expanding and likely to impact on the livelihood of the majority of the population – risks of fall in commodity prices, bad weather, local costs ↑
- Minerals – major foreign exchange earner, healthy prices provide window of opportunity. Risks: oil reserves falling, no new mines on the horizon though some recovery in prospecting
- Informal sector – rise of food production as kina fell.
2004 Budget: Stabilisation with growth

- Growth forecast of 2.8 per cent for 2004
- Of total outlays of K4.1b, K2.8b on recurrent while remaining 1.3b (of which 65 per cent is grant funded) on development (K121m on Highlands Highway).
- EDF for MPs of K100,000 for political stability
- Total revenues estimate of K3.8b, deficit of K300m (2.4 percent of GDP) to be funded by US$50m commercial loan with the remainder from domestic sources.
- Import levy of 2 per cent for 2004 + LLGs given power to impose head tax of K50 max or 5 days work.
- Expenditure restraints – wage and recruitment freeze
Financing options for the deficit

1. More fiscal consolidation and better quality expenditure to close the financing gap and improve growth prospects.
2. Finance to be sourced from
   i) official sources and the most concessional available - PRGF, IDA and ADB – IFIs can be more helpful and
   ii) privatisation proceeds (Telikom etc)
1. The cost of commercial financing is unattractive compared to official sources.
Restructuring debt

- Shifting portfolio of debt from short to long-term maturity will reduce rollover risk
- Limited demand for L/T debt will incur an interest rate penalty
- An increase in the stock of domestic debt will exacerbate interest rate pressures and penalise growth.

Reengagement with IFIs and privatisation the most sensible option.
Policies to induce value-adding activity

Major impediments to growth of private enterprise include

1. poor law and order situation that has raised the costs of doing business – crime tax highest for small non-mining primary producers (≈13% of gross income)

2. poor public infrastructure that has raised transportation costs, and

3. government regulation and ad hoc policy changes including those relating to international trade
“Development has been lagging in Papua New Guinea during the past decade, and time has now come for both Papua New Guinea and Australia to give more attention to long-term development issues.”

“More attention should be paid by Australia to the development process in Papua New Guinea, not only to monitor the use of Australian aid, but more broadly to develop a better understanding of this important neighbour.”

(Jackson Committee Report, 1984: 145)

“The Program is unique to Papua New Guinea and has been designed to re-establish investor confidence and provide an enabling environment for broad based development.” (Announced on launch of the ECP)
“In the four years after its elections, the Somare government showed an impressive ability to deal with the young country’s financial, economic, and political problems.” (page 4)

“no one can say how sturdy or fragile Papua New Guinea’s policy or administration will prove to be, but the short-run record provides strong grounds for optimism and few for anxiety” (page 5)

At independence, Australia accounted for between 40 and 45 percent of the local budget and some 45 to 50 percent of the foreign exchange requirements. There is “reasonable grounds” to believe that this dependence on Australian grant “might end entirely within the next 20 to 25 years” (page 6).