Australian National University

The University of Papua New Guinea

2018 PNG UPDATE: PNG IN THE YEAR OF APEC

Professor Stephen Howes and Professor LN Pillai (eds.)

Front Cover:
The UPNG New Lecture Theatre
(Photo: Shannon Young)

Back Cover:
The Hon Charles Abel MP
The Hon Ian Ling-Stuckey MP
Mr Nelson Atip Nema, Mr Rohan Fox, and Professor Stephen Howes
Dame Meg Taylor
(Photos: Shannon Young)

Table of Contents

Contributors ii

Foreword iii

Inaugural address 1
The Hon Charles Abel MP, Treasurer and Deputy Prime Minister

PNG's economy 7
The Hon Ian Ling-Stuckey MP, Shadow Minister for Treasury and Finance

2018 PNG economic survey 21
Rohan Fox, Stephen Howes, Nelson Atip Nema, Hoai Bao Nguyen and Dek Joe Sum

Leadership and the future 51
Dame Meg Taylor, Secretary General to the Pacific Islands Forum

Contributors

The Hon Charles Abel MP is the Treasurer and Deputy Prime Minister of Papua New Guinea.

The Hon Ian Ling-Stuckey MP is the Shadow Minister for Treasury and Finance of Papua New Guinea.

Mr Rohan Fox is a Research Officer at the Development Policy Centre.

Professor Stephen Howes is Director, Development Policy Centre, Crawford School of Public Policy, ANU.

Mr Nelson Atip Nema is a Lecturer in the Division of Economics at the UPNG School of Business and Public Policy.

Dr Hoai Bao Nguyen is a Lecturer in the Division of Economics at the UPNG School of Business and Public Policy.

Professor LN Pillai is Executive Dean of the UPNG School of Business and Public Policy.

Mr Dek Joe Sum is an Associate Lecturer in the Division of Economics at the UPNG School of Business and Public Policy.

Dame Meg Taylor is the Secretary General to the Pacific Islands Forum.

Foreword

Organised by the University of Papua New Guinea's School of Business and Public Policy and The Australian National University's Development Policy Centre, the annual PNG Update is the premier forum for the discussion of research and analysis relating to contemporary economic and public policy issues in PNG.

The 2018 PNG Update was held in Port Moresby on 14 and 15 June 2018 with the theme "PNG in the Year of APEC."

Altogether, there were more than 70 presentations at the 2018 PNG Update. This volume collates four of the keynote addresses. Other presentations can be found online at https://devpolicy.crawford.anu.edu.au/png-and-pacific-updates/png-update.

Deputy Prime Minister and Treasurer Charles Abel delivered the inaugural address of the Update. His wide-ranging address included reflections on the Australia-PNG relationship and on the upcoming APEC meetings in Port Moresby later in 2018. The Treasurer set out key government economic policies, including getting a fairer share of natural resources, and predicted that this year would show signs of economic recovery.

Shadow Minister for Treasury and Finance Mr Ian Ling-Stuckey also delivered a keynote speech on the state of PNG's economy. His presentation argued that PNG was suffering from the resource curse, and set out the policies which he argued were needed to life PNG's economic growth, especially in the non-resource sector, and to resolve PNG's exchange rate and budget crises.

Also on the economy, the combined ANU-UPNG team presented their annual 2018 survey on the PNG economy. The authors argue that underestimation of the severity of the economy's contraction has contributed to an absence of an appropriate policy response to what can only be described as an urgent economic crisis, and that there is no way around the need for a substantial devaluation of the currency.

Finally, this collection includes the keynote address of the Pacific Islands Forum by the Forum Secretary General Dame Meg Taylor on the theme of PNG, the Pacific and regional leadership. Meg Taylor argues that the Pacific region is at a critical juncture. She concludes that PNG has both much to gain from Pacific regionalism, and much to offer, and challenges PNG to do more to realise its full leadership potential in the Pacific region.

Our thanks to Shannon Young and Ashlee Betteridge who put this volume together, and to all the ANU and UPNG staff whose hard work made by the 2018 PNG Update possible. Acknowledgements also to the Australian aid program for its support to the PNG Update series.

Stephen Howes and LN Pillai

Inaugural Address

The Hon Charles Abel MP, Treasurer and Deputy Prime Minister

Good morning, and thank you for the opportunity to present the inaugural address at the 2018 PNG update.

It's certainly a fantastic new lecture theatre so let's give a round of applause to the Australian government. And one for the PNG government!

I want to thank the University of Papua New Guinea (UPNG) and The Australian National University (ANU) for continuing to host this initiative, and the Australian government and people for the sponsorship through Australian aid.

I think it is wonderful and a sign of Papua New Guinea's maturity as a nation and economy that we can come together, debate and hopefully better understand the challenges facing our country today.

I would like to congratulate the organising committee from ANU and UPNG, notably:

- Professor Stephen Howes of the Development Policy Centre at ANU and Professor Lekshmi Pillai, Executive Dean, School of Business and Public Policy UPNG
- Mr Vincent Maliabe, the Acting Vice Chancellor UPNG, council members and staff
- Sir Charles Lepani, Chairman of the APEC 2018 Coordinating Authority, Ian Ling Stuckey, Shadow Minister for Treasury and Finance
- Dame Meg Taylor, Secretary General, Pacific Islands Forum

- All visitors, participants, speakers, students and friends.

I'm honoured to be invited to this campus once again, having spoken on different occasions here including a previous PNG Update if I'm not mistaken.

I am looking forward to robust debate on all of the key issues raised by the organisers. We have a variety of interesting sessions ranging from land, macroeconomy, health, agriculture and many others, ending in a session on the digital economy. The backdrop to all this is the main theme of "PNG in the year of APEC."

The fortunes of this institution, with its decorated legacy, mirror the fortunes of our nation. The history and progress of this country will always deeply involve the University of PNG.

Challenges will always come and go, but continue to be vigilant in your commitment to this great institution and its standards, whether you are a council member, student or member of the teaching staff or administration.

My daughter Courtney is part of the current cohort of law students, so I'm your Deputy Prime Minister and Treasurer but also a concerned parent. Papua New Guinea cannot compete on the world stage without quality institutions imparting quality education to our children. We still have so much work to do at UPNG and within our education system in general to achieve the required international standards.

I've had an opportunity to travel to the United States, Asia and Israel recently. One thing which continues to strike me as I compare countries is that we have one of the best education systems in the world on our doorstep in Australia. I really believe we need to integrate our education system more with the Australian system, bring more lecturers over here, and teachers into our schools and vice versa. I also believe we should have more PNG grade 10s accessing boarding schools and universities in Australia like in previous years. I have written to the High Commissioner Bruce Davies on this and will take up with my counterpart treasurer, Scott Morrison and Foreign Minister Julie Bishop when we meet next week.

The people to people engagement between our countries that we always talk about needs more realisation. I'd really like to see Australia give us visa on arrival status. There should be more Australians in PNG and more Papua New Guineans in Australia. We need to accelerate the education of our young people, the quality of English spoken and written expression, the adoption of the latest technology and systems by greater interaction with the Australian people and education system.

Another significant and related element in terms of global integration and access to knowledge and accelerating education is a modern ICT infrastructure network. I gave a speech to open the ICT forum recently and emphasised the critical importance of the new 20 terabyte cable from Sydney, and the domestic submarine cable and terrestrial fibre optic network. Access to cheap, speedy internet, means access to knowledge and education. It's a no brainer. It's a part of the 25-point plan, and the procurement of the international cable is underway, again with the help of our Australian friends.

Events such as the 2018 APEC meeting are also about global integration, participation and knowledge sharing. We need modern capital and technology to develop. It is a bold undertaking by our small country to introduce ourselves to the world and we are committed now. We need to take full advantage of it.

The obvious point I'm making here is the importance of education and an educated population. It is the key because we have all the other elements necessary in the development equation. The standard of our human capital is hindering the speed of the transformation to a modern economy delivering the minimum socio-economic standards.

The Asia Pacific region is becoming increasingly significant in terms of the global economy and trade. There is an obvious dynamic going on with the rise and rise of China in particular. We need to be fully aware of this in terms of the opportunities and challenges it represents. Traditional relationships, development assistance, business and trade, are all shifting.

We want trade and investment. We appreciate concessional financing. But we also hold dear democracy and its principles and institutions. We like free press, freedom of speech and human rights. Many of these foundations still remain fragile and we need our traditional partners to remain fully engaged in the region and with us.

Events such as this forum, APEC, the Asia Pacific Caribbean Forum, the Pacific Games, the U20 Women's World Cup and the Rugby League World Cup games, encourage people to come to PNG and see and judge for themselves the opportunities and challenges of our country. They can see that we are an open, democratic country with many opportunities and a lot of potential. Challenging some of the negative stereotypes of our country is not easy and will take time. Post-colonial thinking combined with the advent of rampant social media can certainly make it harder for people to see beyond the rhetoric and look at the direction the country is heading in.

PNG has experienced a sustained period of political stability since 2002, when the National Alliance-led government under Sir Michael Somare completed almost two full terms, due in part to the Morautu government-instituted legal changes that limited movements of Members of Parliament between parties. These provisions have been since deemed unconstitutional.

The O'Neill-led governments of 2011/12, 2012 to 2017 and current coalition have sustained under the relatively original provisions of the constitution unlike previous governments. Political stability is a prerequisite for development, and this was demonstrated in the experience since independence in the constant changes through motions of no confidence which made it extremely difficult for any sort of constructive governance.

I don't think the constitutional architects who wrote the provisions for motions of no confidence really envisioned the manner in which they were ultimately used. The current opening grace period of eighteen months used to be six months in the original constitution. The O'Neill/Dion government tried unsuccessfully to amend the grace period to thirty months.

Political stability is important but not at the cost of political entrenchment of course. The mechanism of motions of no confidence is fine but the various hurdles such as the number of members required to activate a motion must not be so low as to make it potentially frivolous. A weak party system that we still have, in conjunction with an easily activated no confidence process and short grace periods, can lead to election mandates being usurped.

So, political stability under our Prime Minister has enabled us to test our policies in the last six years. We are also able to compare these with the National Alliance (NA) led government, which was in power for nine continuous years, or other governments. It is also noteworthy that Somare-led governments previously also add to this period tally in terms of Somare leadership. Sir Cecil Abel by the way was one of the founders of the Bully Beef Club and a great friend of Sir Michael.

The NA government, particularly in its second term, enjoyed huge revenue flows from a commodity boom and built up large trust account balances that unfortunately, and despite some good intentions, were rapidly spent without much to show for it. When I came in as Planning Minister in 2012, the Sweep taskforce was investigating much of the abuse that had happened at the Department of Planning, and we had to review the method of pooling and distributing funds from programs such as the National Agriculture Development Program and the Rehabilitation of Education Sector Infrastructure.

Despite the wastage the NA government got debt down and delivered the PNG Liquefied Natural Gas (LNG) project. The current low-price environment is revealing some flaws in the project agreement, and of course we did not provide for domestic market obligations or local content obligations. Nevertheless a massive achievement which will bear more fruit one day.

When the O'Neill/Namah and then O'Neill/Dion government took power we began a deliberate program to create a larger resource envelope and invest heavily into infrastructure, education, health and law and order. This commenced with the Tuition Fee-Free (TFF) policy in 2011.

The government pursued a policy of deliberate deficit budgets to continue fiscal stimulus after the PNG LNG construction phase, and to bridge the gap until production began. There was much excitement and anticipation leading into first gas because it was touted that our revenues would double.

Well, it's an old story now that oil prices collapsed immediately after production commenced. We then faced the El Nino drought, devastating earthquake and national elections.

The good news is that there has been significant and visible improvements in our productive capacity through infrastructure in terms of roads, the major sea and airports, hospitals and schools. This stimulates the economy and makes services more accessible. Our economy is slowly becoming more diversified, and revenue reliance on the mineral and petroleum sector has greatly reduced.

The bad news is that against the growth in GDP, particularly related to the PNG LNG project, against which we spent many hundreds of millions for the equity investment and landowners' commitments, we have not had the corresponding revenue growth whilst the interest burden and cost of the public service has grown.

So with these experiences behind us, the O'Neill/Abel government is responding through the 100 Day/25 Point Plan, commencing with the 2017 supplementary budget and now the 2018 budget, with measures to:

- Increase revenue to 14.6% of GDP and beyond
- Restrict costs to 16% of GDP
- Maintain a debt to GDP ratio below 35% and bring budgets back to balance over time
- Bring on the PNG LNG expansion project, Papua LNG and Wafi Golpu project under an improved fiscal template
- Progress internal generation of cheaper, cleaner and more reliable power and reducing reliance on imported diesel
- Progress the local production of rice, stockfeed, dairy, vegetables, eggs and meat, particularly to reduce imports and forex demand
- Address the forex shortage through central bank intervention, new project acceleration and debt restructuring to bring in the balance of the Credit Suisse loan, the World Bank budget support and the ADB health loan and budget support (signed yesterday)
- Fix the Highlands Highway ($1bn ADB Multi Tranche Financing Facility)
- Complete the Lae and POM sea ports and activation of an international operator
- Support SMEs
- Meet our commitments to free education, health and the provincial governments and districts.

We need to continue to give due attention to institutional governance, especially around accountability and procurement, and also corruption. The Prime Minister will be making some announcements shortly on the activation of ICAC.

The sweep of government accounts has not only raised significant revenues that we can use for frontline services, but also reduces our domestic financing costs as we were previously borrowing this money back from the banks who held these surplus funds.

The government is also committed to getting a fairer share of returns on our natural resources whilst appreciating the significance of resources such as our forests, tuna socks and biodiversity in a global sense as explained in the national strategy for responsible sustainable development or stars.

The Alotau Accord highlights the high population growth rate as a development priority, and new programs in health with the World Bank and the Asian Development Bank (ADB) emphasise access to family planning in conjunction with our good friends in the United Nations Development Programme (UNDP) and our NGO partners.

With the impact coming through of our 25 Point Plan interventions as captured in the

2017 supplementary and 2018 budgets, and the oil price sustaining above US$70 per barrel, the indicators are looking promising. If it were not for the massive earthquake affecting gas, oil and gold production, at current prices we were certainly looking at outdoing the 2018 budget revenue projections. We will publish a mid-year financial outlook report shortly to see how we are tracking.

We have had some tough times and that is exactly why government responded as it did straight after the elections.

I believe the APEC event will cap off a year of recovery for our country in spectacular fashion.

Let us have some constructive ideas at this forum, negative and positive views but always in a constructive, solution-driven spirit.

This conference starts by looking at something as fundamental and traditional as land and ends by looking at something as modern as the digital economy. I think this perfectly encapsulates what PNG is about, a country with deep traditional and cultural roots that is able to both embrace the riches of its past with the opportunities of the future.

Thank you to the speakers, participants and audience. Thank you UPNG. A special thanks to those overseas friends who continue to support events such as these and support our beloved country PNG. May you gain satisfaction and fulfilment from your efforts in return.

Thank you.

PNG's economy

Mr Ian Ling-Stuckey, Shadow Minister for Treasury and Finance

Welcome,

Acting Vice-Chancellor Malaibe, Professors Lekshmi Pillai and Stephen Howes, distinguished guests, students of PNG and other colleagues.

It's quite an honour to be here today.

Being at this UPNG/ANU Update gives me some hope. As the Shadow Treasurer, I stand in front of you, our country's future leaders, to present an alternative point of view to the Treasurer's earlier presentation. For this is the essence of something vital for the future of our society – the ability to discuss ideas, express different points of view, back up arguments with facts, reasoning and evidence, to allow for constructive criticism. This is a defining feature of a democracy. In our world, my fear is that there is a retreat from these ideas of free, open and respectful discussion. So I congratulate the organisers of this conference, for encouraging discussion and *debate*.

In this presentation, I want to cover a fair bit of ground, so I'll need to move through the following issues quickly. I will give a short introduction about myself, a historic context, some comments on APEC, then an examination of three crises facing PNG today and solutions.

Business perspective and local politician

Some quick background about myself. I'm not an economist. So if you ask some hard, technical questions, I'll have to ask Professor Howes to answer them - I guess a privilege of being a politician! Rather, the perspective that I bring to the role of Shadow Treasurer, is the pragmatic view of a business person. I'm quite proud that my family has been operating successful businesses in Papua New Guinea for over 80 years-since 1937. Running a business means that you must have a strong vision for what you can offer, it means being realistic and pragmatic in translating your vision to practical implementation, it means being honest if there are problems, and then doing sensible things to fix them. I will bring some of these business perspectives into my presentation.

In addition to being a business person, I am also a politician, currently representing my people from the Kavieng Electorate. I understand the importance of roads, schools and aidposts, even water tanks, to provide reliable drinking water throughout the year. This is my third five-year term in Parliament. I have been a Minister for Mining, Public Services, Commerce and Industry as well as the former governor of New Ireland Province. So I hope I have a perspective from the National through the provincial and district levels, down to the actual village level of our people. And I will reflect on my view of how things are going now relative to previous decades.

Development experience since Independence

Let me put my presentation in a historic context of our development experience since Independence. This helps us better understand our current challenges and the urgency for changing from current policies.

I remember well the joyous days when Independence came to our country. There was a mixture of both joy as well as fear of the unknown as Independence came while I was still in high school.

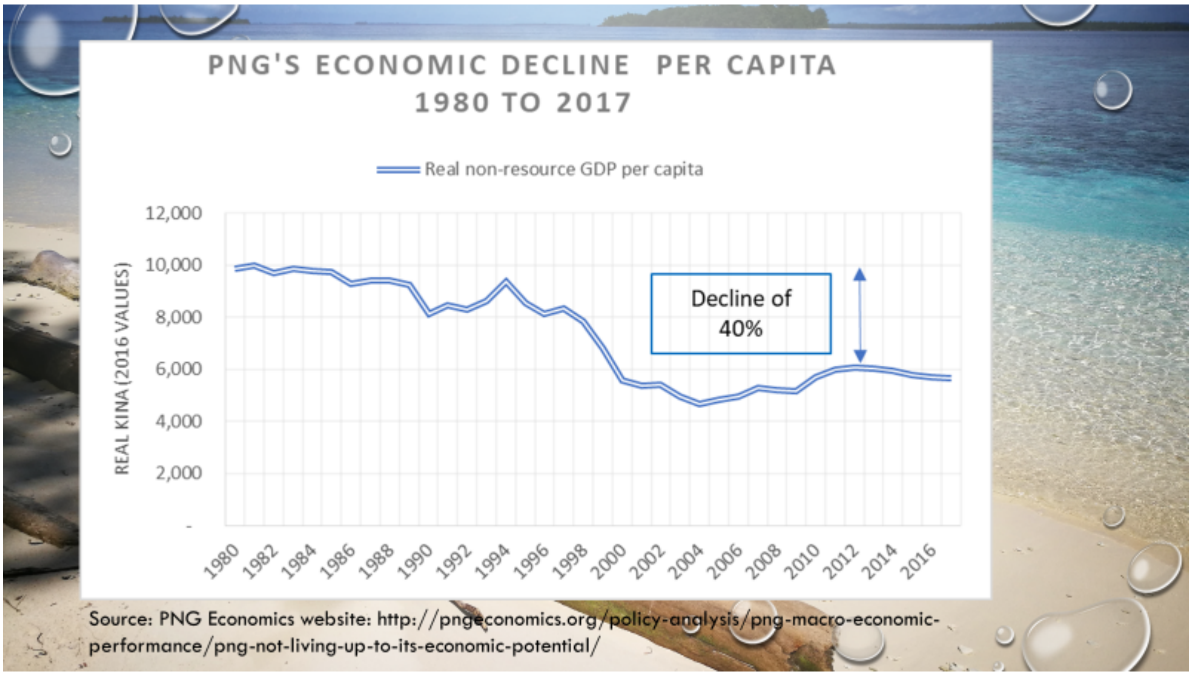
As I reflect on our development experience, one can understand the disappointment of our people. In terms of both social and economic development, we have not done anywhere near as well as we'd hoped.

This slide covers some ten social indicators. On most criteria, we are either at or towards the bottom of most social indicators – poverty, stunting, malnutrition, infant and maternal mortality, diseases and basic services.

As a national politician in this country, I look back on this record and collectively, regret to admit, we've let our people down. The first step for changing this poor performance is to acknowledge it. We cannot pretend that things are good and rosy when they are not.

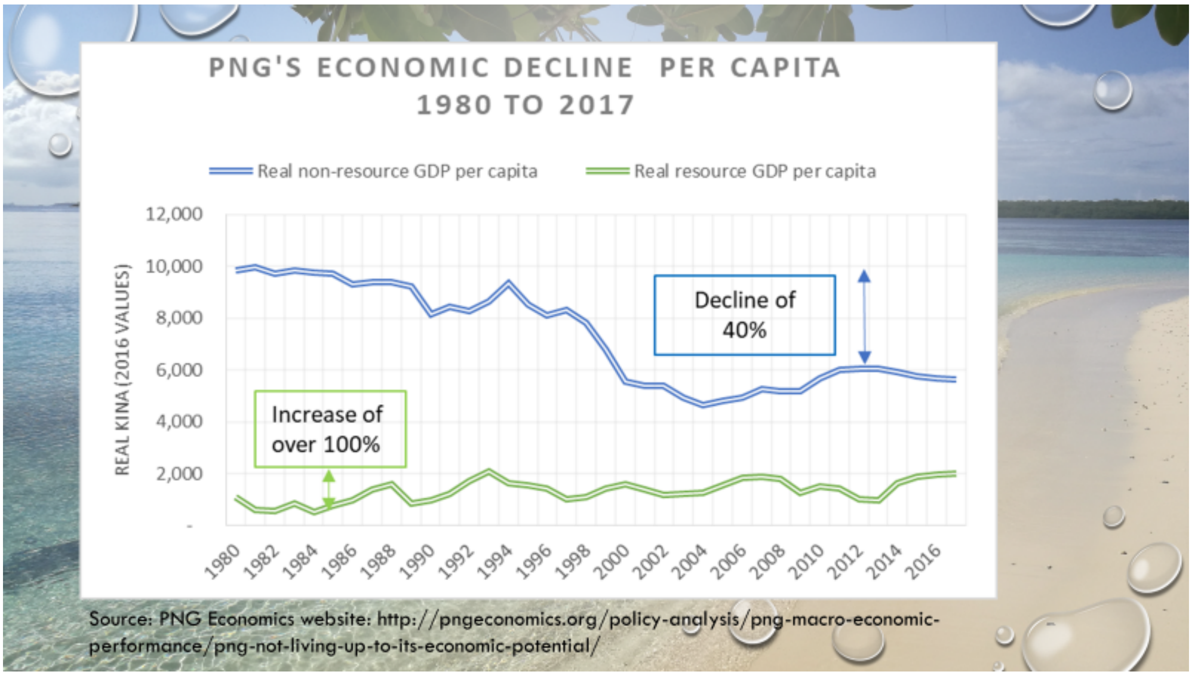
The next slide covers broad economic performance since 1980. This performance is based on measuring real non-resource GDP per capita. The non-resource sector is the focus, as this is where almost all of our economic welfare comes from, for almost all of our people.

The slide shows the terrible drop in average economic welfare in our country. It re-enforces and partially helps explain our poor performance on social indicators. The bottom line is that economic welfare has gone backwards by 40% or over a third since Independence. On average, every person alive in PNG is more than one-third worse off than at 1980.



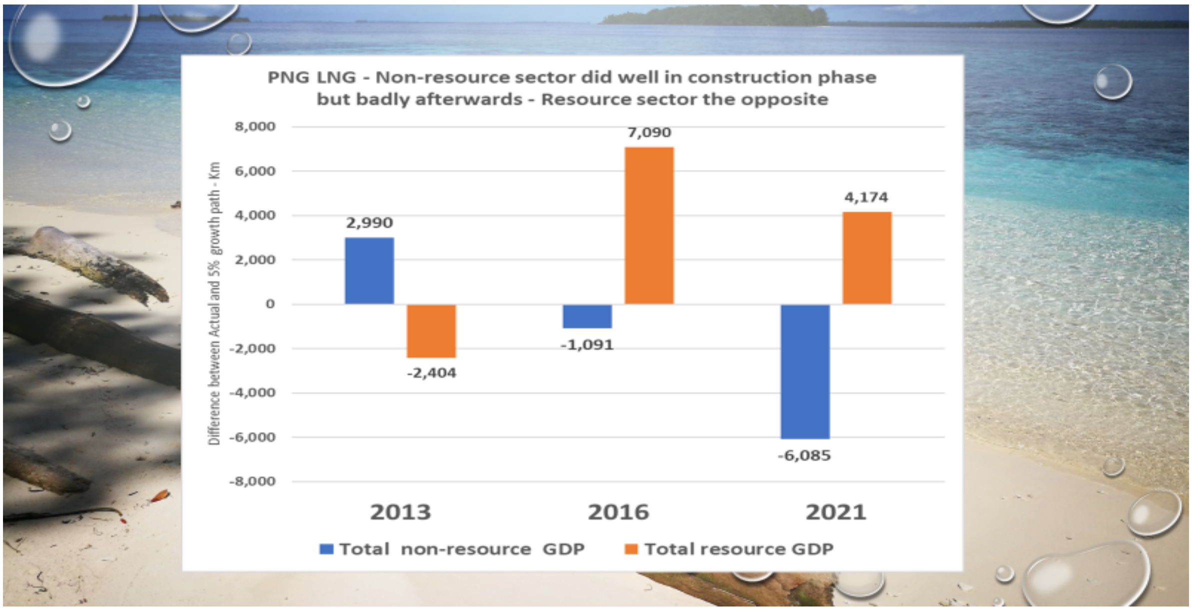
This is a very disappointing economic performance.

You will see from the graph that there was a period of turn-around during the 2000s. Being just a bit political, I note that this period was under a National Alliance government, building on the reforms of former Prime Minister Morauta. However, this upward trend has now been lost. We are going backwards again in per capita terms. Unfortunately, the people of PNG have not been told how badly things have been going in recent years. There has been a regular pattern of either not providing information or of putting a very rosy set of coloured glasses over possible numbers.



In contrast, the resource sector has done well – it has increased by over 100% per capita. But PNG is a highly dualistic economy – so what is good for the resource sector may not translate to what is good for the rest of the economy on which our people's livelihoods depends.

The most recent experience of the PNG LNG project highlights a possible adverse policy cycle loop between big resource projects and the rest of the economy. While still assessing the full details of the recent Jubilee Australia report, on the PNG LNG project, there does seem to be some logic here. While the non-resource economy did well during the construction phase, growth is now at very disappointing levels. Even official government figures project growth rates of some 2.5% per annum – this is pitiful, and less than population growth.



So how is this possible? Such a project should help the economy along. And of course there are hundreds of examples of benefits from the PNG LNG project – whether it be more local jobs than initially expected, or the help that Oil Search provides to the Tari hospital, or the contracts that are provided to local contractors (especially landowner companies).

Resource curse again

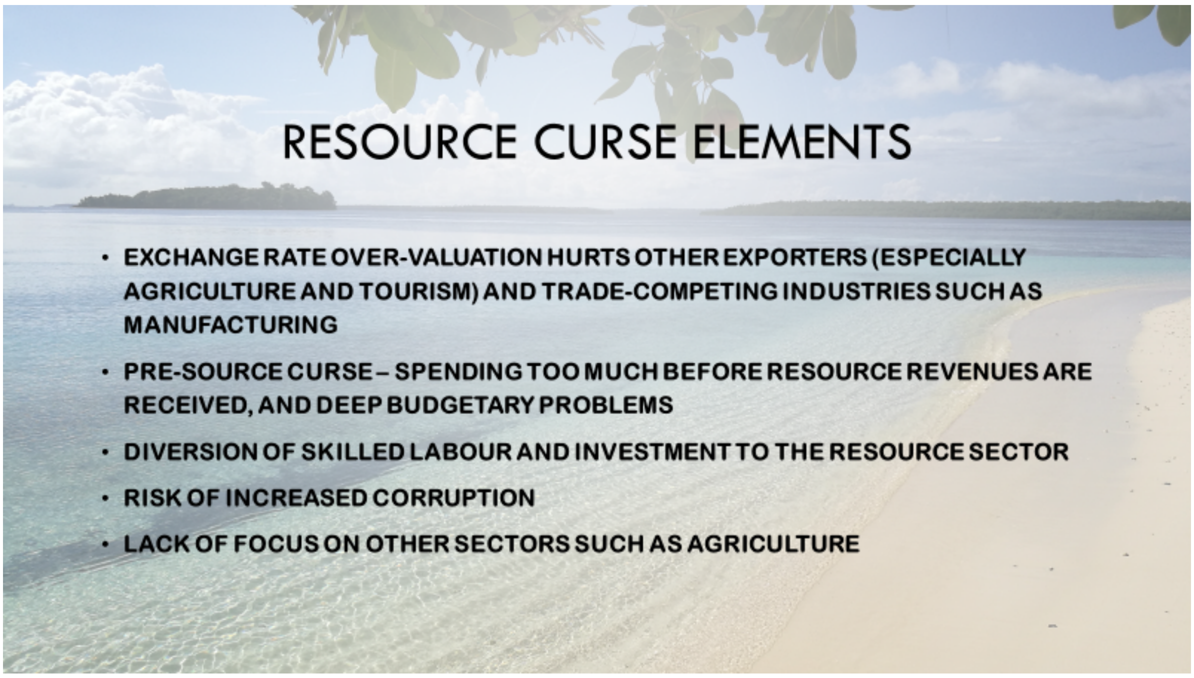
But the big picture perspective is that the non-resource economy is now performing worse than it was before the PNG LNG project. Why is this so?

The likely explanation is that PNG has fallen into what is known as the resource curse, yet again.

So despite what should be the great gains of natural resource wealth, the experience in PNG and many other countries, is that such wealth makes for poor economic outcomes.

Some of these resource curse distortions flow from the exchange rate – it becomes over-valued and hurts other traded sectors such as agriculture and manufacturing.

Some of the distortions result from what the International Monetary Fund (IMF) calls the “pre-source curse” – poor budget policy of rapidly increasing expenditure on false revenue assumptions – encouraged by some resource companies in their promises. PNG has had its worst experience since Independence, of irresponsible budget policy with budgeted expenditure increasing by an extraordinary 50% over the 2013 and 2014 budgets and a subsequent huge build-up in debt.



But there are also more subtle impacts of the resource curse. Skilled resources are attracted to the resource sector. The concentration of large profits increases the risk of corruption. My concern, reflecting on my experiences starting from 1997, is that these corruption pressures are becoming worse.

Too much focus is given to the resource sector. The political priority becomes securing the next resource project. For example, the Prime Minister recently announced the PNG negotiating team for the new Papua LNG project which includes the heads of Treasury, Prime Minister and NEC, along with relevant heads of resource agencies. Where is there a similar committee that meets regularly, to consider how to improve the agriculture sector – the key for the livelihoods of most of our people.

Good government means staying always focused on those areas that are most important for our people – and ultimately, that must come back to supporting our agriculture sector.

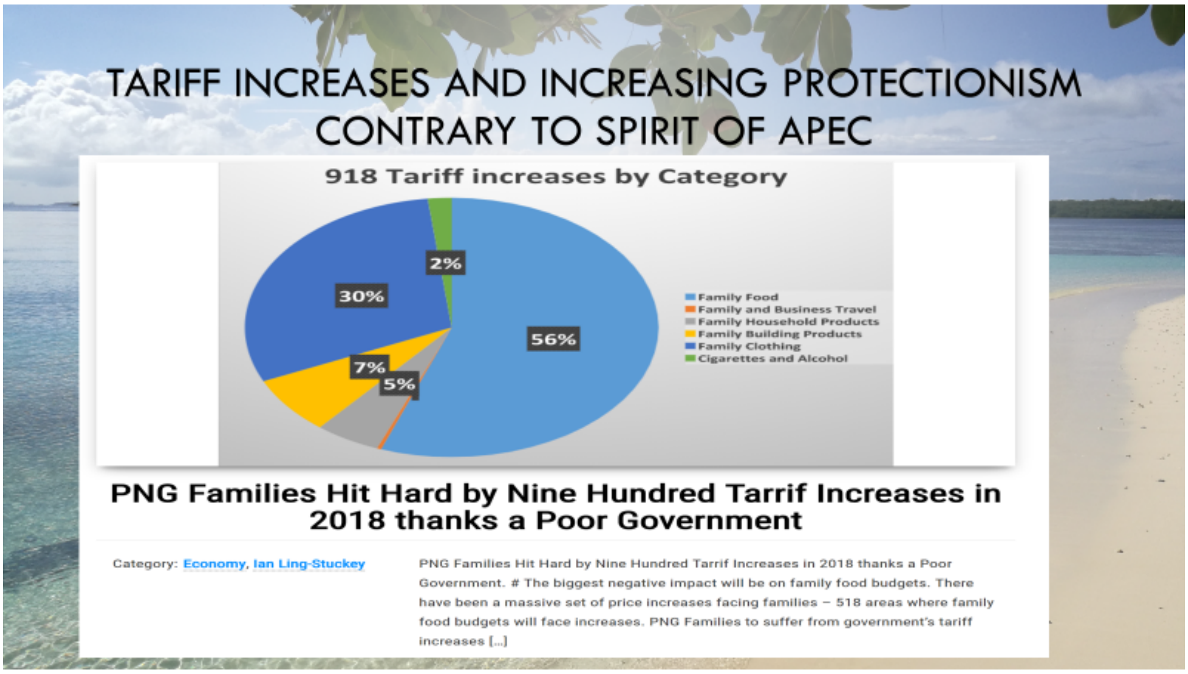
APEC opportunities

As the theme of this conference is around APEC, some quick comments. The Alternative Government believes that we must try and get the best out of the opportunities of APEC. There are real possibilities for showcasing our country. We are very willing to work with the government, to get the most out of this very expensive meeting.

And this is an issue– APEC will be an expensive meeting, both in terms of actual expense to PNG and other donors, but also in terms of being a major distraction to other policy priorities.

One warning is "Beware of false promises". This slide shows some false promises around the South Pacific games. Now I'm a supporter of such games – and I'm proud that I was able to win three gold medals for our country, in the 1983 and 1987 South Pacific games. But the costs of the most recent games were over the top – and we are still waiting for some of the buildings to be completed. We must be realistic in our expectations.

There is also the hypocrisy of our hosting a meeting, which has its focus on building trade and investment links between countries, while PNG introduced over 900 tariff increases. We are becoming less open to trade in both a policy sense, as well as in reality, because of the foreign exchange shortages.

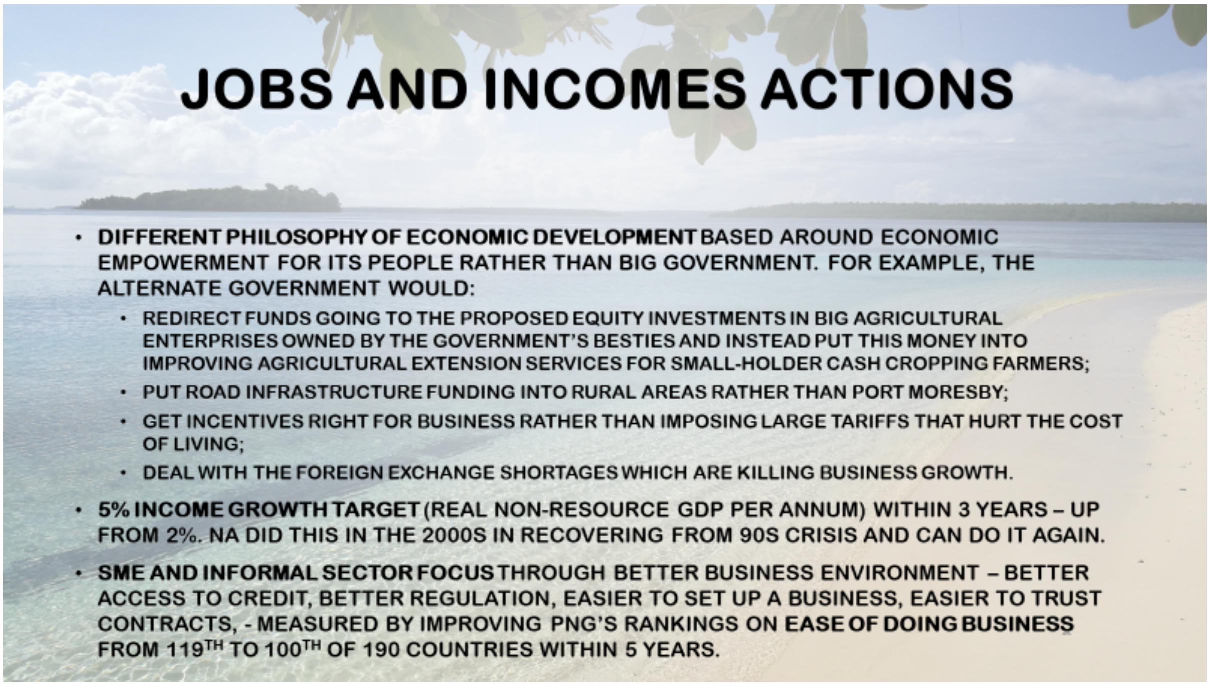


The real issue for PNG and APEC is "What else could we have done instead?" APEC may be a positive for the country, but the real cost of APEC means a lack of focus on other areas, to advance our people's well-being.

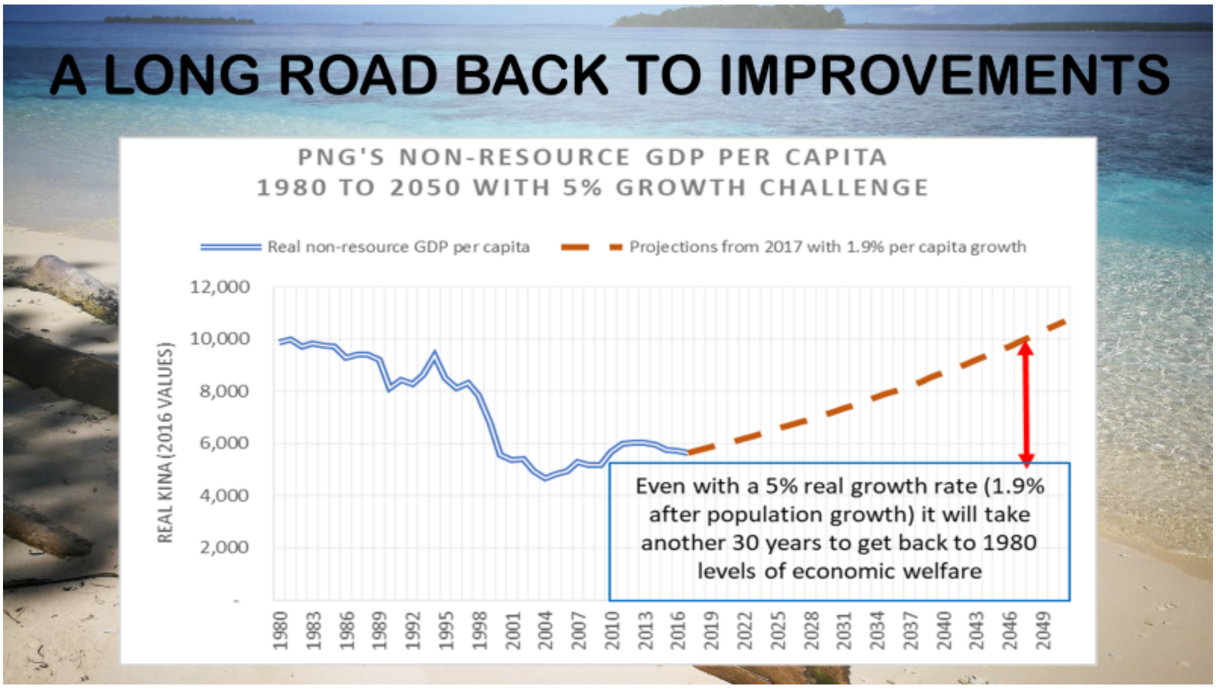
I have no doubt that visiting APEC delegations will be enormously impressed with PNG and what it has to offer. But we need the policies in place to translate this opportunity into reality. Unfortunately, PNG does not have the right policies in place to encourage investment.

Jobs and growth

So what policies are needed to encourage investment and tap into the opportunities of APEC?



Fundamentally, we need policies that can lift PNG's growth in non-resource GDP to at least 5% per annum. This is the minimum required to start getting jobs growth going again, and to boost government revenues to help meet our urgent development needs. Even a 5% real non-resource GDP target is only a small level above our population growth rate of 3.1% - a level that is too high and should be reduced to more sustainable levels.

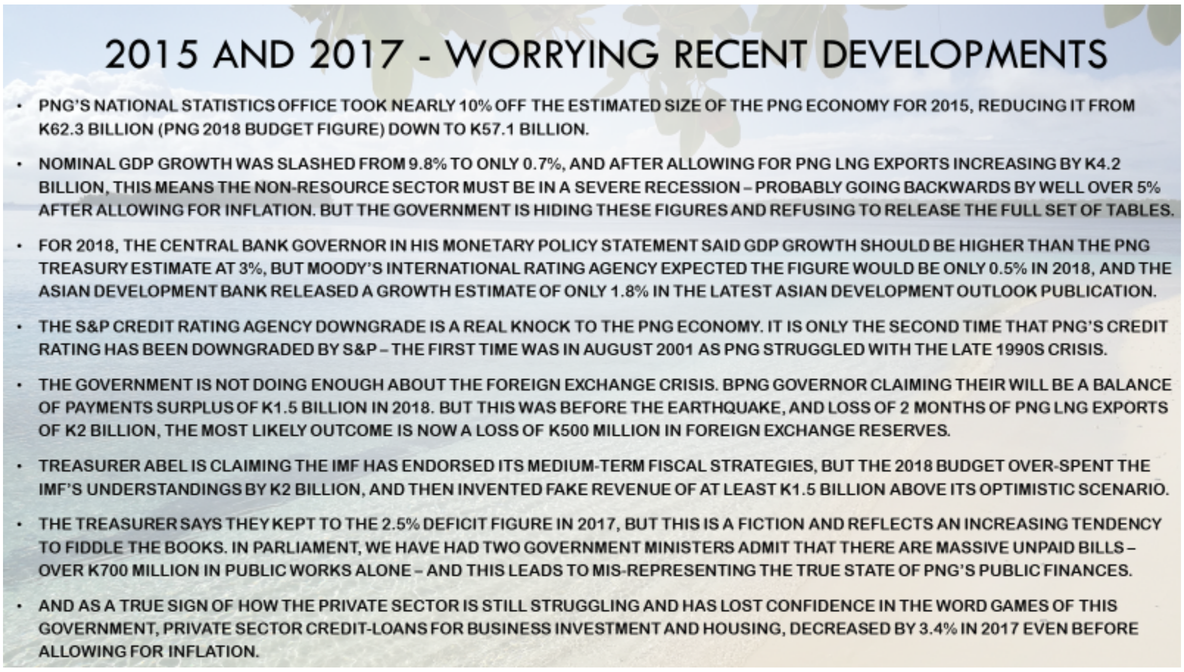


This will be a long trek. So as indicated by the dashed red line, it will take about another 30 years just to get back to the level we had in 1980 – to recover from having gone backwards by a third. Possibly we should set our sights even higher, but as a pragmatic business person, given our recent history, we should start to walk before we try and run.

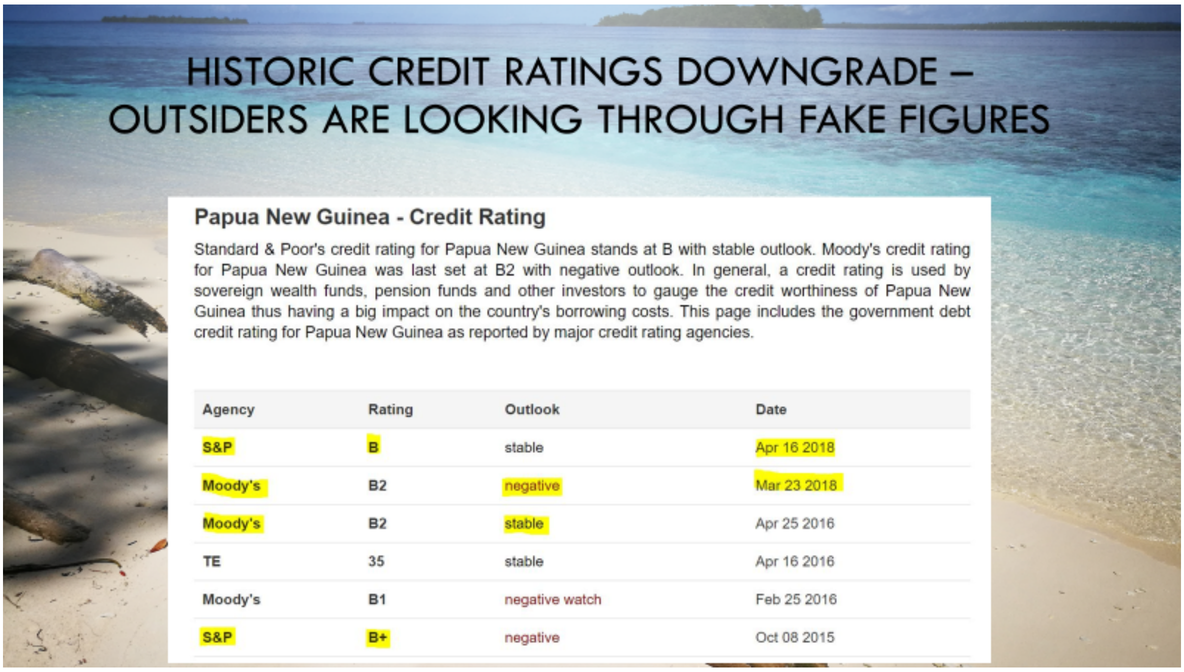
So how are we doing? We have heard one view this morning that there are economic challenges driven primarily by the fall in commodity prices. The argument was that things are now being done to fix things, and despite low growth projections of only 2 to 3% for the next few years, there is a possible boom ahead following the APEC meeting and new resource projects.

My message is a much more cautious one. Things in PNG have not been going well. We don't know how bad things are because key pieces of information are being suppressed, or we have simply stopped measuring certain inconvenient facts. Talk of a super-cycle from new projects raises the risk again, of yet another boom/bust cycle and falling further into the resource curse.

The next slide highlights some of the current problems. Three years out from the fall in commodity prices, we are still struggling. At some time, and this should have been two years ago, the government should have stopped blaming the fall in commodity prices or the drought. Remedies have taken too long and our people continue to suffer.



How are we viewed externally? In March and April, so after the 100 Day Plan, after the 2018 Budget, and after the early release of the 2017 Final Budget Outcome, two international credit ratings that survey our economy have either downgraded PNG's credit rating or put us on negative watch. This has never happened before. People looking from the outside are looking through budget numbers and saying things are not going well, and they don't trust the current government's so-called fixes.



Papua New Guinea - Credit Rating

Standard & Poor's credit rating for Papua New Guinea stands at B with stable outlook. Moody's credit rating for Papua New Guinea was last set at B2 with negative outlook. In general, a credit rating is used by sovereign wealth funds, pension funds and other investors to gauge the credit worthiness of Papua New Guinea thus having a big impact on the country's borrowing costs. This page includes the government debt credit rating for Papua New Guinea as reported by major credit rating agencies.

Agency	Rating	Outlook	Date
S&P	B	stable	Apr 16 2018
Moody's	B2	negative	Mar 23 2018
Moody's	B2	stable	Apr 25 2016
TE	35	stable	Apr 16 2016
Moody's	B1	negative watch	Feb 25 2016
S&P	B+	negative	Oct 08 2015

Our required actions to get growth going again, and to make the best of the opportunities of APEC, can be found in recent surveys about what makes it hard to do business in PNG.

According to our Institute for National Affairs, the latest business survey indicates the greatest current barrier to doing business in PNG is foreign exchange shortages. Having to go begging to your bank for even basic payments to overseas customers, makes it really hard to grow your business - or just keep afloat! Additionally, any business person who currently invests in this country cannot take any profits back out. People will simply not invest in PNG, at the level we want, if people can't get their money back out. An APEC meeting does not deal with this fundamental barrier to investment.

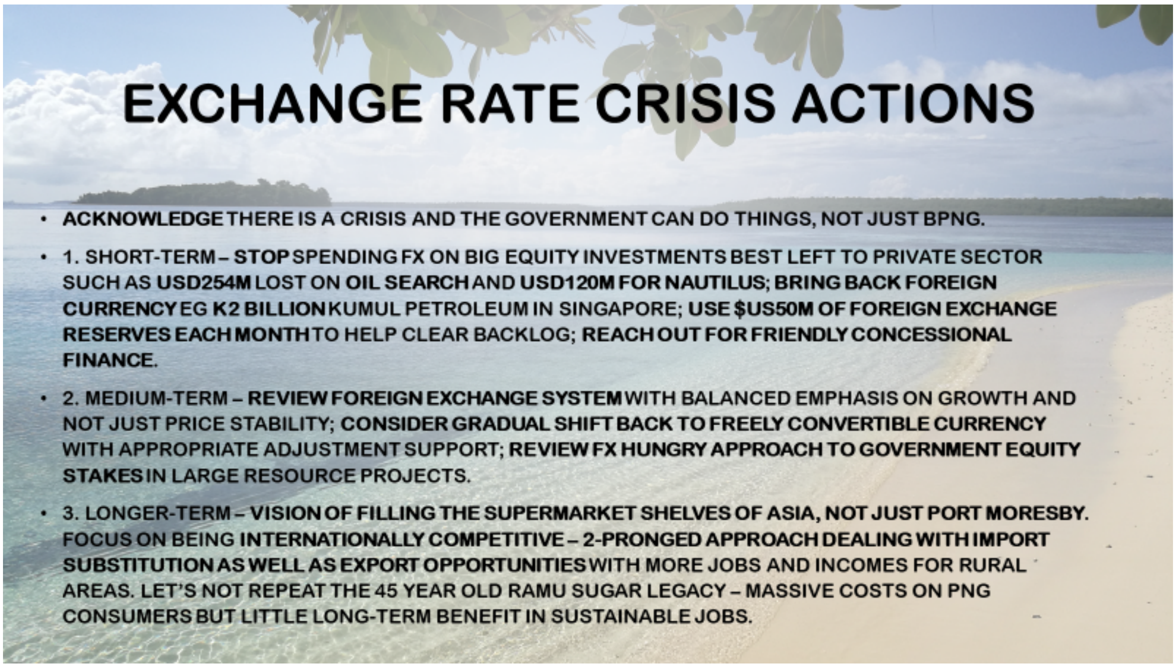
Decisions on investment also must be realistic about other barriers to doing business in PNG. There is a need to sit down with the business community and identify the highest priority five things that can be done to start improving business conditions. Sometimes these changes will be simply about making better regulations. Some actions will require longer-term planning, such as building our police force up to the average per capita size of other countries, and undertaking a major infrastructure program.

A sad fact is that in 2017 lending to the private sector actually fell by 3.4% - so a decline of around 8% after allowing for inflation of 4.7%. Turning this around can include specific actions. However, fundamentally this is about trust. We need to re-build trust – trust that the government procurement system will not be manipulated to serve the interests of besties; trust that if one has a business contract, that payments will be made; trust that power and water will be available at reasonable prices; trust that foreign exchange is freely convertible; trust that taxes won't suddenly be increased to unreasonable levels. People have lost trust in this government.

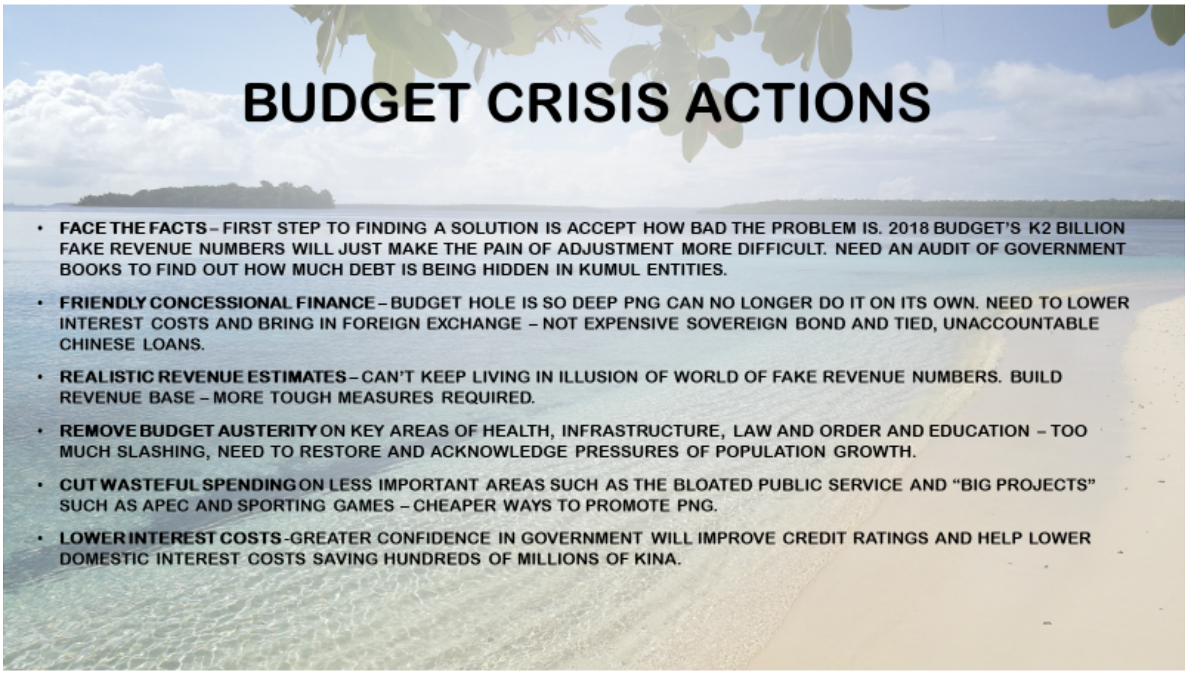
Exchange rate crisis

This conference will certainly cover the ongoing foreign exchange crisis in later presentations. Suffice to say that, 70% of PNG business CEOs regard it as the greatest barrier to doing business in PNG. This is the crisis that was most avoidable. Why on earth did Bank of Papua New Guinea (BPNG) move away from a fully convertible currency in June 2014? While easily avoidable then, nearly four years later, it is now much harder to fix.

Once again, the Alternative Government has a set of policies to correct the problem – some short-term, some longer-term. These are set out in this slide. For example, there is scope to immediately release $US50 million per month of foreign exchange reserves as we transition back to a more fair value exchange rate over 12 months. We need to review our Central Bank Act, as clearly it has not served us well enough over the last six years, as reflected by foreign exchange shortages, lack of growth in private sector credit, and declining central bank independence, reflected by its printing of money to fund the deficit through the "slack arrangement". We need to re-shape our economy so that it is more growth orientated and more open and truly willing to engage in international trade, in line with APEC goals. Our vision is PNG filling the supermarket shelves of Asia with PNG produce, not just the shelves of Port Moresby.



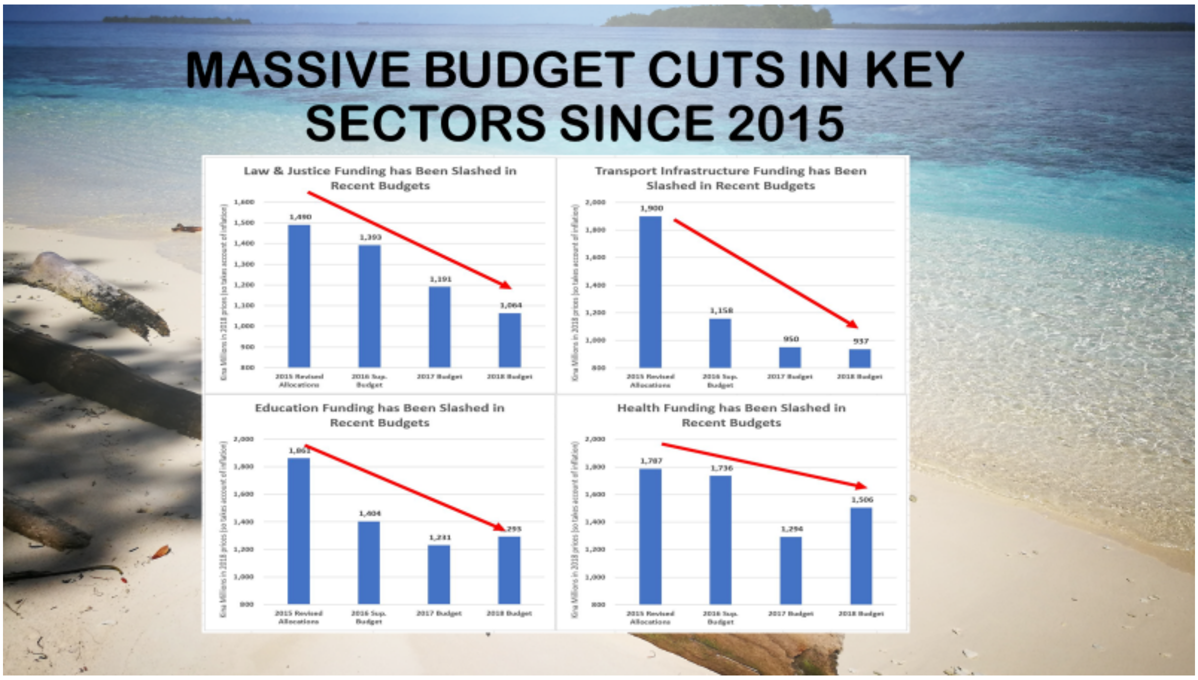
Budget crisis



Almost every day when we wake up there is a further sign of this country's budget and cash crisis – teachers not being paid, shortages of medicines, contractors not being paid, departments being locked out due to non-payment of rent, Tuition Fee Free (TFF) payments running months and months late. PNG is facing a massive cash crisis – one that has been going on for years - and one that has been going on for too long!

The underlying cause is, of course, poor budget policy. PNG has had its largest set of budget deficits in its history, over the last six years. This has inevitably increased debt massively (from K8.0 bill in 2012 to K24.0 bill in 2017). It has also increased interest costs from under K400m per annum in 2012, to over K1,600 million in 2017. And that is only the debt we know about! We know that more debt is hidden in State Owned Enterprises, and there are other unfunded liabilities such as superannuation for our public servants.

Unfortunately, the solution here is made more complicated because the budget numbers have become increasingly untrustworthy. As some of you may know, the Alternative Government considers the 2018 budget to be built on unrealistic revenue projections – this is why we claim it is a fake budget. The detailed reasons for this are set out in my 2018 budget reply speech. The more recent Final Budget Outcome statement is also of great concern. Politically, it is simply too convenient to meet a detailed number such as 2.5% budget deficit within 0.1%. Inap Nau! I know that that the Treasurer would simply claim good management, but I know that there are big games that can be played in a cash based budget, by simply delaying paying for expenditures, delaying tax refunds and deciding not to pay for some important things such as superannuation and education.



We also need to be spending funds effectively, accountably and on the right things. This slide shows extraordinary cuts in health, education, infrastructure spending and law & justice since 2015, which are undermining key investments in our country's future. Although the 2018 budget claimed it will restore some health funding, it will most likely lack the revenue to do so.

Instead, we have seen massive increases in pay for public servants, and a massive increase in interest costs. These are not priority areas – they ultimately represent serious economic mismanagement.

There has also been a major increase in district support programs. I am a supporter of such programs – I believe that these funds can be spent well and more in line with local needs, especially given the demonstrated failure at the national level. However, there must be good management of these funds and much better accountability for how the funds are used. I personally think it's time for a review of the District Support Improvement Program (DSIP), and fast!

Alternative Government policies

I do not want to be too political today. I do, however, encourage students to read the detailed policies the Alternative Government is proposing, to deal with our jobs and growth crisis, our foreign exchange crisis and our budget crisis. More detail is provided in my budget response speech. More detail on government policies is also provided on the Alternative Government website.

Conclusion

There is no magic wand. Our problems are deep – and they have been building up and distorting incentives for the last six years. Taking an even longer perspective, PNG started on a development path that has, for too long, put too much hope on the resource sector or some grand project, such as an APEC meeting.

We need a better development path, one that puts the emphasis back on inclusive development and our people. We need to escape from the resource curse. Fundamentally, this means we must do much more for our agriculture sector, including our subsistence agriculture sector. This will require better policies than the current economic mismanagement.

It will also require more local leaders and honest leaders, who are genuinely interested in the wider well-being of our people. It will require more economists and other professions that can be trained, and then learn to speak out. Such people are in this room. You are our future. May you study hard, and bring a passion for making a better PNG!

When you're visiting Kavieng next, on your break, send me a text and perhaps, join us for a swim at beautiful Lemus Island.

It was nice coming back here today. Thank you.

2018 PNG economic survey

Rohan Fox, Stephen Howes, Nelson Atip Nema, Hoai Bao Nguyen and Dek Joe Sum

Nelson Atip Nema, Rohan Fox and Stephen Howes answering questions on their presentation of the 2018 PNG economic survey.

Abstract Based on the latest National Statistical Office (NSO) figures, the non-resource economy contracted in 2015 by 3.1% after inflation. Whether the economy has started to grow again since 2015 is unclear. While imports and tax data show growth in 2017, credit to the private sector contracted in the same year. Formal sector employment has contracted four years in a row since 2013, with a cumulative decline extending through to the end of 2017 of 7.0%. Underestimation of the severity of the economy's contraction has contributed to an absence of an appropriate policy response to what can only be described as an urgent economic crisis. The government's emphasis is on fiscal correction and now tariff protection. A limitation of this strategy is that it fails to provide any stimulus to exporters and is inadequate to tackle the primary problem facing the PNG economy, namely the shortage of foreign exchange, which is worsening. Two separate surveys of business show that foreign exchange shortages are the most important problem they face, that they have increased in severity and have displaced other longer-standing concerns around corruption, law and order and visas. There is no way around the need for a substantial devaluation of the currency. While a devaluation would reduce the demand for foreign exchange and provide a boost to the economy, for it to have a lasting impact it will need to be accompanied by a range of structural and governance reforms to reduce the cost of doing business and promote economic recovery in PNG.

Acknowledgments The authors thank all who provided time, advice and comments on this paper, including two peer reviewers.

1. Introduction

The ANU-UPNG surveys provide an annual review of the PNG economy. This survey covers the year to June 2018, and is the fifth in this series. As well as providing the usual update on economic growth and fiscal and macroeconomic developments, this survey has a focus on trade policy, where there has been a major shift in direction, and on the changing perspectives of the PNG private sector. As with past surveys, the research for this survey includes a large number of interviews with businesspeople, officials and economic experts. Our thanks to all.

The most recent official data imply that, once the resource sector (which is made up of all PNG's petroleum, gas and mining projects) is excluded, the PNG economy contracted by 3% in 2015. Given the lack of accurate recent data, it is unclear whether the PNG economy is still in a recession. However, formal sector employment has fallen for four years in a row, from 2013 to 2017. Surveys of business show that the extent and duration of the economic tough times were unexpected.

The government's main response to the economic slowdown has been fiscal consolidation to prevent a debt crisis. Expenditure has been slashed, and continues to fall. Last year, a second bow was added to the government's economic policy: protectionism, with planned tariff reductions being shelved, and instead wide-ranging, albeit moderate tariff increases implemented.

Neither policy directly addresses the single most important reason for the extended duration of the PNG recession: namely, shortages of foreign exchange, which remain acute, and which businesses consistently label their top constraint. Tackling this problem requires a devaluation, which would provide a stimulus to exports as well as import-competing industries.

Section 2 looks at recent economic growth trends and outlook. Section 3 examines fiscal trends and the macro position. Section 4 analyses private sector policies and perspectives. Section 5 concludes.

2. Growth

PNG is a resource dependent economy. Much of the resource sector – which makes up 30% of Gross Domestic Product (GDP) – is foreign-owned, and a large share of the benefits flow offshore. For such an economy, GDP is a misleading indicator of national economic activity. Gross National Income (GNI) would be a better indicator for PNG, but is unavailable. In such circumstances, the best indicator of the economy's health is non- resource GDP (sometimes called "non-mining GDP"), that is, GDP excluding the output of the mining and petroleum sectors, but including their spillover effects (e.g. through taxation and private domestic spending).

After surveying the evidence, Howes and Nema (2016) concluded that:

> … it is hard to believe that the non-resource economy has *not* been contracting

in 2015 and 2016. Certainly GDP grew in 2015 thanks to strong LNG export growth. But it should not surprise us if the end of the LNG construction phase and the fall in commodity prices led to a contraction in the non-resource economy. Employment, imports, tax revenue and qualitative evidence all seem to point in this direction.

This was written at a time when the only estimates available for non-resource GDP in 2015 and 2016 showed positive albeit weak growth. The most recent estimate from Treasury, in the 2018 budget, showed growth of 0.7% in the non-resource sector and overall GDP growth of 10.5% in 2015. But in March the PNG National Statistical Office (which receives technical support from the Australian Bureau of Statistics) released its 2015 estimate for GDP. The NSO (on its website) now says that real growth in GDP in 2015 was not 10.5% but 5.3%. The increase in GDP reflects the fact that 2015 was the first full year of LNG production – this resulted in a large increase in resource output But sectoral figures from the NSO (available, but not on the website) show that non-resource GDP fell by 3.1% in 2015.

Table 1: Estimates of GDP, resource GDP and non-resource GDP real growth for 2015

	GDP growth	Resource GDP growth	Non-resource GDP growth
2017 estimate (Treasury)	10.5%	48.3%	0.7%
2018 estimate (NSO)	5.3%	39.0%	-3.1%

Source: PNG Treasury (2017) and NSO (2018).

As we suggested back in 2016, it is hardly surprising that non-resource GDP growth was negative in 2015. After all, construction for the mega PNG LNG project finished the year before. That construction, which was carried out over 3-4 years, was valued at $19 billion, which is about equivalent to PNG's GDP. The removal of that stimulus must have placed significant downward pressure on GDP, both direct and indirect. In addition, 2014 was the year in which government revenue peaked, with revenue falling partly due to economic contraction but also due to a drop in commodity prices. The resulting fiscal contraction would have also caused a contraction in non-resource GDP.

In addition, and again as we noted in 2016, there were several signs of negative growth: not only falling tax revenue, but plummeting import demand, falling employment, and accounts by businesses themselves.

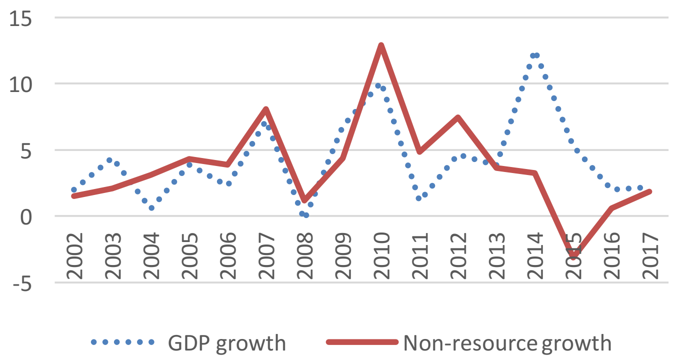
What is more surprising is that this contraction in GDP has taken so long to be recognized in government statistics. It is a very unusual situation to have such a drastic revision to GDP growth numbers. The downgrading of GDP growth from 10% to 5% is not due to a rebasing. In fact, it is not clear what the source for the difference is, other than that one estimate comes from NSO and one from Treasury. However, given that NSO receives support from ABS, the NSO estimates are more credible.

The IMF, the World Bank and the ADB also missed the non-resource recession that is now shown in the official data. The ADB does not report non-resource GDP growth. The IMF and the World Bank do, and their latest figure did deviate slightly from Treasury estimates. Whereas the Treasury had a figure of 0.7% for real non-resource GDP growth in 2015, the World Bank and IMF had growth of about -0.2% (IMF 2017;

World Bank 2017). Nevertheless, the fact remains that the IMF and World Bank figures were much closer to the Treasury than the new NSO estimates.

The only data available for GDP growth for more recent years than 2015 is from Treasury. This shows a modest recovery in the non-resource economy post-2015 (Figure 1). However, since Treasury GDP data has been unreliable in the past, we also need to look elsewhere.

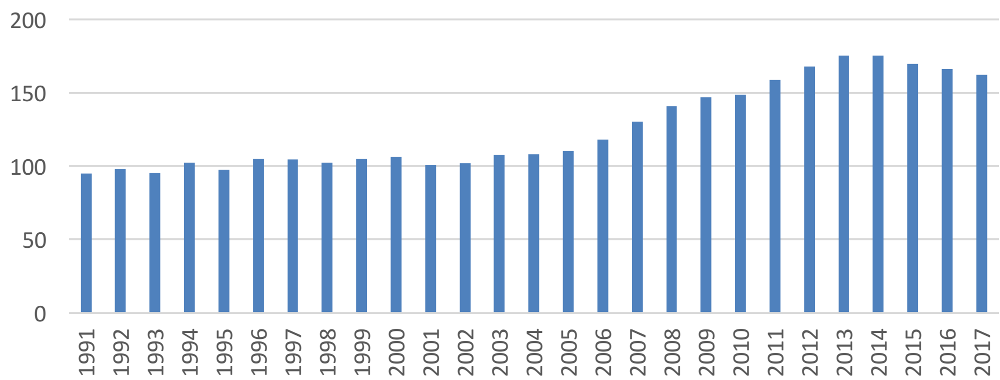
Figure 1: GDP and non-resource GDP growth, 2002-2017, adjusted for inflation



Source: Development Policy Centre (2018) based on PNG Treasury budget documents, except for 2015, for which see Table 1.

Formal sector employment data is released by BPNG every quarter, with a lag of six months or less. The BPNG shows negative growth in formal sector employment for four years, starting in 2013 – see Figure 2.

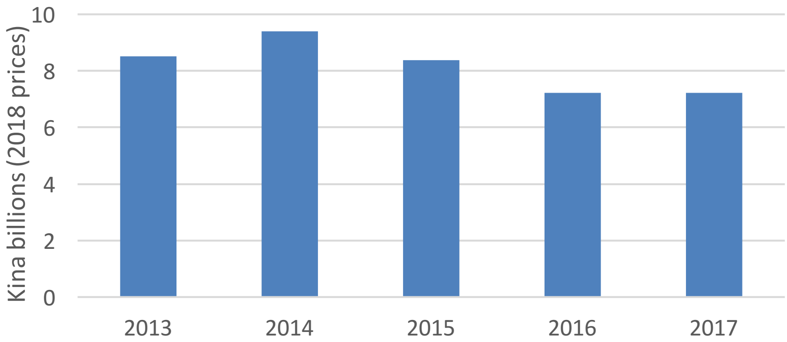
Figure 2: Formal sector employment (March 2002=100)



Source: BPNG, as of March 2018 QEB.

Whereas the employment data suggests a continuing recession, some other data suggests further contraction in 2016, but some recovery in 2017. Figure 3 shows that the three large economy-wide taxes (income tax, non-resource corporate taxes and GST) fell sharply in 2015 and 2016, but stabilized in line with inflation in 2017.

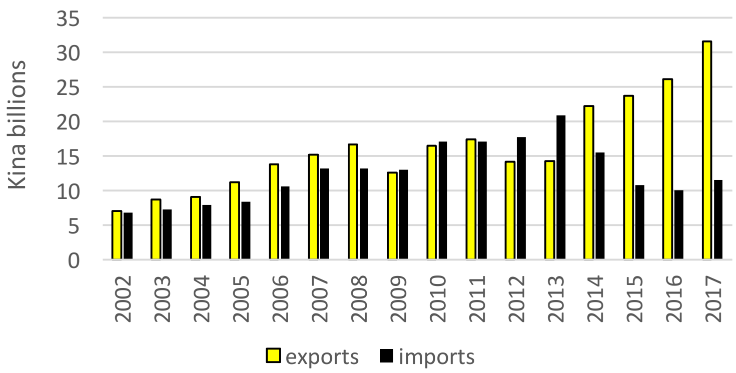
Figure 3. Economy-wide taxes, adjusted for inflation



Source: PNG Budget Database.
Note: Economy-wide taxes are income tax, corporate tax and GST.

Figure 4 shows that imports also recovered in 2017 after three years of decline. Exports continue to grow strongly, driven by the PNG LNG project and recovering commodity prices. This supports GDP growth but not non-resource GDP growth because resource revenues mainly go off shore, resulting in a massive current account surplus and current account deficit (Figure 16).

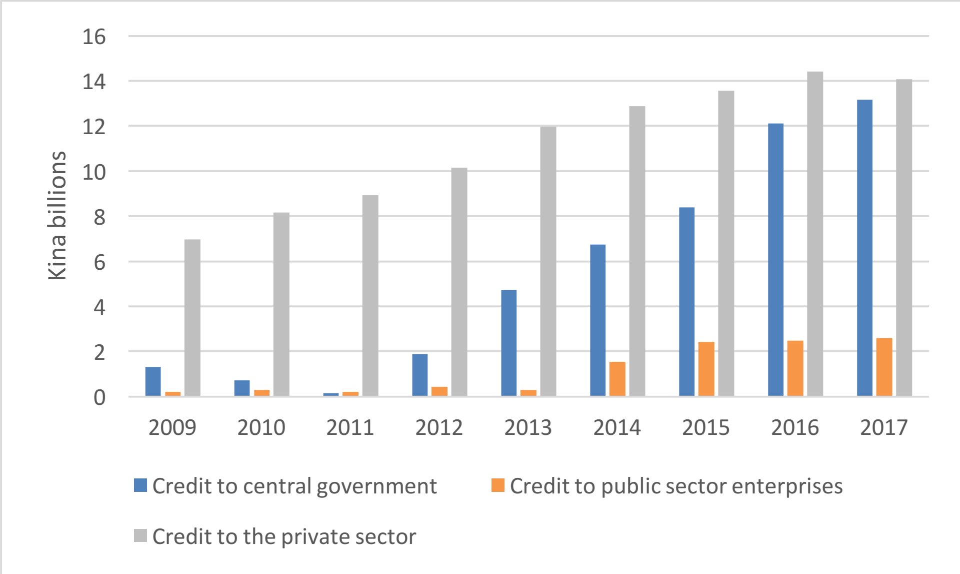
Figure 4: Exports and imports of goods and services



Source: BPNG, as of March 2018 QEB.

However, other data for 2017 is less positive. Figure 5 shows that nominal credit to the private sector fell for the first time in 2017. Growth in credit to the public sector, which has been strong in 2014 and 2015, has also petered out. The rapid increase in "net claims on central government" reflects the deficits of recent years, and build up in government debt, discussed in the next section.

Figure 5: Credit to the private and public sector



Source: BPNG, as of March 2018 QEB.

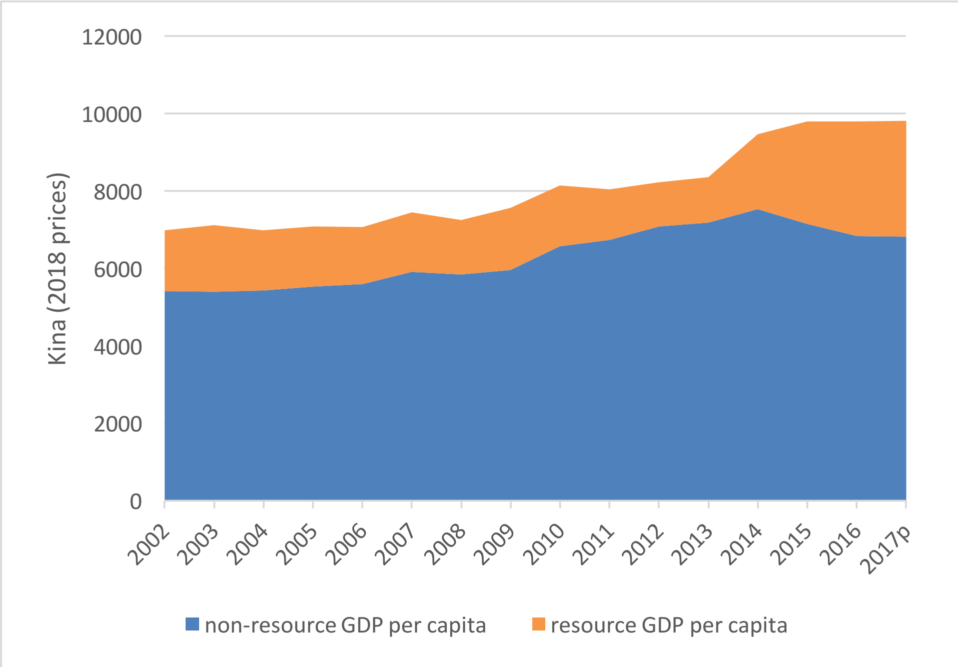
Most businesses we interviewed were still worried about business conditions. The most important constraint on growth, foreign exchange shortages, shows no sign of weakening (see the discussion in Section 4.2). Annual reports of major businesses talk of "the weak economy" (Steamships 2017, p.6). Steamships provides a good monitor of the economy because of its diversified nature, with operations in property, transport and food and beverages. Its turnover has fallen every year since 2014, including in 2017 (Steamships 2017, p.4). Businesses also reflected concerns about the state of infrastructure. Lae businesses were especially concerned about the Highlands Highway.[1]

In summary, we expect that when NSO releases figures for 2016, it will again show negative non-resource GDP growth, but it is unclear whether the recession is over.

Figure 6 shows what the latest GDP numbers mean in per capita terms. Adjusting for inflation, non-resource GDP per capita in 2017 is estimated at K5,168, which is back at 2010 levels, and a 9.4% decline relative to the 2014 peak. Over the commodity cycle, average annual per capita growth is 1.3%.

[1] There is a major ADB project in the pipeline to rehabilitate the Highlands Highway but it is yet to get underway.

Figure 6: Real GDP and non-resource GDP per capita



Source: Development Policy Centre (2018) based on Treasury budget documents; NSO national accounts. Notes: Treasury documents used for 2002-2013; 2014 and 2015 use NSO figures (as per Table 1); 2016 and 2017 are calculated by multiplying 2015 NSO GDP by real sectoral growth rates for 2016 and 2017 found in the 2018 Budget. Population from World Development Indicators.

Views on the growth outlook are mixed. Treasury forecasts GDP growth of 2.4% for 2018, and approximately similar rates for subsequent years, with non-resource growth projected at about 3.5%. (The resource sector is not projected to grow.) Given current trends, and the lack of economic stimulus, such projections may be over-optimistic. The holding of APEC this year in PNG is expected to deliver a modest, temporary stimulus. The government has a strong and welcome rhetorical focus on economic diversification, but the pursuit of this goal is hampered by the high costs of doing business and the over-valuation of the currency in particular (see Section 4.2). Businesses we spoke to were not optimistic, and those in Lae, PNG's business capital, forecast more job losses.

Some predict much more rapid growth in later years with various resource projects in the wings. However, the understandable desire to renegotiate fiscal terms (as discussed in the fiscal section), as well as various proposed, controversial revisions to the Mining Act, and other environmental and social issues will slow down the progress of pipeline projects to construction. It also needs to be recalled that older projects will reduce production over time, so newer projects are needed just to replace them.

3. Fiscal trends and macroeconomic update

In April, Standard & Poor (S&P)'s downgraded its sovereign (long-term, foreign currency) credit rating for PNG from B+ (negative outlook) to B (stable outlook), citing slower than expected economic growth and revenues, and rising government debt. This moved PNG down from the top to the middle tier of the three S&P "highly speculative" ratings, which is the category above junk bond or "substantial risks" status. The S&P downgrade was also reflected in a downgrade by the same agency to the credit rating of Bank South Pacific (BSP), due to its high level of PNG exposure (BSP, 2018).

Moody's had already downgraded PNG's sovereign credit rating from B1 to B2 (equivalent to S&P's B) in April 2016, and it downgraded the outlook in March of this year from stable to negative. These rating downgrades are indicative of the chronic and severe macroeconomic problems the country is facing.

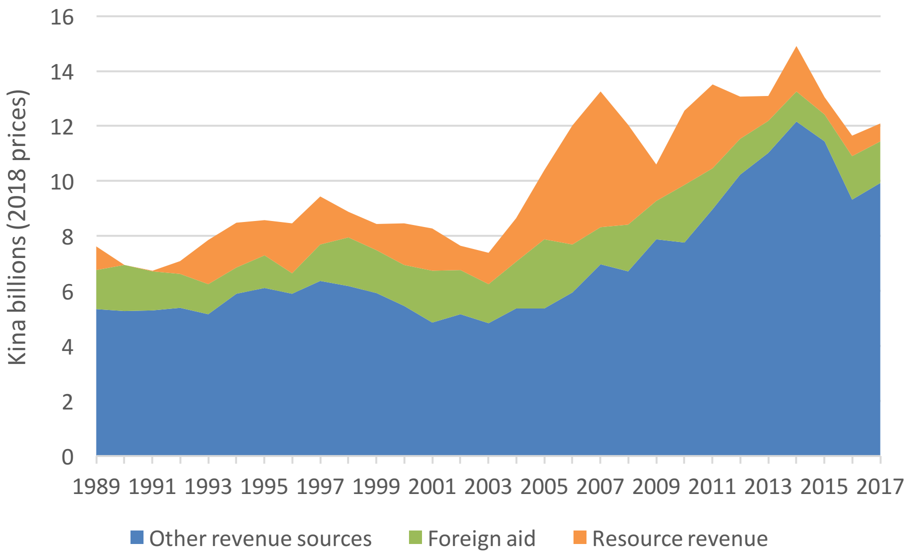
The next sub-section looks at fiscal trends, and the following one at inflation, the balance of payments and the exchange rate. These topics were covered in detail in the previous survey (Fox et al. 2017), much of which remains relevant today.

3.1 Fiscal trends

Revenue in 2017 was 3.8% higher than in 2016 after inflation, and the first year in which there was even nominal growth in revenue since 2014. However, revenue was still below 2015 levels, and in historical terms equal to revenue some ten years earlier.

Figure 7 divides revenue into three main types: foreign aid, resource revenue, and everything else. We consider each in turn.

Figure 7: Government revenue: resource revenues, foreign aid and other revenue resources



Source: Development Policy Centre (2018).

Resource revenues have almost been reduced to fiscal irrelevance in PNG. The IMF has concluded that PNG's tax treatment of the resources sector is relatively generous by international standards.[2] Since 2015, resources revenues (corporate taxes and dividends from mining and petroleum) have been at their lowest level since 1992. Accelerated depreciation and tax holidays mean that new projects such as PNG LNG (accelerated depreciation) and Ramu NiCo (accelerated depreciation and tax holiday) pay no or virtually no resource revenue. But it is surprising that even older projects are paying very little revenue, and more analysis is required. The country's two biggest mines are Lihir (which began in 1997) and Ok Tedi (which began in 1984). As Table 2 shows, Lihir is still very profitable, but according to PNG Extractive Industry Transparency Initiative (EITI) reports (PNG EITI 2015, 2016, 2017), has paid virtually no corporate tax since at least 2013. Ok Tedi is still a major tax payer (except for 2015 and 2016 where earnings were hit by the drought which caused it to temporarily cease operations), but is much less profitable than it used to be.

[2] "...[T]he tax arrangements for PNG's mining and petroleum sectors are very generous compared to other resource rich countries and do not reflect the maturity of the PNG resource sector." (IMF 2016, p.9)

Table 2: Income, expenses and earnings for Lihir Gold and Ok Tedi mines (USD)

	2011	2012	2013	2014	2015	2016	2017
LIHIR GOLD							
Revenue	887	964	961	1055	1020	1035	1181
Operating expenses	293	313	421	702	857	638	639
Depreciation & amortisation	106	97	126	221	192	198	259
Earnings before income and tax	488	554	414	132	-29	199	283
OK TEDI							
Revenue	1895	1615	1176	965	400	649	996
Operating expenses	844	864	895	645	502	415	542
Depreciation & amortisation	187	116	245	128	87	64	76
Earnings before income and tax	864	635	36	192	-189	170	378

Source: Newcrest and Ok Tedi Annual Reports 2011-2017.
Note: Earnings before income and tax is revenue minus operating expenses minus depreciation.

PNG is a developing country, and foreign aid still provides a considerable portion of the government budget. Though there has been a recent recovery, aid is relatively stable in real terms.

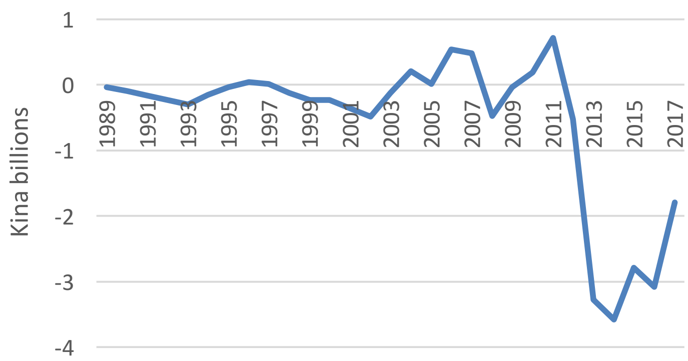
Finally, non-resource non-aid revenue in 2017 ("other revenue sources" in Figure 7) was higher after inflation than in 2016, but still lower than in 2015. As discussed earlier (Figure 3), the three main taxes – personal income tax, company tax and GST – increased in line with inflation. Non-resource non-aid revenue did better due to significant increases in dividends from statutory authorities, and increased revenue from imports, gambling and international travel. The government projects a further significant increase in non-resource non-aid revenue in 2018, largely on the back of increased payments from statutory authorities: those with independent revenue have now been forced to hand most of it over to the government.

Expenditure is constrained by not only poor revenue performance but also by the need to control government borrowing. Figure 8 shows that, even though the fiscal deficit has fallen since its 2014 high, the five deficits between 2013 and 2017 are still all much larger than any other in PNG history.[3] PNG struggles to raise the debt it needs, and is reliant on lending from the Central Bank, and planning to borrow more off-shore.

There is a huge volume of expenditure arrears. For example, in April 2018 the Works Minister indicated that "around K700 million in outstanding invoices are owed by the National Government to contractors involved in road maintenance projects around the country." (Loop PNG, 2018). In such a context, the deficit is an arbitrary figure which can be adjusted simply by not paying outstanding bills or tax refunds. The government is now targeting a zero non-resource primary balance. The deficit is projected to be roughly constant in nominal terms in 2018 and 2019, and then decline to K1.3 billion by 2022.

[3] This is clearly true in nominal terms as Figure 8 shows. But it is also true if deficits are adjusted for inflation. As a ratio of GDP, however, the deficits of 1981 and 1982 and of 1992 and 1993 are comparable to that of 2017.

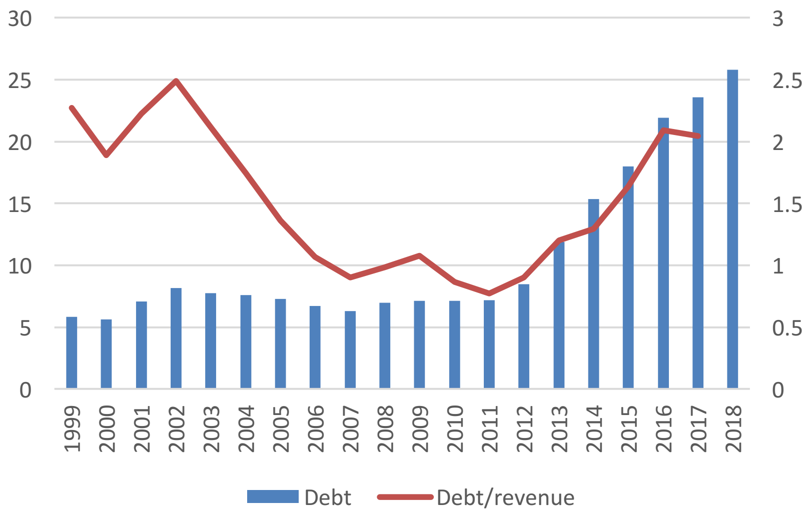
Figure 8: Government budget balance (nominal revenue minus expenditure)



Source: Development Policy Centre (2018).

Debt and interest payments are rising rapidly. The ratio of debt to revenue is slightly below pre-boom levels (Figure 9). (Note that the debt figures exclude all the arrears that have accumulated, as well as off-balance-sheet public-sector debt.)

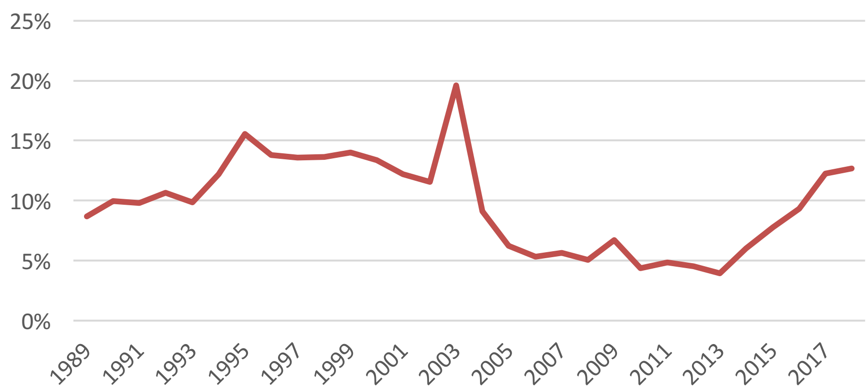
Figure 9: Nominal debt and debt-to-revenue



Source: Development Policy Centre (2018).

The interest bill as a proportion of total expenditure has increased each year for the past four years, from 4% in 2013 to 12% in 2017 (Figure 10).

Figure 10: Interest bill as a proportion of total expenditure

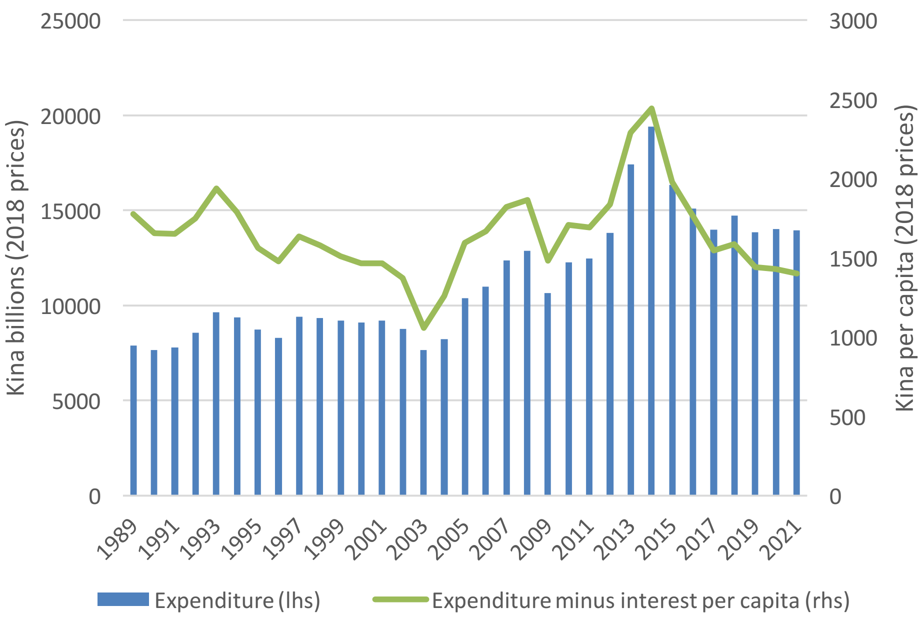


Source: Development Policy Centre (2018).

While the government has done well to meet its debt-service obligations in a time of fiscal stress, PNG's fiscal crisis has been manifested in many other ways, most notably through a struggle to pay payroll, rental for government offices, massive arrears, a virtual disappearance of funds for roads maintenance (Office of Development Effectiveness, 2018), and a shortage of drugs and equipment across PNG's health system including in its premier hospital (Mola 2018).

The fiscal outlook is bleak. Although expenditure is projected to increase more than inflation in 2018, after falling for each year from 2014 to 2017, it is projected to increase at most in line with inflation out to 2021. This means even by 2021 total expenditure will be back at its level of 2010. And, even assuming that interest payments stabilize, expenditure-after-interest is projected in 2021 on a per capita basis to be at one of the lowest levels seen over the last three decades (Figure 11). While growth could pick up with higher commodity prices or construction of a large resource project, it would be unwise to make such a contingency the basis for fiscal hope.

Figure 11: Government expenditure, adjusted for inflation

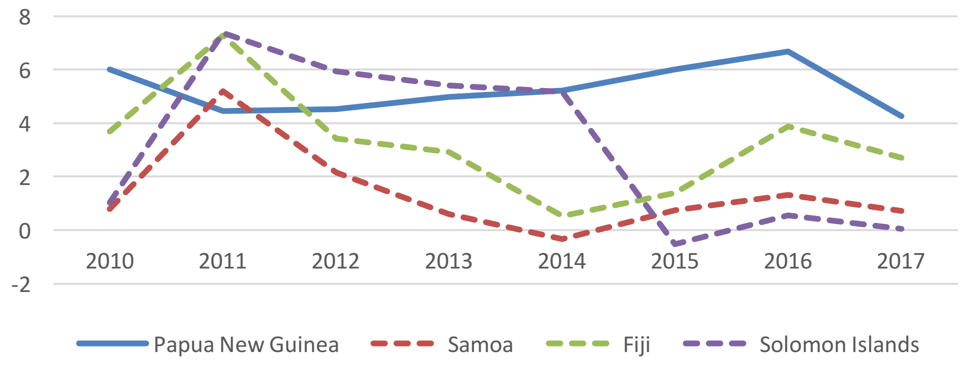


Source: Development Policy Centre (2018).

3.2 Macroeconomic performance

In 2017, inflation was 4.2%, the lowest over the past five years, though still high compared to other Pacific islands (Figure 12). The downward trend in inflation reflects the slowing down of the PNG economy as well as the lower imported inflation and relative stability in the kina exchange rate (BPNG, 2017). World Bank (2017) notes however that underlying inflation was only 2% in 2017, and that headline inflation was pushed higher due to high alcohol and betel nut price inflation. Broad money growth is reported by BPNG to be negative in 2017, perhaps reflecting the decline in foreign exchange reserves. However, given the excess liquidity in the PNG economy, there is unlikely to be a clear relationship between inflation and money supply.

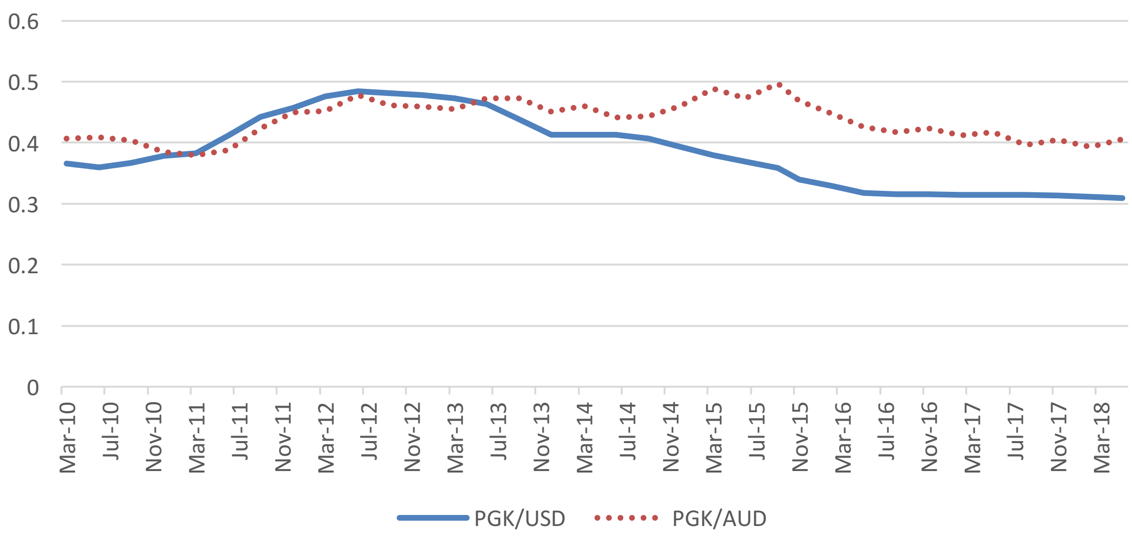
Figure 12: Inflation in selected Pacific Island countries (%)



Source: IMF IFS (2018).

Figure 13 shows the nominal USD-Kina and AUD-Kina exchange rates over the past eight years. Since mid-2016, the Kina exchange rate has been fixed by BPNG at approximately 0.3 US dollar per kina. This stability has come at a cost. Fluctuations in the exchange rate, in any economy, may cause some uncertainty to investors but they facilitate market clearing in the foreign exchange market and allows the economy to respond to external shocks.

Figure 13: PGK/USD and PGK/AUD exchange rate (2010-2018)

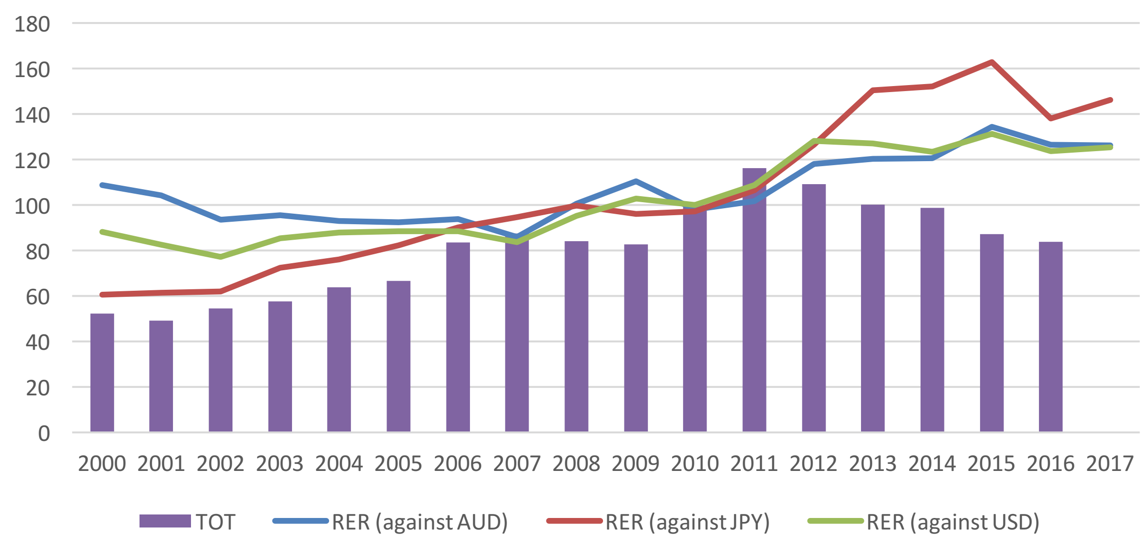


Source: IMF IFS (2018) and RBA (2018).

Figure 14 depicts the evolution of the real exchange rate (RER) of the kina against PNG's main trading partners. This is the nominal exchange rate after adjusting for the difference between PNG's inflation and inflation in the country being compared. These adjustments make sure that the exchange rate captures the changes in relative fundamentals between the PNG economy and its trading partners. Values above/below 100 indicate exchange rate appreciation/depreciation as compared with the level in 2010. Figure 14 shows that the kina has appreciated by about 0-15 per cent, depending on the foreign currency, relative to 2012. But, as the figure also shows, commodity prices have fallen since 2012 by almost 25%: see the terms of trade (TOT) line in the figure below.

In a resource dependent economy, the equilibrium RER is dependent on commodity prices (Schroder and Fox 2018). The appreciation of the RER at a time when commodity prices have fallen shows why the exchange rate is so over-appreciated today. How much is hard to say, though recent estimates from the Development Policy Centre and the ANZ put it at about 20% (Schroder and Fox, 2018; Sen, 2018). The IMF (2017, p.15) has also recommended that "that the Kina be allowed to depreciate to eliminate the current over-valuation of the currency, end the FX shortage, and promote external competitiveness."

Figure 14: PNG's real exchange rate index and terms of trade, 2010=100

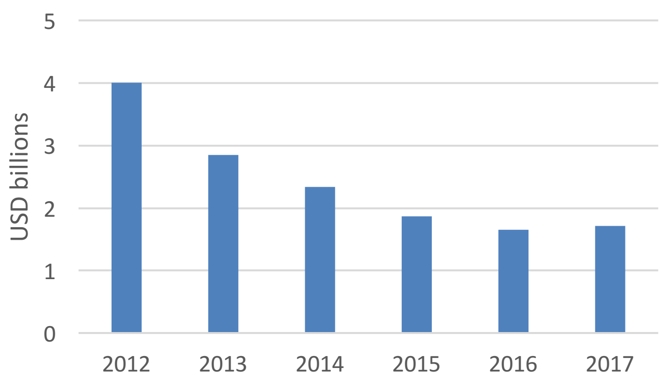


Source: RER against AUD and JPY are calculated by authors and RER against USD is retrieved from IMF IFS (2018), TOT taken from World Bank and adjusted as 2010 = 100.

Because the Kina is over-appreciated, there is excess demand for foreign currency. This has been managed by foreign exchange (FX) rationing. Four years after their introduction in mid-2014, foreign exchange restrictions continue to be in place. As we reported in the last survey, there are bans on trade financing, on the opening of new foreign currency accounts by PNG residents, and on the remittance of dividends. There is a long queue to obtain funding for imports and there is no data on how large it is. However, estimates of $US 1 billion were suggested back in March 2015 and foreign exchange reserves have depleted since then.

As Figure 15 below shows, the government is not willing to allow reserves go below about $1.5 billion, or around 6.5 months of import cover. With lower bounds on both foreign exchange reserves and the exchange rate, foreign exchange shortages and rationing are acute. Indeed, as discussed in Section 4.2, businesses now rate foreign exchange shortages as their top concern.

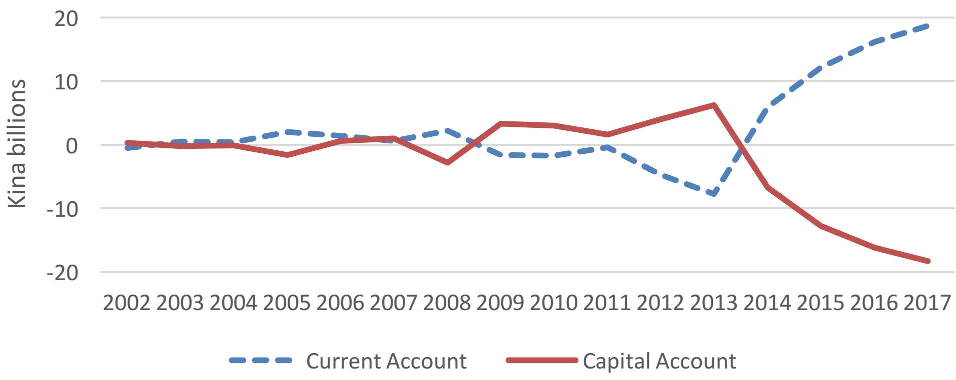
Figure 15: Foreign exchange reserves (USD, at the end of each year)



Source: BPNG, as of March 2018 QEB.

Figure 16 shows the current account and capital account for PNG. The current account has gone sharply into surplus in recent years with imports compressed due to foreign exchange rationing (Figure 4) and exports booming due to the PNG LNG project. However, the massive current account surplus (now about 30% of GDP) has not led to improved FX availability. Rather, as Figure 16 shows, most of the Kina that PNG has earned through exports have been re-exported in the form of capital outflows.

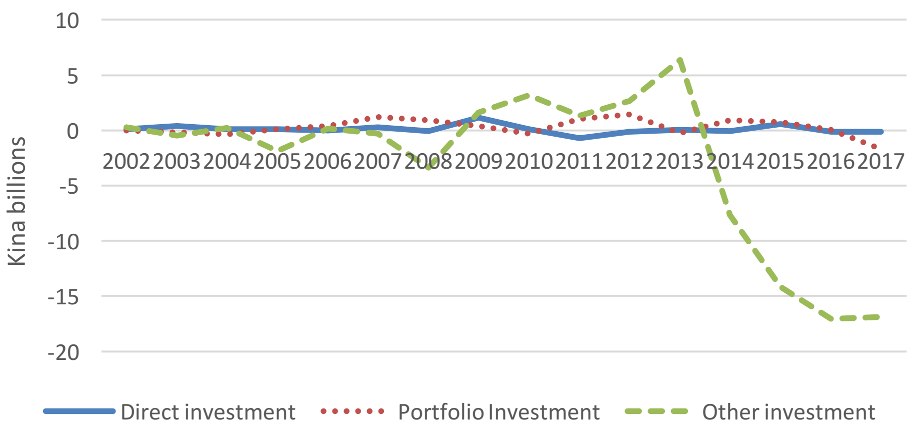
Figure 16: Current account and capital account (2002-2017)



Source: BPNG, as of March 2018 QEB.

Decomposing the PNG's capital account, as shown in Figure 17, reveals that the capital deficit is not caused by foreign direct investment to abroad by PNG investors or offshore portfolio investment. Rather, it seems that profits are being taken offshore in the form of dividends and loan repayments by resource owners. (The ban on profit repatriation imposed by BPNG does not apply to the large resource owners who have project agreements that allow them to keep export proceeds offshore.) The large capital account deficit is consistent with the very low value of resource revenues being captured by the government (as discussed in the previous section) and indicates a worrying lack of re-investment of profits, which are instead being sent offshore where possible. All the restrictions placed by BPNG on conversion of Kina into foreign currency, as well as the risk of devaluation, result in strong incentives to keep funds offshore.

Figure 17: Decomposition of PNG's capital account (2002-2017)



Source: BPNG, as of March 2018 QEB.

4. Private sector policies and perspectives

So far the message of this survey has been as follows. Despite a booming resource sector, the non-resource economy has contracted and formal sector employment continues to fall. The macroeconomic situation is getting increasingly risky as evidenced by the credit downgrades over the last two years. To protect macroeconomic stability, the government is attempting to reduce the deficit, protect foreign exchange reserves, and defend the exchange rate. But this is itself undermining growth performance and prospects. Clearly fiscal and macroeconomic stabilityare not enough. Economic growth is urgently needed. This section looks at the economy from the perspective of the private sector. Earlier surveys reported on government policies towards the private sector, in particular the controversial small and medium enterprise policy (Cornish et al. 2015), but implementation of this policy seems to have stalled. The most important changes recently have concerned trade policy, and these are the focus of Section 4.1. Section 4.2 examines private sector perspectives on the economy.

4.1 Trade policies

The first sign that PNG would be taking a more protectionist trade policy came in late 2015, with the banning of a number of fresh fruit and vegetable imports from Australia. That ban was short-lived, but this last year has seen a major reversal in trade policy. For the last two decades, PNG has been following a policy of tariff reduction. As part of its negotiations with the World Bank and IMF, PNG introduced a Tariff Reduction Program (TRP) in 1999, which set out tariff reductions to 2006. Despite some opposition, the TRP was upheld by a 2003 review (PNG Treasury, 2003), and the 1999 program was broadly implemented. Another review in 2007 (Scollay, 2007) resulted in a further round of reductions out to 2018. The reductions planned and/or achieved are shown in the table below. It is important to note that most tariff lines (three-quarters) in PNG are in fact zero, with no tariffs being applied on imports of most goods for which there is no domestic production. Table 3 shows the reduction in tariff rates over time for those goods that are subject to tariffs. Since 1999, there have been three tariffs - 'intermediate', 'protective' and 'prohibitive'. All have fallen significantly.

Table 3: Tariff rates under PNG's two Tariff Reduction Programs

	pre-1999	1999-00	2001-2	2003-5	2006	2011	2012	2015	2018
Intermediate	30	30	25	20	15	15	12.5	10	10
Protective	49	40	35	30	25	25	20	15	10
Prohibitive	55-100	55	50	45	40	40	35	30	25

Notes: Figures up to 2006 from the 2007 tariff review; and figures from 2011 from the 2012 budget.

With a few exceptions, the tariff reductions have been implemented as planned. The unweighted average of the three tariff categories fell from 42% in 1999 to 18% in 2015. The Import and Export Customs Tariff Act of 2012 legislated a series of tariff changes that would come into effect immediately, with further reductions to come into effect on January 1 2015, and yet more to be implemented on January 1 2018.

However, in August 2017, the TRP was suspended (Post Courier, 2017) and in the 2017 Supplementary Budget tariffs were increased on soft drinks, alcohol and tobacco. In the 2018 budget about 250 tariffs lines were increased, and over 600 decreases were abandoned. On average the tariff increases were moderate (about 7%), but there were some substantial increases. In particular, a 25% tariff on milk—which had been duty-free—was introduced to support the new Ilimo Dairy Farm. Table 4 shows a sample of the increases.

Table 4: Selected tariff increases from the Customs Tariff (2018 Budget) (Amendment) Bill 2017

		Old	New
Clothing	Stockings, socks	15%	20%
	Cotton or woolen clothes	15%	20%
Household and consumer items	Toilet paper	15%	20%
	Tablecloths	10%	20%
	Baths, sinks, washbasins	10%	25%
	Detergents	10%-15%	20%-25%
	Glue	10%	20%
	Soap	15%	20%
	Shampoo	10%	20%
	Nail polish	10%	20%
Food products	Ice cream	15%	20%
	Milk	0%	25%
	Palm oil/coconut oil/other oils	10%	25%
	Cocoa products	10%	15%
	Meat	10%-15%	12.5%-20%

Examples of protectionist measures from the past in PNG are instructive. Ramu Sugar was initially partly government owned, and has received generous protection since its inception in the 1980s. PNG Halla Cement was also partially government owned and received support in the 1990s. Neither business lived up to expectations. Ramu Sugar provided no dividend in its first 10 years of operation. The government stake in Ramu Sugar was eventually sold to New Britain Palm Oil, who converted 2,500 hectares of the land from cane sugar to palm oil. Despite now being over three decades old, hardly part of an infant industry, it is still said that it wouldn't be able to survive without large tariffs, now 30% on the import of sugar. After 7 years of poor performance the PNG government sold its 50% share in PNG Halla Cement to Japanese company Taiheyo. The privatized company is said to be profitable now, though still benefits from a 10% tariff, and has a monopoly on the cement market in PNG. It has also had difficulty meeting demand in the past (Oxford Business Group, 2012).

It is odd to increase tariffs in the same year that PNG is hosting APEC, an organisation created to promote free trade. It is also a departure from past economic policies, which emphasized outward orientation (Scollay 2007). Administrative costs are higher for a less uniform system (the new changes have introduced new tariff rates of 12.5%, 20% and 25%, in addition to the older ones of 10%, 15% and 30%). Now that the TRP has been abandoned, businesses will lobby for further tariff increases.

On the positive side, the tariff increases are mainly moderate, though there are some significant exemptions (the tariff on imported frozen chicken doubles from K1.80 to K3.50 per kg, and that on soft drinks from K0.25 per litre to K3 per litre). The moderate increases may be justified given exchange rate overvaluation. However, a more efficient method to help domestic producers of both imports and exports would be to devalue the exchange rate. (Just as a more efficient way to tax sugar would be to tax all soft drinks, not only imported ones.)

The problems being faced on the export side are illustrated by the difficulties PNG is facing in implementing its tuna processing policies, where there have also been important changes in the last year. In 2017, the PNG Government announced that all fish caught in PNG waters would have to be processed in PNG, and that its existing policy of subsidized fishing in PNG waters in return for some processing, would be replaced by a rebate for fish processed in PNG (Post Courier, 2017). This policy is not favoured by tuna processors, because PNG is an expensive place in which to can tuna. For example, the minimum wage in the Philippines is $2,053, whereas that in PNG is $3,304 (minimum-wage.org).[4] PNG had earlier enjoyed a tariff preference for its exports to the EU, but the same duty-free status that the EU provides to PNG is now provided to the Philippines as well. Philippines' exports to Europe are booming.

PNG has undertaken to provide a rebate on fish processed in PNG, but only for two years, and with PNG's cash flow problems there would be concerns as to whether this rebate would be paid (Loop PNG, 2018).[5] In response, one of PNG's six tuna processors, Frabelle, closed its plant at the end of April 2018, resulting in 800 workers losing their jobs (RadioNZ, 2018). It is unclear how this dispute will play out, and there is clearly a tussle underway between the government and the industry.[6] Increasing tariffs does nothing to help the tuna processing industry. If the PNG government really wants to encourage onshore tuna processing (or timber processing), the best thing it could do would be to depreciate the exchange rate which immediately lifts its overall level of international competitiveness.

4.2 Private sector perspectives

While it is often commented that PNG suffers from a paucity of data, private sector perspectives are one area to which this comment does not apply. Since 2002, the Institute of National Affairs has undertaken 5-yearly business surveys (in 2002, 2007, 2012 and 2017). And since 2012, Business Advantage (BA) has undertaken seven annual surveys of business, the most recent being published in 2018.

The BA survey is referred to as the "PNG 100 Survey" and is said to be a survey of "senior executives from a representative sample of Papua New Guinea's largest companies, across all sectors of the economy." (Business Advantage 2018a, p. 19). The

---

[4] Philippines is the top exporter of tuna to the EU.

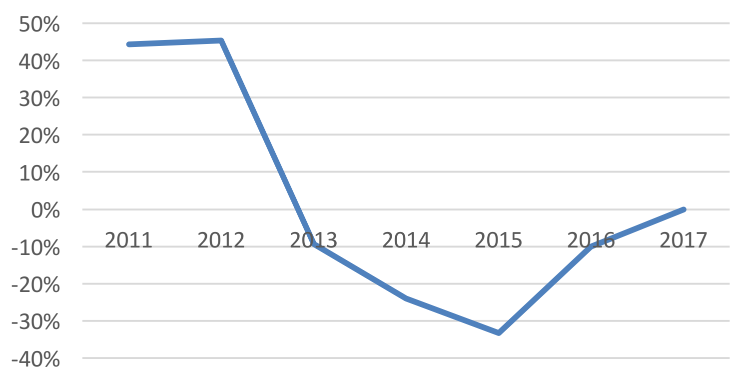
[5] This replaced an earlier arrangement in which ships were given discounts on their fishing licenses if they processed tuna onshore. However, the ships only processed a small share of their tuna catch in PNG (about 20%). In February, it was reported that rebates were paid. However, the recent policy shift requiring the National Fisheries Authority and other statutory agencies to hand over 90% of their funds to the central government will reduce the confidence of processors that rebates will be paid.

[6] Frabelle has emphasized that it has not closed its factory permanently.

INA surveys are somewhat larger. The 2017 survey covered 187 firms, the 2012 one 136 (Holden et al. 2017), and the 2007 one 243 (ADB 2008, p.1). The INA survey covers both large and small businesses.

The Business Advantage (BA) survey is useful in understanding recent economic trends. Each survey BA asks employers how their performance compared to expectations in the previous year. Figure 18 aggregates the data provided to give an overall score between - 100% and +100%. The higher the percentage, the better businesses feel they performed relative to expectations. Zero is a neutral score: it indicates that as many businesses say that performance exceeded as those that say performance fell short of expectations. Figure 18 shows that during the boom years of 2011 and 2012 businesses were positively surprised by their performance with scores of above 40%. In 2013, performance was roughly equal to expectations, but 2014 and especially 2015 were disappointing years with many more businesses doing worse than they expected than better. By 2016, expectations and performance were becoming closer aligned, and by 2017 performance was back in line with expectations.

Figure 18: Business performance v expectations index



Source: Business Advantage (2012-2017).
Notes: The score is calculated by combining the percentage of those who say that business performance greatly or slightly exceeded expectations in the previous year and subtracting the percentage of those who say that business performance fell slightly or substantially short of expectations. 2017 data is from the 2018 survey, and so on.

Despite finding that performance has not lived up to expectations for four of the last five years, PNG businesses have remained optimistic. BA surveys also ask about profit, investment and employment expectations in the coming years. As Figure 19 shows, these have always been overall positive, and typically around one- third, staying high throughout the last few difficult years. Expectations are of course not always realized. Despite strongly positive employment expectations for the last three years, actual formal sector employment has fallen in each of these years (Figure 2). Likewise, despite strong support for increased investment, private sector credit growth has been slow, and negative in 2017 (Figure 5).

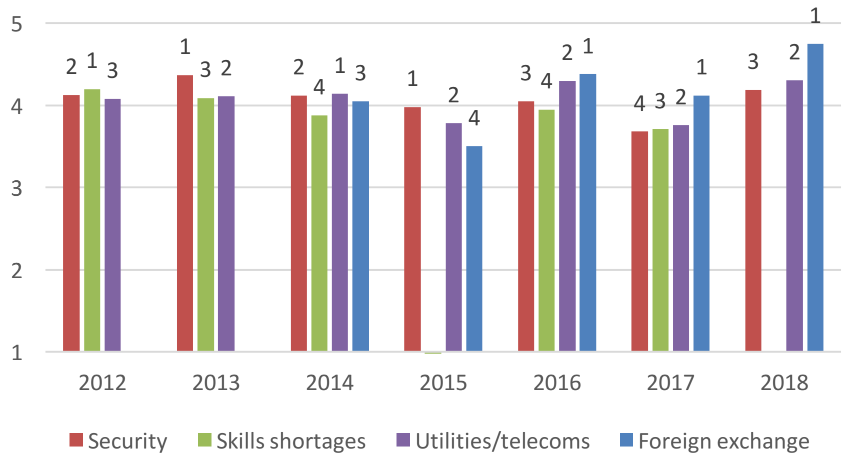
Figure 19: Business expectations index

Source: Business Advantage (2012-2017).
Notes: The score is calculated by combining the percentage of those who say that they expect profits, investment or staff to substantially or somewhat exceed levels in the previous year and subtracting the percentage of those who say that they expect profits, investment or staff, respectively, to be slightly or substantially less than in the previous year.

The BA survey also asks businesses about constraints. Respondents answer on a scale from 1 to 5 with a larger number indicating a bigger hindrance. In 2017, the scale was changed from 1 to 4. 2017 answers have been rescaled to make them comparable.

Of the 16 responses reported over the six years (including a residual "other"), there are four that tend to dominate: foreign exchange; security; skills shortages; and utilities/telecoms. The ranking of these four is shown in Figure 20. Foreign exchange was not a constraint at all in 2012 or 2013, but it became one of the top four issues in 2014, when it was the third highest-ranked constraint. It was also third highest in 2015, and since then it has been the top-ranked constraint. The other three constraints (security, skills shortages, and utilities/telecoms) have been top-four constraints every year since 2012, except for skill shortages, which did not rate in 2018.

Figure 20: Top four impediments facing business

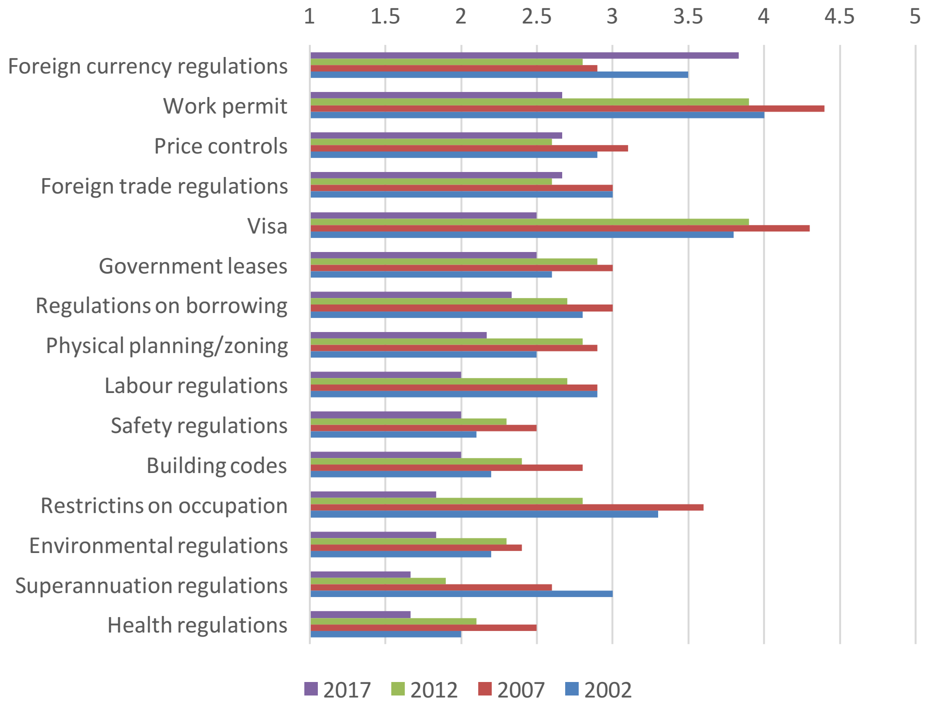


Source: Business Advantage (2012-2017).
Notes: This graph shows the impediments that are most frequently ranked in the top four in the Business Advantage Surveys. The numbers show the ranking in the year concerned, with one the highest ranking. The only indicators which have been rated in the top four which are not shown in this graph are "lack of government capacity"(ranked fourth in 2017 and third in 2015), "logistics" (ranked fourth in 2013), and "access to necessary expertise (ranked fourth in 2012). The answers are based on a ranking of 1 to 5. In 2018, a ranking scale of 1-4 was used, and these have been converted via a linear transformation to a 1-5 scale. In 2017 and 2018 "unreliable telecommunications" were asked about separately from "unreliable utilities", but this summary combines the two into "utilities/telecoms" taking whichever is higher.

The INA survey gives us a longer-term perspective on the thinking of business over the last 15 years. In each of its four surveys, the INA has asked business about 15 "government controls as a hindrance to business". Respondents answer on a scale from 1 to 6 with a larger number indicating a bigger hindrance. In 2017, the scale was changed from 1 to 4. 2017 answers have been rescaled to make them comparable.

Figure 21 shows the ratings on the 15 controls over the four surveys, ordered by their perceived importance in 2017.

Figure 21: The importance of various government controls as hindrances to business



Source: ADB (2008) and Holden et al. (2017).
Notes: This graph shows the 15 government controls businesses are asked to rate as hindrances to business in the various INA surveys. The answers are based on a ranking of 1 to 6. In 2017, a ranking scale of 1 to 5 was used, and this has been converted via a linear transformation to a 1 to 6 scale.

As can be seen from Figure 21, in 2017, for the first time, foreign currency regulations were rated as the biggest hindrance to business. In 2012, it was the 4th most hindering constraint; and in 2007 the 8th, and in 2002 the 3rd. 2002 was the last year prior to the recent economic boom in PNG. There had been significant currency depreciation, and there may have also been shortages and controls in place. Price controls and foreign trade regulations also moved up in 2017 to equal second place (along with visas). In 2012, price controls and foreign trade regulations were ranked 9th and 10th.

As Figure 22 shows, typically work permits and visas have been ranked as the biggest hindrances: they are one and two (or equal first) in 2002, 2007 and 2012. But in 2017 they were pushed into second place and below by foreign currency regulations. Figure 22 also makes it clear that there has never been such a big gap between the top government hindrance and all others as there was in 2017 between foreign currency regulations (the top-rated hindrance) and all others.

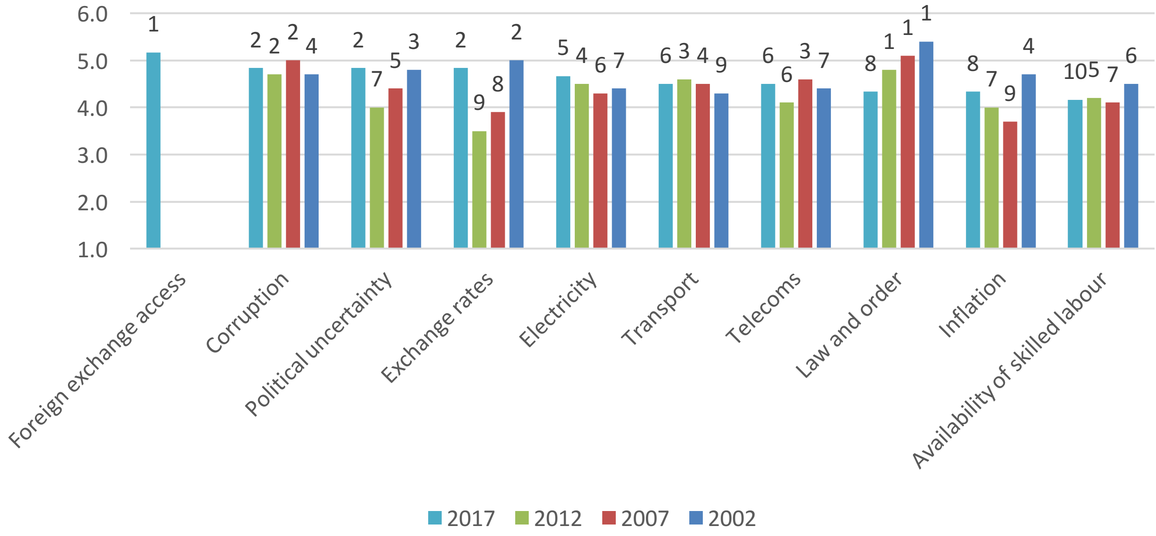
Figure 22: Top three government controls hindering business

Source: ADB (2008) and Holden et al. (2017).
Notes: This graph shows the three controls that are most frequently listed as top three constraints in the various INA surveys. In 2007 "restrictions on occupation" was listed as the third most important hindrance, and in 2007 "government leases". The answers are based on a ranking of 1 to 6. In 2017, a ranking scale of 1 to 5 was used, and this has been converted via a linear transformation to a 1 to 6 scale.

The INA survey also asks more generally about constraints to business. Over the four surveys, questions have been asked about 28 possible constraints. Figure 23 below shows the top 10 constraints for 2017, and how they fared in previous years. In general, there is a high degree of commonality. Nine of the top 10 constraints in 2017 were also top-10 constraints in the other three surveys. Corruption is always one of the top four constraints. Infrastructure constraints (electricity, transport, and telecommunications) are always in the top 10. Law and order is the top constraint for 2002, 2007 and 2012, but only the 8th most important in 2017.

The one constraint in 2017 which does not feature in earlier years is foreign exchange shortages. This was added as a possible constraint to the survey for the first time in 2017, and it went straight to first place. The exchange rate which was nominated as the second most important constraint in 2002, but only the eighth or nine most important in 2007 and 2012 returns to (equal) second place in 2017.

Figure 23: Top ten constraints to business in 2017, and how they were regarded in earlier surveys



Source: ADB (2008) and Holden et al. (2017).
Notes: This graph shows the ranking and rating in all four surveys of the constraints that were nominated in the INA survey by businesses as the most important in 2017. The answers are based on a ranking of 1 to 6. In 2017, a ranking scale of 1 to 5 was used, and this has been converted via a linear transformation to a 1 to 6 scale.

Overall, the message from both surveys is the same: foreign exchange shortages are business's biggest worry. In the words of the IMF (2017, p.13):

> The main obstacle to business activity and investment are difficulties in obtaining foreign exchange. This is adversely affecting both current activity and the willingness of parent companies to continue investing in PNG.

5. Conclusion

PNG faces the twin risks of further economic contraction and macroeconomic stability. So far, too much emphasis has been placed on the latter, perhaps because of the underestimation to date of the non-resource economy's contraction. Yet, a strategy biased in favour of macroeconomic stability will not succeed even on its own narrow terms, as shown by the downgrading of the country's credit rating by both major rating agencies over the last two years. In the meantime, the data suggests that employment continues to fall with declines in formal sector employment in each of 2014, 2015, 2016 and 2017. It is neither desirable nor feasible to solve PNG's fiscal and macroeconomic problems without an acceleration in economic growth, leading to more jobs, expenditure and revenue.

To stimulate the economy, PNG has turned to tariff protection to promote import substitution. PNG's long-standing Tariff Reduction Program has been abandoned, and rather than tariff decreases, a large number of moderate tariff increases have been implemented. These increases will not help exporters (in fact they will harm them) and will not be enough to tackle the primary problem facing the PNG economy, namely the shortage of foreign exchange, which is worsening. Two separate surveys of business show that foreign exchange shortages are the most important problem they face, and that they have increased in severity and displaced other longer-standing concerns around corruption, law and order and visas.

There is no way around the need for a substantial devaluation of the currency. It would not be feasible to move quickly to a floating exchange rate, but the Bank of PNG could easily shift downwards the rate at which it makes foreign exchange available to the banks.

There is simply no other way to reduce the extent of foreign exchange rationing, the primary drag on growth. An exchange rate depreciation is now recommended not only by ourselves, but by the IMF and the ANZ. Such a policy shift would benefit the majority of PNG's poor (who live in rural areas, and can grow coffee and cocoa to export, and root crops and vegetables to substitute for rice and other food imports). Conversely, maintaining an overvalued exchange rate will work against the government's current plans to diversify the economy and encourage domestic processing (e.g. of tuna).

The two main arguments against depreciation are that it will boost inflation (and thereby hurt the urban poor) and that it will not boost exports (Business Advantage, 2018b). On the former, with inflation down and the macroeconomy stable, there will be no better time to depreciate. While there will be pain involved especially for urban dwellers, the alternative is continued economic stagnation and job losses, which will also, above all, hurt the poor, urban and rural. On the latter issue of export pessimism, apart from the international evidence (Ghei and Pritchett, 1999), Nakatani (2017, p.28) simulates the impact of a 10% RER depreciation specifically in PNG and finds that it leads to "an increase of about $150 million in exports and a decrease of about $100 million in imports, suggesting that the FX will increase by $250 million [per year]." Earlier research by Allen et al. (2008) show that in PNG "smallholders are responsive to market opportunities" (p. 309) and sensitive to price changes. They show that domestic food production expanded substantially due to the devaluation of the Kina in the 1990s (p. 297).

If it was possible to engineer an economic recovery without a depreciation, it would have happened by now. Yet, while a devaluation is essential to reduce the demand for foreign exchange and provide a boost to the economy, it would not be a panacea. PNG faces a daunting agenda to improve business confidence and reduce the costs of doing business. We have addressed the broader reform agenda in our earlier surveys, and do not repeat it here in order to focus on the primary concern of businesses, namely exchange rate shortages. As the IMF puts it, currently "[t]he main impediment to private sector development is macroeconomic policies." (IMF, 2017, p.13)

Despite the range of advice reaching the government in favour of devaluation of the Kina, for more than two years there has been no nominal depreciation to speak of, and the real exchange rate has continued to rise, and businesses have continued to suffer. The government can take credit for avoiding both a balance of payment crisis and a government debt default, but the price they have paid for this stability is a smaller economy and reduced service delivery. Of course, for a devaluation to have a lasting impact it would need to be accompanied by a range of structural and governance reforms to reduce the cost of doing business in PNG. But a devaluation is a critical first step. Without a change in the government's policy stance, our projection is for very subdued economic growth in the coming years, resulting in higher unemployment, and very poor human development outcomes.

6. References

ADB 2008 "Foundation for the future: a private sector assessment for Papua New Guinea", Asian Development Bank, Mandaluyong City.

Allen A, Bourke, RM and McGregor, A 2008 "Cash income from agriculture", Part 5 in Bourke, M and Harwood T (eds.) *Food and agriculture in Papua New Guinea*, ANU Press.

Bank of Papua New Guinea 2018 Quarterly Economic Bulletin Statistical Tables.

Bank of Papua New Guinea 2017 "Monetary policy statement".

BSP 2018 "Media release: BSP rating for 2017".

Business Advantage 2018a "Business Advantage Papua New Guinea 2018", Business Advantage International, Melbourne.

Business Advantage 2018b "Foreign exchange restrictions will not ease in Papua New Guinea until new investment flows come, says ANZ MD", Business Advantage International, Melbourne.

Business Advantage 2017 "Business Advantage Papua New Guinea 2017", Business Advantage International, Melbourne.

Business Advantage 2016 "Business Advantage Papua New Guinea 2016", Business Advantage International, Melbourne.

Business Advantage 2015 "Business Advantage Papua New Guinea 2015", Business Advantage International, Melbourne.

Business Advantage 2014 "Business Advantage Papua New Guinea 2014", Business Advantage International, Melbourne.

Business Advantage 2013 "Business Advantage Papua New Guinea 2013", Business Advantage International, Melbourne.

Business Advantage 2012 "Business Advantage Papua New Guinea 2012/2013", Business Advantage International, Melbourne.

Cornish, M, Fox, R, Howes, S, Nicholas, W, Prabhakar, A and Rova, A 2015 "PNG survey of recent developments, 2014-15", Development Policy Centre Discussion Paper 41, Australian National University.

Development Policy Centre 2018 PNG Budget Database - 2017 FBO, ANU, Canberra.

Fox, R and Schröder, M 2017 "After Papua New Guinea's resource boom: is the Kina overvalued?", Development Policy Centre Discussion Paper 54, Australian National University.

Fox, R, Howes, S, Nema, N, and Schröder, M 2017 "2017 PNG economic survey", Development Policy Centre Discussion Paper 66, Australian National University.

Ghei, N and Lan, P 1999, "The three pessimisms: Real exchange rates and trade flows in developing countries" in Hinkle, L and Montiel, P (eds*). Exchange rate misalignment: concepts and measurement for developing countries*, The World Bank.

Holden, P, Barker, P and Goie, S 2017 "Being heard: the results of the 2017 survey of businesses in Papua New Guinea", INA Discussion Paper 105, PNG Institute of National Affairs.

Howes, S and Nema, N 2016 "Has the PNG economy been in recession?", Devpolicy Blog.

IMF 2018 International Financial Statistics.

IMF 2017 "Papua New Guinea 2017 Article IV Consultation – staff report; and press release", International Monetary Fund Country Report no.17/411, IMF, Washington DC.

IMF 2016 "Papua New Guinea 2016 Article IV Consultation – staff report; and press release", International Monetary Fund Country Report no.17/22, IMF, Washington DC.

Loop PNG 2018 "K700m in backlog for road maintenance".

Loop PNG 2017 "New fisheries system to be in place".

Mola, G 2018 "Severe drug and equipment shortages at Port Moresby General Hospital", Devpolicy Blog.

Nakatani, R 2017 "External adjustment in a resource-rich economy: the case of Papua New Guinea" IMF Working Paper No. 17/267.

NSO 2018, "Gross Domestic Products - National Accounts".

Newcrest 2018 "Newcrest Annual Report 2017" .

Newcrest 2017 "Newcrest Annual Report 2016" .

Newcrest 2016 "Newcrest Annual Report 2015" .

Newcrest 2015 "Newcrest Annual Report 2014" .

Newcrest 2014 "Newcrest Annual Report 2013" .

Newcrest 2013 "Newcrest Annual Report 2012" .

Newcrest 2012 "Newcrest Annual Report 2011" .

Office of Development Effectiveness 2018 "Road management in Papua New Guinea: an evaluation of a decade of Australian support 2007-2017", Department of Foreign Affairs and Trade.

Ok Tedi Mining 2018 "Ok Tedi Mining Limited Annual Review 2017".

Ok Tedi Mining 2017 "Ok Tedi Mining Limited Annual Review 2016".

Ok Tedi Mining 2015 "Ok Tedi Mining Limited Annual Review 2014".

Ok Tedi Mining 2014 "Ok Tedi Mining Limited Annual Review 2013".

Ok Tedi Mining 2013 "Ok Tedi Mining Limited Annual Review 2012".

Ok Tedi Mining 2012 "Ok Tedi Mining Limited Annual Review 2011".

Oxford Business Group 2012 "The Report: Papua New Guinea 2012".

PNG EITI 2017 "Papua New Guinea Extractive Industries Transparency Initiative: report for 2016", Ernst and Young Australia.

PNG EITI 2016 "Papua New Guinea Extractive Industries Transparency Initiative: report for 2015", Ernst and Young Australia.

PNG EITI 2015 "Papua New Guinea Extractive Industries Transparency Initiative: report for 2014”, Ernst and Young Australia.

PNG Treasury 2017 “National Budget - 2018”.

PNG Treasury 2003 “2003 tariff review: a review of the tariff reduction program”.

Post Courier 2017 “Tariff reduction program suspended”.

Radio NZ 2018 “More than 800 tuna workers in PNG are laid off”.

Reserve Bank of Australia 2018 Exchange Rates.

Scollay, R 2007 “Review of the tariff reduction program: prepared for PNG Treasury”, Auckland UniServices Limited, Auckland.

Sen, K 2018 “PNG is on the cusp of a super cycle in mining investment”.

Steamships Trading Company Limited 2017 “Annual report 2017”.

The National 2018 “Tuna processor thanks state for K8.6 million rebate payment”.

World Bank 2017 “Papua New Guinea: reinforcing resilience”, The World Bank Group.

Leadership and the future

Dame Meg Taylor, Secretary General to the Pacific Islands Forum

Apologies for not being with you yesterday. The Highlands were calling!

It is wonderful to be back home in Papua New Guinea and to be afforded the opportunity to share with you my views on leadership and the future.

I would like to approach this session's theme by reflecting on regional leadership and taking into account my experience as the Secretary General of the Pacific Islands Forum. In doing so, I will also offer my observations on Papua New Guinea's engagement with the wider Pacific Islands region, and its potential for greater regional leadership.

The regional context

Distinguished colleagues, the term 'leadership' is often used to indicate dominance or overt influence, particularly when we use that term in the context of international relations. But I hope that through my discussion this morning, you will come away with a different sense of what leadership means in the context of Pacific regionalism, and the potential for Papua New Guinea in the region. Indeed, dominance is arguably inimical to the very concept of Pacific regionalism, in which we are seeking to all contribute to the wider good of our region. To my mind, key elements of leadership for Pacific regionalism include active participation in discussions, and at the core of participation is persistence and determination to progress our region's priorities.

With this concept of leadership in mind, let us turn to the current state of our region.

State of the region

In 2013, Sir Mekere Morauta conducted an extensive review of the Pacific region on behalf of the Pacific Islands Forum and he concluded that:

> "The region as a whole is experiencing significant social, economic and environmental change and challenges; it is also the subject of new levels of geopolitical interests within and beyond its shores. But the region is vulnerable and it remains significantly dependent on the economies and goodwill of others."

This statement is now 5 years old, and pre-dated my commencement with the Pacific Islands Forum. But it still rings true to me in describing the state of our region today.

I am particularly conscious of Sir Mekere's identification of the new levels of geopolitical interest within our region. This level of interest has in fact grown significantly in the past five years. The global geopolitical shifts that have taken place, rather rapidly, over the past one to two years have once again made our region a place of strategic importance. The result is increased attention by both new and old partners who recognise the strategic importance of our region and who, therefore, are seeking to strengthen their influence over what happens here.

We see this increased interest and jockeying for influence on an almost daily basis in the news and the media. Countries are calling for our region to support their strategies for increased engagement in the Indo-Pacific region – but with little regard for our region's reasonable requests for more information about what these strategies consist of and what they will mean for our countries. And with apparently little regard for the institutions and systems we have worked hard to establish at the national and regional levels.

These geopolitical trends are inextricably connected with a wide range of other economic, social and environmental changes and challenges. We are well used to reading erudite reports on various aspects of our region, but this year my colleagues and I at the Pacific Islands Forum Secretariat took on the challenge of going out to as many of our Member countries as possible to hear directly from governments, civil society and the private sector about their experiences and concerns and ambitions for the future.

We visited 15 of our 18 Members, including Papua New Guinea. And across a diverse range of countries, and a broad spectrum of people, we saw common issues emerging, including:

- The impacts of climate change, particularly on food and water security;
- Social justice issues including access to quality education, housing, and gender equality;
- Health issues, particularly non-communicable diseases;
- The erosion of cultural traditions and heritage;
- Poor national governance;
- Connectivity, including air and sea transport and telecommunications technology;
- Transnational crime; and

- Threats to the sustainable management of our ocean.

I am sure that many of these issues will resonate for you in the context of Papua New Guinea. A number of these issues have been discussed in presentations yesterday.
And so against this backdrop of challenges and concerns, our region has some important questions to ask itself - how do we make our voice heard in the current geopolitical environment? How do we position ourselves and set the terms of engagement for what happens in our own region? How can we work together to address our shared challenges?

These are questions that speak at a fundamental level to leadership – and the willingness of our region to assert itself and confidently drive our political and developmental ambitions.

Framework for Pacific Regionalism and the Blue Pacific

I believe that in recent years we have established a solid foundation for the Pacific Islands region to proactively and strategically identify our common goals. In 2014, as a result of Sir Mekere's work, the Leaders of the Pacific Islands Forum endorsed the Framework for Pacific Regionalism. The Framework seeks to raise our region's ambitions for collective and inclusive action in pursuing our Leader's vision for a region of peace, harmony, security, social inclusion and prosperity. It also emphasizes the need and importance of reaching "political settlements".

To maximize the potential of the Framework for Pacific Regionalism, Forum Leaders in 2017 endorsed 'the Blue Pacific' identity. The Blue Pacific represents our collective identity, drawing on our common connection to the Pacific Ocean. The Blue Pacific identity reminds us of our stewardship of our vast and abundant Pacific Ocean. And it serves to empower us – reminding us of the value and potential of our region. It rejects the characterization which has been in place for too long, of a small, isolated and fragile region. As the Blue Pacific, we have a strong and collective voice, on issues vital to our development as a region. This identity has great transformative impetus for our region in the way we see ourselves, and the way we interact with the wider world.

Papua New Guinea and the Blue Pacific

Let me now turn to Papua New Guinea's role in our current efforts to revitalize and strengthen Pacific regionalism.

When the idea of the Blue Pacific was being socialized last year and early this year in Papua New Guinea, people asked 'How is the Blue Pacific relevant to Papua New Guinea?' and 'What relevance does it have to our populations in the Highlands?'. People pointed out the obvious differences between us and most other Pacific island countries, with Papua New Guinea's significant land resources, our large population and economy. Indeed, these were questions I also asked myself, as a woman from Papua New Guinea.

In reflecting on these questions, I kept coming back to a deep belief in the existence and value of the Blue Pacific identify. We are all connected by the Pacific Ocean, whether we live just metres from its shores or faraway in the interior mountains and highlands of our diverse islands. I see the Blue Pacific as conveying to each other and to the wider world our common experiences and our shared commitment to working together to tackle common challenges and harness our strengths.

Just two weeks ago, Papua New Guinea hosted a meeting of the APEC Ministers Responsible for Trade. And it was encouraging to see Papua New Guinea's Foreign Minister, the Honourable Rimbik Pato, conveying the Blue Pacific identity to his ministerial colleagues in APEC. I see this as a very practical demonstration of regionalism, indeed of regional leadership.

Papua New Guinea and APEC

As the only Pacific island economy member of APEC, Papua New Guinea is well-positioned to play an important role in bridging the Pacific and Asian region that other Forum Members do not, or cannot, play. This is particularly significant when you consider that all air and sea transport and digital data of Pacific Island countries must pass through an APEC economy in order to connect with the rest of the world.

As the chair of APEC this year, Papua New Guinea's focus on the digital economy is significant for the Pacific Islands region. The geographical remoteness of Pacific Island countries, and the small size of our markets, make it difficult for businesses in our region to successfully engage in international trade, especially for Micro, Small and Medium Enterprises (MSMEs) and women-owned enterprises. E-commerce has the potential to offer partial relief to structural constrains experienced by Pacific Island countries – and APEC economies represent an important source of support for our Members in accessing infrastructure to develop digital connectivity.

And while I am pleased to see Papua New Guinea using its role as chair of APEC to shine some light on the interests and concerns of Pacific Islands countries to APEC, I believe that Papua New Guinea still has some way to go to realise its full leadership potential in the Pacific region.

Our Leaders' policy agenda is replete with issues that are directly relevant to the concerns of Papua New Guinea and which would also benefit from the rich experience and expertise of the people of Papua New Guinea.

Regional security cooperation

Regional security cooperation is one of those issues that come directly to mind. Through the Pacific Islands Forum, our Member countries have developed a rich array of instruments, networks and initiatives to promote cooperation in addressing the wide range of transnational security issues that affect our region. This regional security architecture provided the platform for the Regional Assistance Mission to the Solomon Islands (RAMSI) – which I am sure you are all familiar with, and which stands as one of the most ambitious and successful examples of regional cooperation through the Forum to date.

At the Forum Leaders' meeting in 2017, Leaders recognized the successful completion of the RAMSI mission as an opportunity to revisit our region's approach to security, so as to ensure that we are well positioned to handle our current and emerging security environment.

This is a significant area of work that my colleagues are leading on, in close consultation with Member countries and other stakeholders to develop advice to Leaders when they meet in September 2018.

We will face increased geo-political power struggles in our region.

We will need to take decisive steps to protect our maritime boundaries, our Exclusive Economic Zone (EEZ). We need to secure our resources: land and sea - our land, our coastal fisheries and our pelagic fisheries. We need to continue to advocate change and build our own resilience facility.

We need to ensure our people are healthy and address the issue of non-communicable diseases.

We need to educate our people. So we now participate at regional & international levels with decisiveness.

We need to participate in the economic growth of our countries whilst also ensuring the active participation of women. We need to secure the future for our youth and children including our people with disabilities.

We need, above all, transparent strong national governance throughout our region.

We need to listen and support those who want to determine their own future, without fear of their human rights being abused.

This all requires collective effort and political settlements.

PNG's contribution to Pacific regionalism

Coming together as the Pacific Islands Forum, the political leaders of our region have identified regional action for the security and prosperity of our Blue Pacific. As the only Pacific Island economy member of APEC, Papua New Guinea has the opportunity to be a compelling advocate for the Pacific Islands region. This is a particularly important community for the Pacific Islands region when you consider that because of our geography, almost all of our air and sea transport and digital data must pass through an APEC economy for us to connect with the rest of the world.

We are at a critical juncture in the history of our region. The decisions and actions we take now and in the next couple of years will have important implications for determining the future of our Blue Pacific. This is a time that demands focused collaboration and cooperation amongst the countries of our region to strategically navigate the complex geopolitical environment. To honour this, our political leadership must remain aligned and focused on delivering for the betterment of the Pacific people – our people.

Conclusion

Distinguished colleagues, I believe that our region is at a critical juncture in the history of our region. The decisions and actions we take now and in the next couple of years will have important implications for determining the future of our Blue Pacific. This is a time that demands focused collaboration and cooperation amongst the countries of our region. I keep reading that APEC will put us, Papua New Guinea, on the map. So what will we do from the experience of APEC?

We must invest in our talented young people. We must ensure that they carry our country forward by serving at the national, regional and international levels and fostering in them the spirit to contribute decisively with confidence and certainty.

I sincerely believe that Papua New Guinea has much to gain from Pacific regionalism, and just as importantly, it has much to offer the wider Blue Pacific. It has much to contribute. It requires persistence and determination to be constantly at the talanoa table, with stakeholders so as to reach the collective decision.

I thank you.

Australian National University

The University of Papua New Guinea