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KEYNOTE ADDRESS BY THE OPPOSITION LEADER, HON. PATRICK PRUAITCH CMG MP – 2019 PNG UPDATE

UPNG WAIGANI CAMPUS, PORT MORESBY

PLENARY ADDRESS ON THE ECONOMY

Let me at the outset congratulate the Australian National University and the University of Papua New Guinea for conducting this joint annual PNG Update.

I am sure attendees will get a closer, in-depth look at current issues facing the PNG economy as well as many sectoral and public policy issues. I commend you for these efforts. Better information flows should contribute to improved governance and improved outcomes.

Many of you today will be aware that I have been quite vocal in the last few years on the subject of economic mismanagement. Hopefully, in my presentation I will convey why this is so and some of the changes necessary as we move forward.

THE TROUBLESOME PAST

Many of you may have been too young to remember that it was only less than two decades ago that foreign commentators were questioning whether PNG was a failed state. These are memorable times because I became a Member of Parliament in August 2002.

Gross domestic product in 2000 was around US$3.5 billion. The economy in that year shrank by 2.5%. (I am using World Bank data, in US dollar terms, to avoid the fluctuations that occur with the Kina, which was stronger than either the US dollar or Aussie dollar in the immediate years after independence.)

Per capita income fell from a high of US$1,153 in 1994, when the economy grew by 5.9%, to a mere US$632 by 2000. By 2002, at the depths of what a former Treasurer said should have been termed a 'depression' rather than a 'recession, per capita income had fallen to US$512.

In real terms, income levels were the lowest since independence in 1975. Inflation in 1999 and 2000 were running at over 15% - a period when PNG would have been among the worst performing economies in the Asia-Pacific.

In a relatively short period of eight years, between 1994 and 2002, average PNG incomes more than halved in nominal terms – never mind the dramatic change in real terms!

These days politicians have robust arguments about whether Government Debt to Gross Domestic Product has breached the 30% level set by the original Fiscal Responsibility Act. This was temporarily adjusted upwards to 35% by the previous O'Neill Government.

When we look back to 2002, we recognise how difficult the fiscal situation would have been. Public Debt stood at 72% of GDP. One reality of the irresponsible policies of the 1990s, now called 'the lost decade', was that one quarter of the 2002 budget of K3.2 billion was needed to service debt.

TURNING AROUND DIFFICULT ECONOMIC CONDITIONS (2002-07)

In its first five years in office the NA-led government had managed to make up for all the losses during the lost decade, with per capita incomes running at a record level of US$1,440. In that year GDP had grown by 11%. LNG had not come into the picture as yet.

When Sir Rabbie Namaliu, as PNG Treasurer, presented the Somare Government's 2007 budget on 14 November 2006, this is what he had to say:

"*The Government we replaced in August 2002 had been spending far more than it had been raising by way of taxation and other revenue, resulting in a large and rapidly growing budget deficit….our public debt was rapidly approaching dangerously unsustainable levels…*

…Investors had lost confidence in PNG, with 2002 being the third year in a row of the real level of economic activity falling… It is no understatement to say that, in economic terms, Papua New Guinea was going backwards. And the Government had been living well beyond its means."

Sir Rabbie said that by restoring Fiscal Responsibility and cutting back on government expenditure the government managed:

- First, to make 2007 the fourth consecutive year with higher GDP growth than population growth and rising per capita incomes;
- Second, inflation was cut from 11.8% in 2002 to 1.7% by 2005;
- Third, the Kina recovered from less than US20c in 2000 to US33c. (Sadly, it stands today at US30c!!);
- Fourth, a balanced 2006 budget pushed debt to GDP down from record highs to 42.5%; and
- Finally, formal sector employment grew 7.8% in the year to June 2006, making an impressive 20.4% in jobs growth in a four-year period.

I don't really want to dwell on the past. This introduction serves as a reminder of the precarious journey this nation has made in the past two decades. For the record 2006 was the year in which the NA Government passed the Fiscal Responsibility Act, as a milestone and guide for disciplined forward economic planning and development.

FAST FORWARD TO O'NEILL REGIME

The economy was in a strong position when Members of Parliament ignored two Supreme Court rulings that the change of government in August 2011 was illegal and unconstitutional. Prime Minister Peter O'Neill and his Peoples' National Congress Party went on to win office in the 2012 national election.

The former government inherited a strong economy that was growing well, based on sound fundamentals, including strong growth and exceptionally low public debt levels.

Average income by this time had risen to US$2,474 even though political turmoil in 2011 severely impacted on economic growth, which fell to 1.1% compared with 10.1% the year before.

During the nine years from August 2002 to August 2011, per capita incomes had risen five-fold, a record that will not be matched in our lifetime!

The PNG economy underwent a radical transformation to grow from US$3 billion to US$17.98 billion in a period of two decades. The O'Neill Government was riding high when it took office but economic mismanagement and soaring debt levels caused incomes to decline and living standards to fall.

The O'Neill Government spent billions of kina on the 2015 Pacific Games and last year's APEC Summit. Virtually all projects were grossly over-priced and most were never completed within proposed budgets. This legacy of misappropriation occurred on a scale never seen before.

Monuments to this massive waste are the unfinished Sir Hubert Murray Stadium and hundreds of vehicles purchased for APEC that continue to lose value out in the open on Port Moresby's waterfront.

The Minister responsible claimed the government would recoup costs when the cars are sold. One would have to be virtually brain dead to have believed him.

While Port Moresby prospered and took on signs of a modern city, much of the nation felt neglected. Local and regional road networks fell into a state of disrepair, impacting on the daily lives of rural communities.

The Pacific Games and APEC Summit were 'feel good' events but totally unproductive from an economic perspective. The billions in debt raised by the O'Neill Government will remain a burden for PNG's next generation.

The impetus given the national economy by the PNG LNG project, approved by the previous government, resulted in a surge in investment and employment until LNG construction ended in mid-2014.

According to the World Bank per capita incomes peaked at US$2,973 in 2014 before falling sharply to US$2,462 two years later. This outcome would have worsened considerably in 2018 after the economy shrank by 0.7% to record the nation's worst economic performance since 2000 when GDP fell 2.5%.

An unexpected plunge in oil and gas prices at the end of 2014 caused government revenue to fall by 14% in 2015 and by 6% in 2016.

Instead of streamlining government expenditures, the O'Neill Government chose to announce record annual budgets based on contentious revenue figures and record levels of public sector debt. The seeds were planted for a deepening crisis.

Ironically, there are clear parallels with the early 1990s when governments indulged in excessive borrowing that contributed to the 'lost decade'.

PARALLELS BETWEEN 2000 AND 2019 CRISIS

When Grand Chief Sir Michael Somare took office in August 2002, most State-Owned Enterprises were virtually insolvent and incapable of surviving without government support.

This picture had been almost totally transformed by the time O'Neill took office in 2011. Air Niugini's revenues had topped K1 billion. PNG Power had become self-sustaining, particularly after the Rauna-2 hydropower station refurbishment.

The money grab by the O'Neill Government destroyed the sustainability of many SOEs. The new Minister for State Enterprises, Sasindran Muthuvel, says SOEs have in recent years amassed debts totalling K6 billion.

For the moment the Marape Government continues to perpetuate the O'Neill Government mantra of wanting to maximise dividends payments to government from SOEs that are financially troubled.

Like Governments in the early 1990s, the O'Neill Government was prone to counting its chickens before they were hatched. In the 90s, as oil production commenced at Kutubu and gold from Porgera, governments of the day began rounds of heavy borrowing for deficit budgets, leading to the 'lost decade' I mentioned earlier.

WHAT HAS GONE WRONG

Even before the US$19 billion PNG LNG Project began production, the government borrowed heavily to finance deficit budgets. The planners forget that big resource projects, like Ok Tedi in the past, are highly capital intensive and rely on substantial debt. They can take many years – almost ten years in the case of Ok Tedi – to become significant payers of company tax.

In 2013 the O'Neill Government borrowed K3.07 billion, K3.4 billion in 2014, K2.6 billion in 2015 and K3.09 billion in 2016. Public debt this year will surpass K28 billion, K13 billion more than it was five years ago or K20 billion more than when O'Neill became Prime Minister.

For some perspective, recall that government borrowing in 2013 alone was more than the entire PNG National Government budget in 2002.

Despite the sharp fall in commodity prices – minerals in 2012 and oil and gas at the end of 2014 – the O'Neill Government continued to borrow and spend at an unsustainable rate.

When debt becomes counterproductive…

I have nothing against borrowing with funds that are put to good use. With slack expenditure controls and numerous excessively priced projects even so-called 'cheap loans' become a rip off and a severe burden.

When spending of this nature does not provide adequate returns it becomes counterproductive with debt levels that cannot be properly serviced by wealth generation. PNG has reached the stage where debt servicing costs are double the expenditure on education or, for that matter, for health or law and order.

Many loans from China in this category involve dubious political involvement and questionable outcomes. Many have generated minimal employment within PNG. In spite of the tremendous government spending in the past six years, employment levels have fallen dramatically. Surely this is a clear sign of things going wrong.

According to Bank of Papua New Guinea, non-resource sector employment rose by 6.2% in 2011 and 6.5% in 2012. Employment levels remained flat in 2013, and fell by 2.9% and 4.2% in 2014 and 2015 respectively.

The formal sector jobs plunge resumed with a vengeance in 2017 when 5% of the workforce lost their jobs. The World Bank estimates another 2% of jobs disappeared last year.

You would recognise that every employed person losing his job would result in severe financial problems for five or six additional people. Thousands of people would have fallen into the poverty trap under the O'Neill regime.

Part of the dismal employment record in recent times is linked to the outflow of Foreign Direct Investment, which has become a hidden scourge on the economy. No one talks about this. There is little public awareness. What it reflects are poor national and international perceptions of government policies that contribute to a weakening investment climate.

Companies are pulling out and taking their money abroad. Even our Central Bank makes passing reference to this issue without discussing it in any detail. If not for monitoring done by the World Bank, we would not be aware that this problem exists.

Negative FDI flows are also a little discussed contributor to the nation's foreign exchange problem. According to the World Bank, negative FDI has occurred in PNG in 2011 and 2012, linked to political turmoil and uncertainty, with this trend continuing in 2014, 2016 and 2017.

This is the worst record of any government since independence. FDI turned negative historically only on two occasions – when the Australians packed up to go home in 1975 and again in 2008, at the height of the global financial crisis.

With the Marape Government adopting much of the rhetoric and policies of its predecessor this challenge is certainly not going to go away. The Prime Minister and his high-powered delegation have come away with good intentions and feelings from their recent state visit to Australia. Unfortunately, the rhetoric and the actions do not appear to be in sync.

The World Bank had said so in recent economic statements on PNG. The local business community is also sounding alarm bells, but it seems that many politicians have become deaf to this ‘noise’.

HOW THE LNG STORY FITS THE MACROECONOMIC PICTURE

In his recent Economic Update to Parliament, PNG Treasurer Sam Basil said the previous expectation of 0.3% economic growth had been downgraded to a contraction of 0.7% because of the poor performance of the PNG LNG Project in the second half of 2018.

This is a fallacy. In the second half of last year the PNG LNG Project had its best performance since the start of production in May 2014. It should therefore have lifted the nation’s economic performance. Instead it now means the recovery anticipated this year is likely to be sub-3% and contribute to a further fall in per capita incomes.

High oil and gas prices, and the falling value of the Kina, meant LNG export revenues last year rose 22% to an all-time high of K12.8 billion.

Since the fall in oil and gas prices at the end of 2014 there has been a lot of criticism channelled at the PNG LNG Project. Much of this is misplaced and based on misinformation. The government inability to complete clan vetting processes cannot be considered a failure of the LNG project.

A study completed last year by the National Research Institute concluded that the PNG LNG Project led “to a permanent upward shift in productivity growth” but that these positive impacts would not occur if the government “were to squander the proceeds of the Project on wasteful spending”.

The co-authors of the study said that among the intangibles is the fact that PNG’s crude oil production has been four times higher by 2016 than it would have been without the LNG project.

The higher growth trajectory generated by the LNG project means that PNG’s total GDP would be K81.7 billion higher and reach K169.5 billion in 2030. If the LNG project had not taken place total GDP would only have reached K87.8 billion in 2030. I’m sure those of you interested in this topic could avail yourselves of the NRI study.

MEDIUM TERM OUTLOOK

Unfortunately, I do not have any good news to deliver today. Since the Marape Government took office a couple of months ago the outlook for PNG has worsened. The 2019 MYEFO paints a rather grim picture for the current year with a soaring budget deficit and public debt.

First, from a global perspective: The International Monetary Fund has downgraded the outlook for the world economy due to the ongoing trade conflicts between the United States and China, a significant slowing in world trade and rising Middle East tensions. The US-China trade war is worsening as we speak, sending negative signals to global markets.

This will have direct and indirect impacts on the PNG economy. Crude oil prices have become volatile. Lower anticipated world demand has become a crucial factor. There is no consensus about the path of energy prices in the next few years.

Oil prices are in the balance because of uncertainty over whether US shale oil production can be sustained at levels that have made the United States the world’s biggest oil producer. Despite extremely strong demand for natural gas from China, spot prices for natural gas have dropped sharply in the highly competitive East Asian markets.

On the domestic front, much emphasis has been placed on Papua LNG and Wafi-Golpu as projects that will underwrite stronger economic growth.

The government decision to approve the previous gas agreement for the Papua LNG Project is welcome. However, it appears likely that Front End Engineering and Design (FEED), which had been stalled, is only likely to commence next year. It will be conducted under a cloud with many countries paying greater attention to the use of renewables. The United States could also become a significant factor as it becomes the world’s third biggest LNG exporter after Qatar and Australia.

Newcrest and Harmony Gold, equal partners in Wafi-Golpu, have abandoned plans for early works. The government has also failed to deal clearly with the expiring Mining Licence for the Porgera mine. The mine operators have now received a court directive that allows them to continue production while the government makes up its mind on the mine extension.

From this perspective it would be realistic to expect that economic growth in the coming year would slow down to the sub-3% GDP levels at which per capita incomes continue to fall.

The Marape Government shows no signs of making the tough decisions that are necessary. The current inertia in dealing with the revenue gap, as has happened in the past, could lead to further macroeconomic instability and strongly rising public debt. Part of that inertia is reflected in the government's inability to discipline the management and board of Kumul Petroleum.

As the NRI study points out, income distribution that have accrued to government "were being diverted to Kumul Petroleum". The study said the concept of the Sovereign Wealth Fund has "been watered down substantially as a result of income distributions now going to Kumul Petroleum instead of the SWF as originally intended".

I would like to disclose to this distinguished audience today why every Papua New Guinean should hang his head in shame over the unethical behaviour of the management and board of Kumul Petroleum. I am not referring to the recent concerns about how this State-Owned Enterprise has locked away billions of kina worth of foreign exchange in its Singapore bank accounts, while the shortage of forex has caused thousands of people to lose their jobs since 2014.

Many of you who attend industry conferences would have heard the Kumul Petroleum Managing Director, Mr Wapu Sonk, boast about their equal partnership in NiuPower with Oil Search. This gas-fired power station is already providing the people and industry of this city with much needed electricity.

But let me disclose today that after signing all the joint venture documents, and taking credit for implementation of this project, Kumul Petroleum has failed to meet its share of costs for the venture. Basically, it has shown an attitude of 'you can go to hell' when requests were made for settlement.

We have all come to learn in recent times that Mr Sonk believes his organisation is not answerable to Parliament. We are sick of the lies, mistruths and half truths coming out of this organisation. There is no excuse for its refusal to pay its share of costs for this joint venture. If this issue is not sorted out immediately, we are left with no option but to blame the government of the day.

CONCLUSION

The inability of the Marape Government to deal quickly and effectively with key resource project issues will impact on most other policy areas, including inadequate spending on education and health. Populist policies may sound nice and encouraging and have many people applauding from the sidelines.

But if the end result is inability to compete on a global scale, investment flows will continue to shrink and, worse still, continue to flee this country and make the task of economic development and progress even more elusive. In many areas, a back to the basic’s agenda is needed.

Most affected will be aspirations to improve the performance of the agricultural sector and especially the high percentage of Papua New Guineans involved in subsistence farming.

Like the O’Neill Government, the current government is prone to support capital intensive agricultural ventures which tends to employ small numbers of people and neglect the majority of the nation’s farming communities.

As in many other areas what is called for is much greater investment and involvement in the subsistence sector, with greater use of extension workers and programs such as the World Bank’s Productive Partnerships in Agriculture Program. Such programs raise the prospect of doubling or even tripling agricultural output and in quickly improving living standards among rural communities.

In this regard the latest World Bank economic commentary on PNG has noted that the provision of extension services is extremely limited.

This, it said, was due to the complex and poorly understood organic laws governing relationships between the national, provincial, district and local level governments. The WB intimated that poor extensions services are linked with corruption, such as “the practice of appointing unqualified personnel, motivated by political gain or nepotism". This, it said, creates conditions that make policy development and implementation unworkable.

Without strong and enlightened leadership, the problems and challenges of the past will continue to haunt policy makers.

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