Economic survey

A new dawn for Papua New Guinea's economy?

Timothy Curtin

The Morauta government that took office in July 1999 has succeeded not only in stabilising the economy, with its return to sound fiscal and monetary policies and resumption of dialogue with the international donor community, but also in carrying through some major reforms, including granting full control over monetary policy to the central bank, and making preparations for privatisation of the state-owned commercial bank. However this paper shows that much remains to be done to complete the process of structural adjustment, and that aid donors' conditions, notably those of the IMF and World Bank, have not addressed such issues as land reform, tax effort, and giving the public service the same protection from political interference as now enjoyed by the central bank.

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Once again Papua New Guinea has lived up to its reputation for unexpectedness in the year since Sir Mekere Morauta became Prime Minister in July 1999. When Sir Mekere took office, the kina appeared to be in free fall, especially against the Australian dollar which governs most import prices, foreign exchange reserves were disappearing, interest rates were approaching 30 per cent, as was the rate of inflation, mainly because the outgoing government of Prime Minister Bill Skate had failed in its efforts to find external financing to fill the 1999 Budget's financing gap. Since then

- the kina stabilised, and since March 2000 turned in one of the stronger performances of any developing country currency
- the balance of payments turned around after the deficit in the year to July 1999
- the mobilisation of foreign balance of payments loans and a return to fiscal discipline led to an improvement in net foreign exchange reserves, which had climbed to US$230 million as of June 2000, compared with US$55 million a year earlier
- the budgeted deficit is 1.9 per cent of GDP in 2000 but likely to be overstated, with some prospect of the actual surplus as of end September being maintained to year-end
- inflation, which had been running at an annual rate of 19 per cent between March 1999 and March 2000, is still over 20 per cent but the underlying rate of 14 per cent

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(July 1999–July 2000). Prices of imported foods such as rice and milk have fallen with the recovery of the kina against the Australian dollar
- there have even been signs of increases in employment after many years of stagnation, with an increase of 3.3 per cent from June to December, 1999.

The new Prime Minister also took on the portfolio of Treasury Minister and, in that capacity, Sir Mekere Morauta immediately reversed the disastrous macroeconomic policies of his predecessors, Prime Minister Bill Skate and Treasury Minister Iairo Lasaro. His first action was to introduce a supplementary budget in August 1999, rationalising previous expenditure estimates, with cuts in capital expenditure that reflected the already low disbursement rates, deferral of retrenchment benefit payments, and introduction of some new revenue-raising measures (Harden and Sugden 1999). The government also made preparations to meet the International Monetary Fund (IMF) and World Bank conditions for resumed support with proposals to increase central bank independence, reform the public service and ensure its integrity, strengthen the supervision of bank and non-bank financial institutions, and privatise the larger public enterprises.

The Morauta mini-Budget 1999

The Prime Minister's mini-Budget sought to reduce the projected budget deficit for 1999 to K157 million (1.7 per cent of GDP)—an ambitious task given the first half deficit (January–June 1999) of K217 million. The new revenue measures included higher excise duties on alcohol, tobacco, luxury cars and motor fuel, and higher taxes on poker machines and log exports, with an expected revenue yield of 1 per cent of GDP. The previous government's interest-withholding tax on resources industries was abolished, although its 4 per cent levy on the mining industry (to recoup revenue that would otherwise have been lost after the introduction of VAT in July 1999) was retained pending a new review of mining taxation. The mini-Budget also reversed the Skate–Lasaro budget's termination of public funding for some 19 research institutes and other public bodies, and deferred its planned 7,000 civil service retrenchments with the concomitant payments of terminal benefits (Curtin 2000a).

Resumption of dialogue with donors

Sir Mekere Morauta's most significant initiative was reopening dialogue with the IMF and World Bank. These institutions had kept only distant relations with Skate's government because they considered his Chief Economic Adviser, Pirouz Hamidian-Rad, to be in breach of contract with the World Bank, his previous employer. There was also a rapprochement with the Australian government, which provided an initial US$30 million with a further US$80 million standby facility (conditional on IMF/World Bank approval of the 2000 Budget), and with other bilateral and multilateral donors like Japan and the Asian Development Bank, at the meetings of the Friends of Papua New Guinea donor group and the World Bank Consultative Group in Port Moresby in November 1999.

After further negotiations, a total financing package of around US$300 million had been pledged by June 2000, including a structural adjustment loan from the World Bank of US$90 million, and similar loans of US$80 million from Australia and US$50 million from Japan, in addition to balance of payments support from the IMF (*Australian Financial Review*, 23 June 2000). Only the loan from Japan is on fully concessionary terms, with interest at 2.2 per cent, a grace period of ten years and repayments over 30 years; the others are on the World Bank's usual terms for all but the poorest countries. For example, the Australian loan of US$80 million carries an interest rate of 7.05 per cent, with repayment over five years. Such non-concessional terms create an imperative for the funds to be used productively.

Restoration of prudential financial management

Another early initiative of the new government was its cancellation of the exemptions from the licensing requirements of the Bank of Papua New Guinea (BPNG) for the pyramid schemes that had been granted by the previous Treasurer, Iario Lasaro, and Governor of the BNPG, Morea Vele. Apparently, the general public had subscribed some K500 million to the promoters, who then absconded. A deadline was issued for the schemes' operators to submit full disclosure of their operations, and authority to prosecute the schemes' owners was delegated from the public prosecutor to lawyers appointed by the central bank. As a result, the two largest schemes were placed under liquidation (Callick 2000).

A similar improvement in governance was achieved with the public inquiry into financial irregularities in the management of the National Provident Fund (NPF) during the tenure of the previous government. The new management installed in 1999 found that members' funds had been dissipated by losses amounting to over K150 million, resulting from unauthorised borrowing and unsound investments, including shares purchased in companies such as Cue Energy and Highlands Pacific (in the latter case, at the direction of the Finance Minister in 1997, Chris Haiveta). By 1999, the investments were worth less than 25 per cent of the price paid by NPF.

An even more significant move was the dismissal of the Board of Papua New Guinea Banking Corporation (PNGBC), the 100 per cent state-owned commercial bank, by Wilson Kamit, the Governor of BPNG, on 31 August 2000.[1] At the end of May 2000, PNGBC accounted for 43 per cent of the total assets of all Papua New Guinea's commercial banks. With reserves of only 31 per cent of the total for all banks, however, its balance sheet was being propped up by the central bank, with a deposit of K48.9 million, and the government, which placed 82 per cent of its deposits with PNGBC. By contrast, it held only 36 per cent of all treasury bills, which of course were both risk free and high yielding (over 20 per cent), while accounting for 74 per cent of loan advances to statutory authorities (mostly Air Niugini), which are generally non-performing and always low yielding. Its 'investments' were mostly past loans converted to 'equity' (Table 2). As the supposed star performer among the state assets due to be privatised, PNGBC looked more like a lemon. The removal of the Board by BPNG is belated—but better that than never.

The millennial budget

Sir Mekere Morauta's budget for 2000 concentrated on consolidating the new directions he had set out in the August 1999 mini-Budget. The budget aimed to hold the financing deficit to K215.1 million, less than 2 per cent of GDP (Figure 1a), and projected surpluses in 2001 and 2002. This may be compared with the Skate–Lasaro 1999 budget's projected but unrealistically low deficit of K80 million, which in the event blew out, despite tax increases to K172.3 million (1.6 per cent of GDP) contained in the mini-Budget (see Table 1 for a detailed comparison of budgeted and actual revenue and expenditure since 1998).[2]

The 2000 Budget provided for the *de facto* termination of the Mineral Resources Stabilisation Fund (MRSF) after the Treasurer directed the remaining balance of the fund to be drawn to reduce the government debt held at the central bank. During 2000, all inflows to the MRSF will be transferred on receipt to the consolidated revenue account.

Table 1 **Papua New Guinea Government revenue and expenditure, 1998–2000** (million kina)

	1998 Actual	1999 Estimated	2000 Budget	2000 Projected
Revenue				
Personal income tax	448.80	494.70	560.00	590.00
Company tax	185.50	218.00	245.00	245.00
Dividend witholding tax	42.50	40.90	45.00	55.00
MRSF taxes	240.60	235.30	280.00	340.00
Other direct	67.80	94.20	88.90	115.00
Gaming tax	22.70	38.90	50.00	60.00
Excises	152.20	201.60	270.00	280.00
VAT	-	165.00	340.00	300.00
Mining levy	-	23.00	34.70	60.00
Other indirect	0.30	0.60	0.70	0.70
Import duty	397.80	270.00	85.00	95.00
Export duty	40.10	65.00	80.00	130.00
Total tax revenue	1,598.30	1,847.20	2,079.30	2,270.70
Non tax revenue	279.50	212.00	245.10	176.10
Total revenue	1,877.80	2,059.20	2,324.40	2,446.80
Percentage of GDP	21.10	19.40	20.30	21.35
Grants	470.30	517.60	542.30	554.70
Percentage of total revenue	25.05	25.14	23.33	22.67
Total revenue and grants	2,348.10	2,576.80	2,866.70	3,001.50
Percentage of GDP	26.40	24.30	25.00	26.20
Percentage of exports	61.68	48.07	50.31	52.68
Expenditure				
National departments	861.50	952.80	1,170.70	1,170.70
of which: Salaries and wages	383.00	427.90	492.60	492.60
Goods and services	478.50	407.90	477.10	468.10
Arrears and SAP payments	-	117.00	101.00	210.00
Provincial departments	559.60	573.50	517.10	540.20
of which: Teachers' salaries	197.60	247.70	236.90	260.00
Other salaries and wages	108.90	121.70	121.70	121.70
Administration grants	51.70	40.20	40.20	40.20
Church health services	26.50	12.30	12.30	12.30
Education subsidies	25.50	20.00	20.00	20.00
Bougainville	8.90	9.80	9.80	9.80
Derivation grants	9.70	11.20	11.20	11.20
Conditional grants	130.80	110.60	65.00	65.00
Transfer to statutory bodies	135.30	118.10	118.10	118.10
Interest payments and fees	337.20	397.90	380.80	450.70
of which: Domestic loans	229.80	283.70	233.30	316.80
External loans	107.40	114.20	147.50	133.90
Net lending to statutory bodies	-4.90	-4.60	-8.30	-8.30
Total recurrent	1,888.70	2,037.70	2,178.40	2,271.40
Percentage of GDP	21.20	19.20	18.10	19.82
Public investment program	586.50	711.40	903.40	942.30
Percentage of GDP	6.60	6.70	7.90	8.22
Total expenditure and net lending	2,475.20	2,749.10	3,081.80	3,213.70
Percentage of GDP	27.80	25.90	26.90	28.05
Percentage of exports	65.02	51.28	54.09	56.40
Amortisation	239.50	1,259.80	404.90	564.20
Percentage of GDP	2.69	11.90	3.53	4.92
of which: Domestic loans	37.30	1,042.30	127.50	121.90
External loans	202.20	217.50	277.40	442.30
Loan repayments re: CSAs	4.90	4.60	8.30	8.30
Total payments	2,719.60	4,013.50	3,495.00	3,786.20
Total payments in A$	2,096.27	2,442.62	2,236.80	2,423.17
Percentage of GDP	30.60	37.90	30.50	33.04
Memo: GDP	8,887.58	10,589.71	11,459.02	11,459.02
Memo: Exports	3,807.00	5,361.00	5,698.00	5,698.00
Memo: Exports as a percentage of GDP	42.84	50.62	49.73	49.73
Memo: Total expenditure in 1983 prices	958.27	928.12	941.01	981.28
Memo: GDP in 1983 prices	3,393.50	3,685.94	3,498.94	3,498.94

Note: The large amortisation of domestic loans in 1999 reflects accounting transfer from MRSF, a previously unrecognised asset. The projected out-turn for 2000 is based on preliminary actuals to end of September.
Source: 2000 Budget, vol.1.

Enhancing transparency as well as ending the previous exaggeration of the government's domestic public debt (which was always quoted gross, even by the BPNG, ignoring the asset of the MRSF balance). This differs from the previous fictional arrangement where the MRSF retained part of the kina counterpart funds generated by mining taxation as a reserve, only for the government to borrow from the BPNG (by sale of treasury bills) in even larger amounts to support the budget.[3]

Transferring the MRSF balance of K721 million as at 30 December 1999 to the public account 'reduced' the domestic public debt at a stroke by the same amount, to K2 billion—but this was no less than the previous net debt. At 25 per cent of GDP, Papua New Guinea's domestic debt is in reality not enormous, and the external debt in March 2000 of K3.59 billion (US$1.37 billion) or 35 per cent of GDP is also relatively small (Figure 3). Total budgeted debt servicing (interest and amortisation) of nearly K800 million is nevertheless a significant drain on fiscal resources, especially when so few of the loans in question have been translated into income-generating assets.

In real terms, and perhaps out of necessity, the 2000 Budget continued the long-standing stagnation in the growth of real public expenditure per head that is apparent when inflated kina values are re-expressed either in CPI-adjusted kina terms (Figure 1c) or in Australian dollars (Table 1). The virtually constant level of real spending per head contrasts with the steady growth of GDP per capita evident in Figure 1c,

Table 2 **Assets and liabilities of commercial banks, 31 May 2000** (million kina)

	PNGBC	Others*	Total	% PNGBC
Total liabilities	1,536.20	2,017.20	3,553.40	43.23
Central government	185.10	39.80	224.90	82.30
BPNG	48.90	0.10	49.00	99.80
Other financial	156.40	168.00	324.40	48.21
Demand deposits	579.50	656.50	1,236.00	46.89
Term deposits	311.50	728.40	1,039.90	29.95
Capital and reserves	94.30	208.90	303.20	31.10
Other PNG liabilities	152.90	135.10	288.00	53.09
Foreign liabilities	7.60	80.60	88.20	8.62
Total assets	1,536.20	2,017.20	3,553.40	43.23
Currency	51.30	38.70	90.00	57.00
Government securities	319.90	559.20	879.10	36.39
Deposits at BPNG	67.80	125.80	193.60	35.02
Other deposits	48.90	43.30	92.20	53.04
Loans and advances				
Private enterprise	540.10	776.50	1,316.60	41.02
Households	104.50	100.40	204.90	51.00
Government	26.30	9.00	35.30	74.50
CSAs	105.90	37.50	143.40	73.85
Investments	86.80	0.80	87.60	99.09
Other PNG assets	157.80	114.90	272.70	57.87
Foreign assets	26.80	211.00	237.80	11.27

Note: * the other commercial banks are Westpac, ANZ, Bank of South Pacific, Bank of Hawaii and Maybank.
Source: Bank of Papua New Guinea. *Statistics Update*, 30 June 2000.

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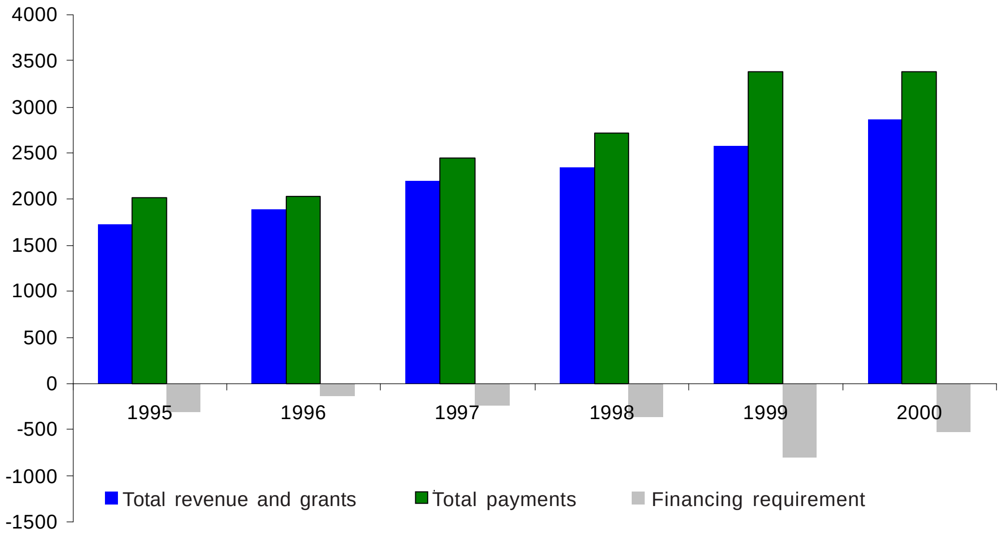
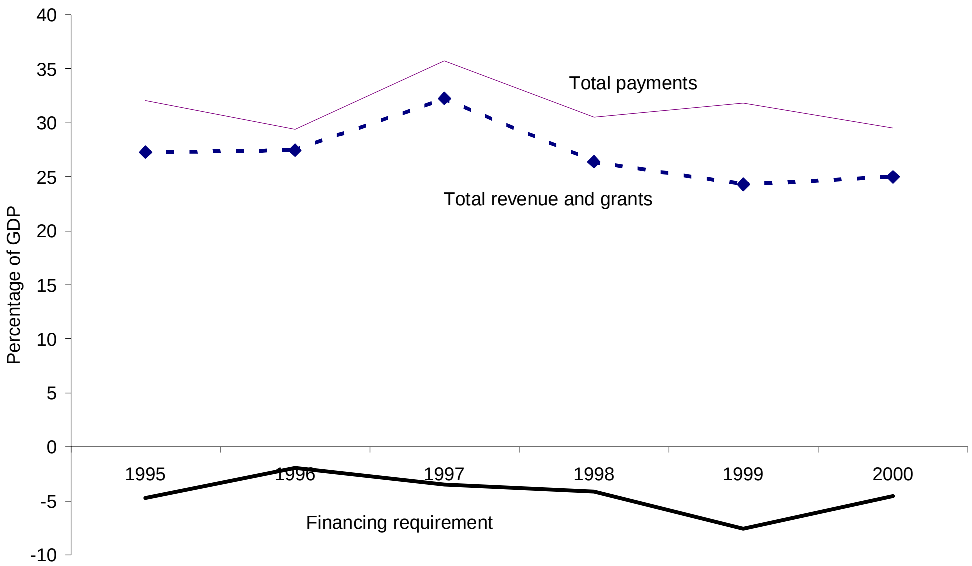
Figure 1a **Papua New Guinea: overall budget deficits, 1995–2000** (million kina)



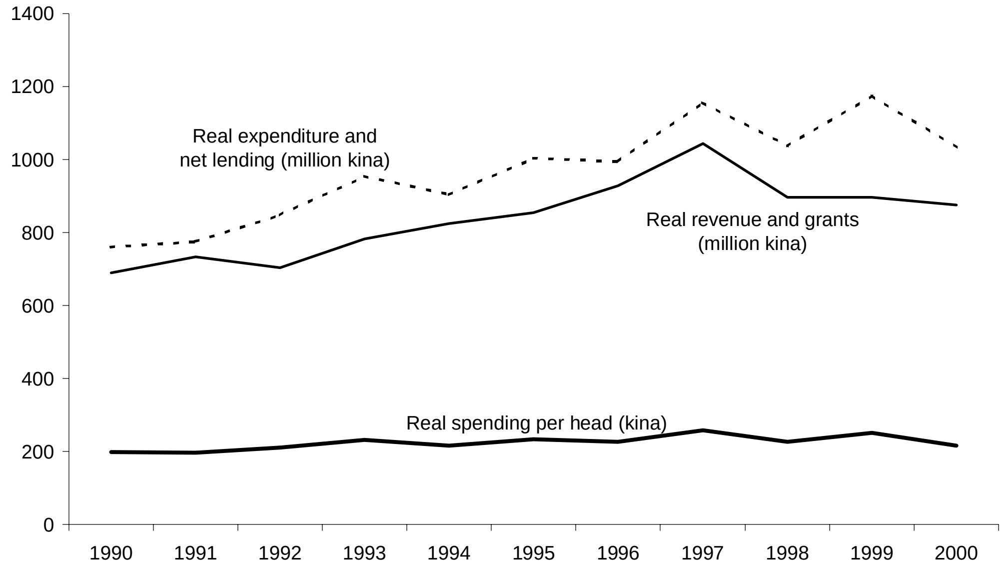
Source: Budget Documents 1995–2000, vol. 1.

Figure 1b **Papua New Guinea: fiscal GDP ratios, 1995–2000** (per cent of GDP)



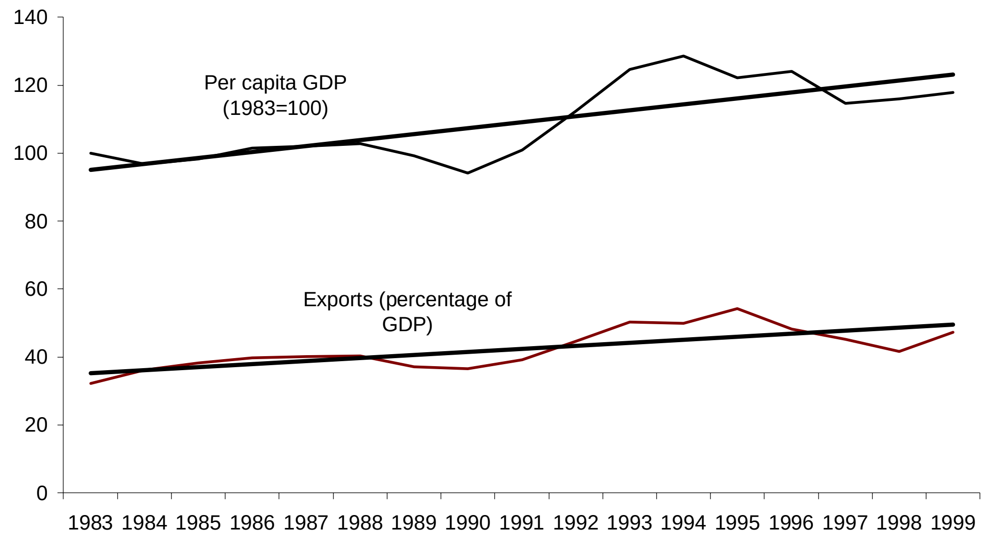
Source: Budget Documents 1995–2000, vol. 1.

Figure 1c **Papua New Guinea: real public expenditure and revenue, 1990–2000** (1983 prices)



Source: Budget Documents 1995–2000, vol. 1.

Figure 1d **Papua New Guinea: exports and GDP per capita, 1983–99**



Source: BPNG, 1998. *Money and Banking in Papua New Guinea;* Budget Documents 1995–2000, vol. 1.

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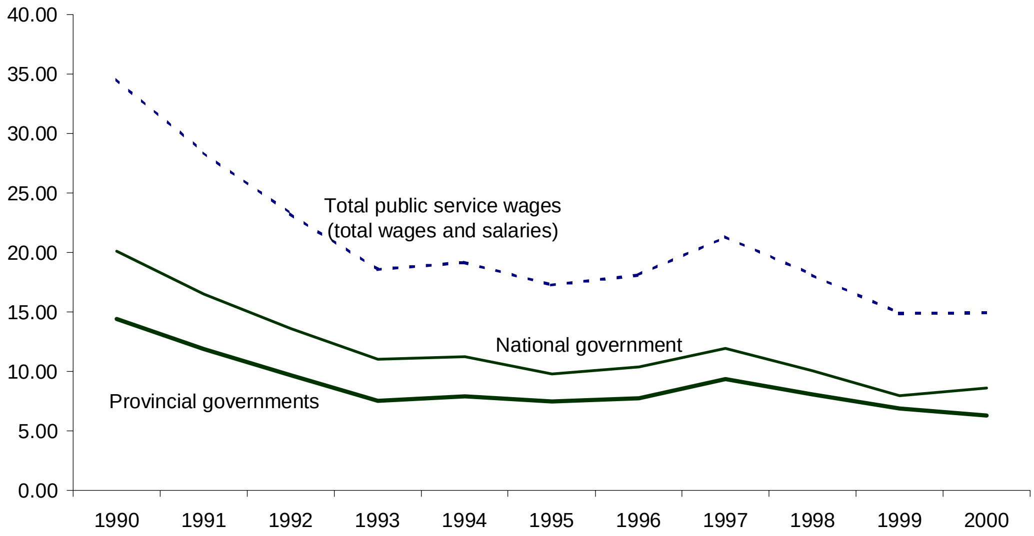
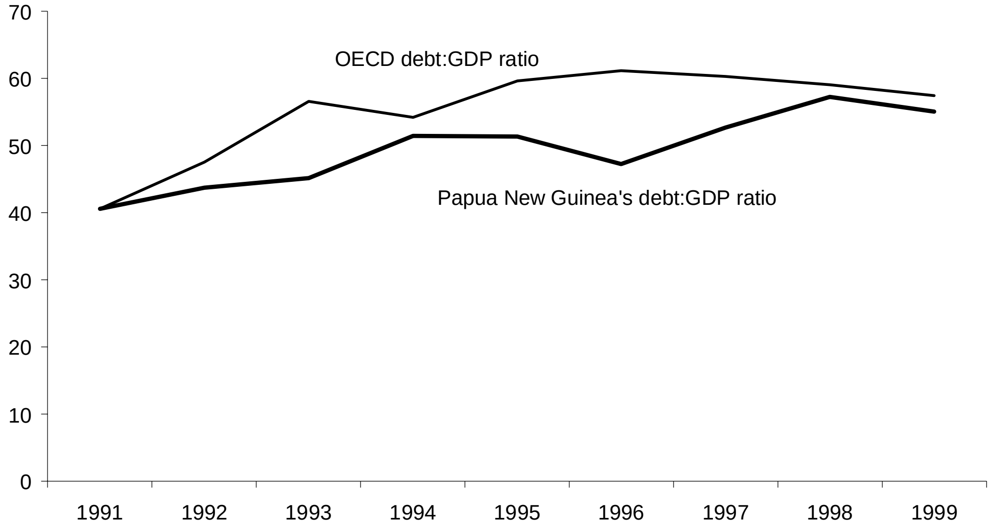
Figure 2 **Papua New Guinea: public service wages and salaries as percentage of exports, 1990–2000**



Source: Budget Documents 1995–2000, vol. 1.

Figure 3 **Papua New Guinea and OECD: public debt as a percentage of GDP, 1991–99** (PNG debt net of MRSF)



Source: Budget Documents 1995–2000, vol. 1; OECD.

suggesting that growth in private incomes has not been matched by public services.

Total expenditure and net lending in 2000 is projected to be A$1.94 billion, up from A$1.67 billion in 1999 because of the recovery of the kina–Australian dollar exchange rate, but about the same as the A$1.91 billion in 1998. The outcome is declining real levels of resource allocations to key public services like health, education and police services. For example, in Australian-dollar terms there has been no increase in funding for teachers' salaries or for the church health services funded by the government (Table 3, Table 4). With real salaries falling given consumer price increases of up to 20 per cent per annum, the widely reported absenteeism in rural schools—only 27,000 teachers out of an establishment of 31,000 are actually at work (*Post Courier*, 16 October 2000)—is not surprising. The decline in funding for church health services might not matter if government clinics were expanding, but outside the towns most of these have ceased to function.

Also regrettable is that after 25 years of independence, during which time the population has doubled, the police service has achieved no expansion of numbers (O'Connor 2000). At present, Papua New Guinea has 111 sworn officers per 100,000 people, compared with 464 in Australia's Northern Territory (closest to Papua New Guinea's geography and population density), 211.5 in densely populated New South Wales, and 222 across Australia (*Canberra Times*, June 2000).

Declines in funding of education, health and police services are hard to justify when all external critics, including the World Bank and the United Nations Development Programme, unite in condemning Papua New Guinea's performance in the key social sectors, and the private sector and others lament the deteriorating law and order situation (Levantis 2000). The country's high infant mortality rate and remarkably low levels of enrolments in any form of post-school or tertiary education and training are described in the government's own *Human*

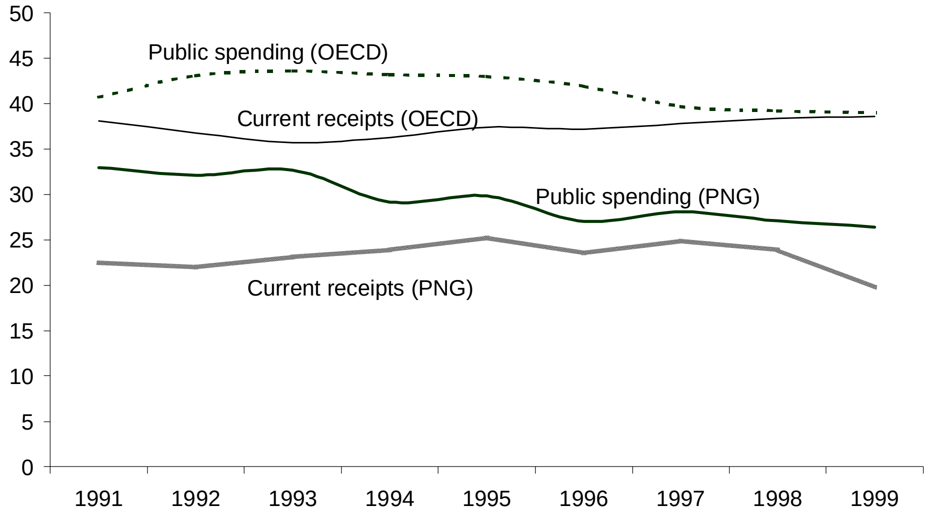
Table 3 **Papua New Guinea: teachers' salaries, 1998**

Category	K/2 weeks	K/p.a.	A$ p.a. (K1.00=A$0.66)
1	47	1,220.18	793.12
2	315	8,186.88	5,321.47
3	350	9,112.74	5,923.28
4	387	10,052.90	6,534.39
5	430	11,177.14	7,265.14
6	479	12,454.00	8,095.10
7	534	13,894.40	9,031.36
8	598	15,557.10	10,112.12
9	670	17,414.28	11,319.28
10	733	19,054.88	12,385.67
11	780	20,283.90	13,184.54

Number of teachers	26,000
Total wage bill (million kina)	245
Average salary per annum (kina)	9,423

Note: The salaries shown are the starting level in each grade, with seven increment levels within each grade.
Source: Richard Guy, NRI, *Post Courier*, 21 June 2000

Figure 4 **Papua New Guinea and OECD: public spending and revenue as a percentage of GDP, 1991–99**



Source: Budget Documents 1990–2000, vol. 1; OECD.

Table 4 **Papua New Guinea: health and education expenditure, 1996–2000**

	Million kina/A$				
	1996	1997	1998	1999	2000
Primary and secondary education	27.82	32.43	72.18	91.67	96.37
A$ million	26.86	30.37	55.63	55.79	63.61
Higher Education, Office of*	10.88	20.56	15.71	18.77	18.77
A$ million	10.50	19.25	12.11	11.42	12.39
Universities	48.20	53.50	58.37	47.10	n.a.
A$ million	46.53	50.10	44.99	28.67	n.a.
Teachers' salaries	152.00	181.30	197.60	247.70	236.90
A$ million	146.73	169.79	152.31	150.75	156.35
Health, Department of	40.56	45.67	52.20	58.91	71.35
A$ million	39.16	42.77	40.24	35.85	47.09
Hospitals	46.32	41.66	49.00	54.00	92.65
A$ million	44.71	39.01	37.77	32.86	61.15
Church health services			26.50	12.30	12.30
A$ million			20.43	7.49	8.12
Memo					
Kina to A$	0.97	0.94	0.77	0.61	0.66

Note: * administration and student support, excludes grants to the universities.
Sources: Budget Documents, vol.2, 1998–2000

Development Report 1998. The dearth of crime statistics does nothing to belie a general perception of mayhem in key areas of the country, such as the Southern Highlands and along the Highlands Highway from Lae to Mount Hagen, in addition to the alarming levels of violent crime in the main cities, Port Moresby and Lae.

Despite external perceptions of a 'bloated bureaucracy' (Callick 2000), 'public spending out of control', and the like, total public expenditure in Papua New Guinea is in fact a rather low proportion of the country's GDP—only 27 per cent in 2000 (30 per cent if debt amortisation is included)—far below the level in Australia and the rest of the OECD (Figure 2). Such ratios might suggest that the people of Papua New Guinea have less need of public services than Australians, Canadians, the British and the Germans, or that the conventional wisdom of the international donors about Papua New Guinea lacks an important dimension.

One partial justification for the donors' paradigm is that increasing the quantum of public spending in Papua New Guinea would not be helpful when arguably the quality of even the present level of spending is very low. Yet it could also be the case that the quality of teaching and nursing services in Papua New Guinea is at risk because of minimal investment in training and the low salaries and wages for teachers and nurses.

The country's only teacher training college—the University of Goroka—has suffered from the general neglect of higher education in Papua New Guinea throughout its 25 years of independence, with effectively no increase in enrolments since the early 1980s. The main reason is the lack of increases in funding for student support grants, even though the numbers qualifying for entrance have expanded rapidly since 1995. Perhaps the decision of the Morauta government with the most negative long-term consequences so far was the abolition of the Natschol student grant in January 2000 and its replacement with a steep increase in fees, moderated only for those achieving set academic standards. Although promised, no loans are being offered. One can sympathise with the aim of improving student motivation while decrying the limitation of access to those whose parents can afford both tuition fees and living support over the four years of a standard degree. External observers perhaps do not appreciate how few Papua New Guineans earn enough to pay fees that would amount to more than 20 per cent of their incomes (Curtin 1997).

Papua New Guinea's problem has arguably been not so much the level of public expenditure, including expenditure on education, given their falling proportions of exports and GDP (Figures 1 and 2), but the structural problem that even relatively small deficits lead to credit expansions which the internal monetary economy cannot absorb in productive domestic lending. The lack of domestic lending opportunities leads to the banks' concentration on financing external trade—and to the preference of élite Papua New Guineans (like former Prime Ministers Chan, Wingti and Skate) for real estate investments in Queensland, for example, instead of at home. The resulting net outflows of foreign exchange produce the regular large falls in reserves of the central bank. Unfortunately, the IMF has overlooked the structural issue of the large kina counterpart funds created by export earnings finding no useful outlets at home.

Monetary developments, June 1999–June 2000

Until its own fiscal reforms could take effect, the Morauta government was initially obliged to maintain the desperate monetary measures resorted to by the Skate–Lasaro regime following the collapse of their fiscal strategy. Thus their increase in the minimum liquid assets ratio was first maintained at 20

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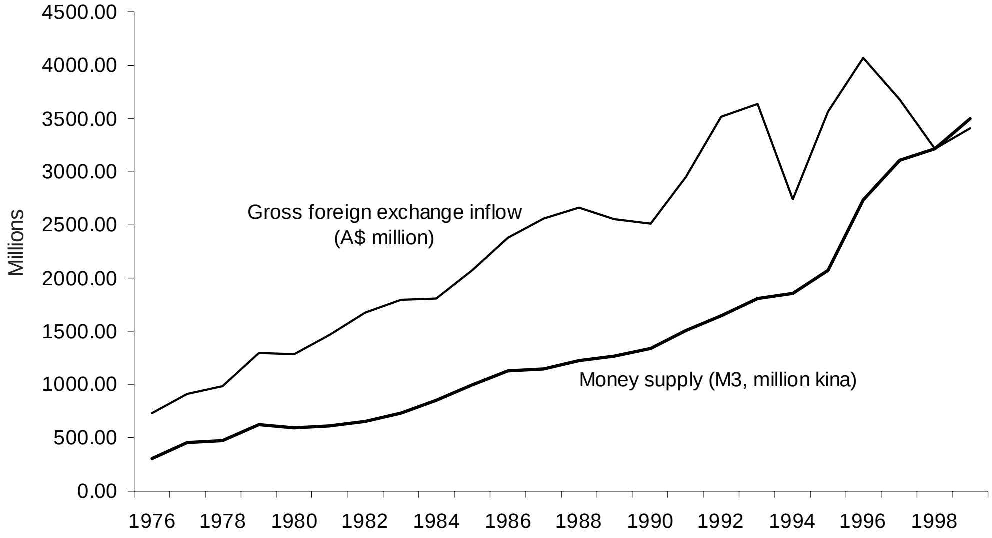
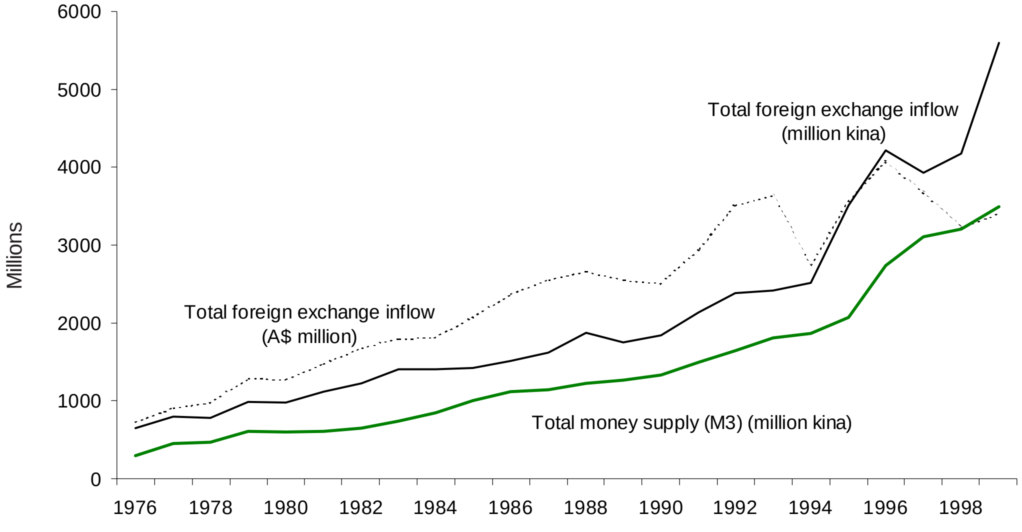
Figure 5a **Papua New Guinea: foreign exchange inflows, 1970–99**



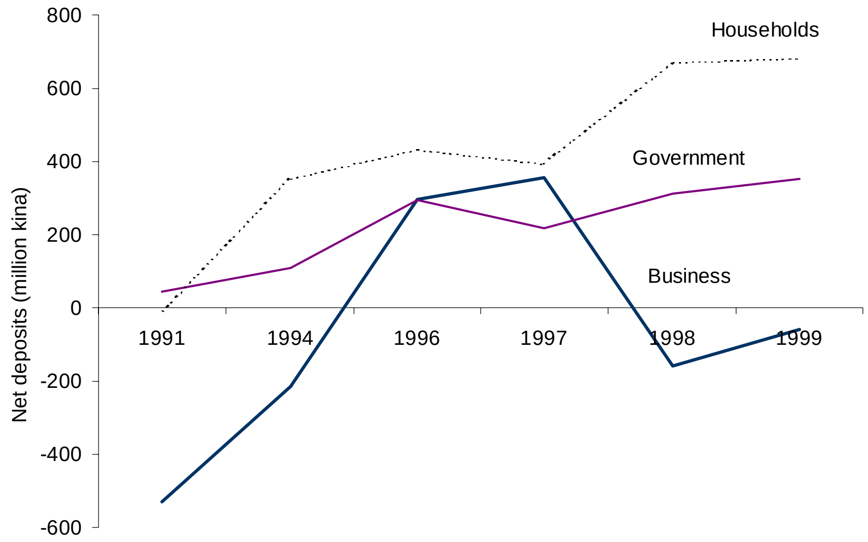
Source: BPNG, 1998. *Money and Banking in Papua New Guinea*, BPNG, Port Moresby.

Figure 5b **The case for a currency board**



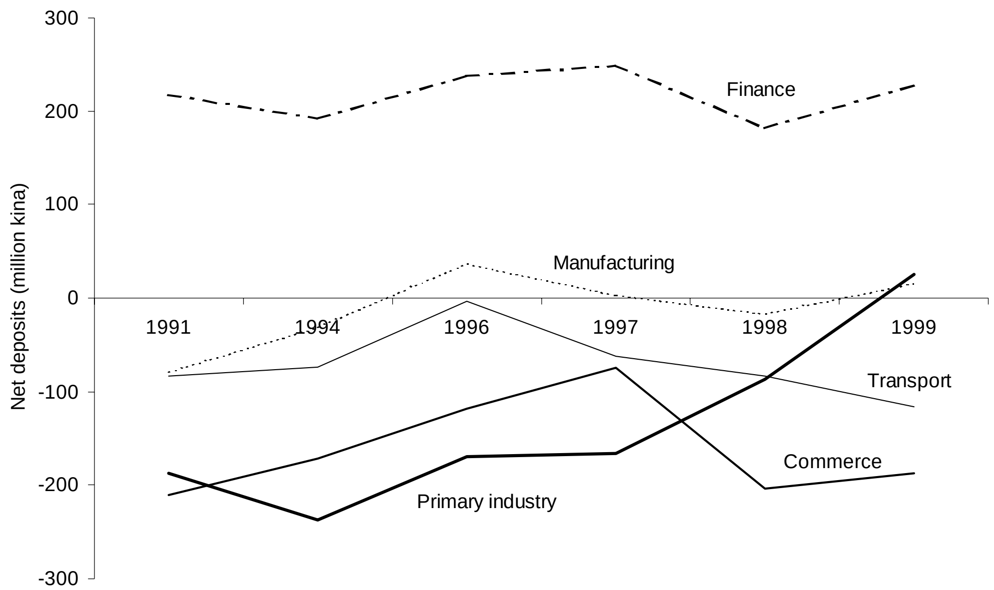
Source: BPNG, 1998. *Money and Banking in Papua New Guinea*, BPNG, Port Moresby.

Figure 6 **Net deposits by sector, 1991–99**



Source: BPNG, 2000. *Quarterly Economic Bulletin*, March, Port Moresby.

Figure 7 **Net deposits by selected industry, 1991–99**



Source: BPNG, 2000. *Quarterly Economic Bulletin*, March, Port Moresby.

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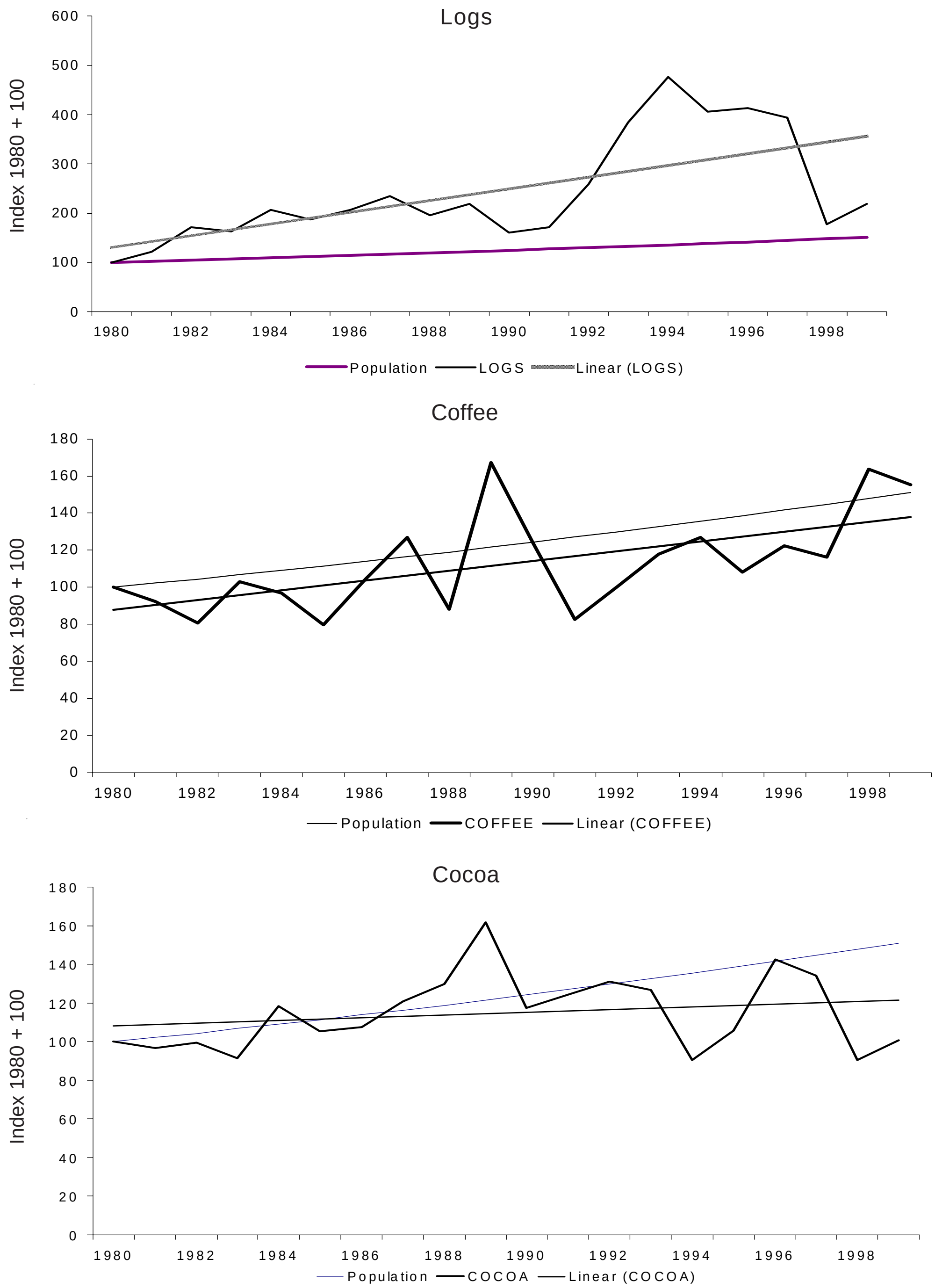
Figure 8 **Population growth and exports**



Source: *Quarterly Economic Bulletin,* March 2000, BPNG.

per cent and then increased to 25 per cent in September 1999, in addition to the interest-free cash deposit requirement imposed on the commercial banks in August 1998 (initially at 10 per cent of total deposits and other prescribed liabilities, but reduced to 5 per cent from March 1999). The zero-interest cash deposit at the BPNG had the effect of adding 2 per cent to the banks' base lending rate (to compensate for the loss of earnings on about K190 million of total deposits of K2.7 billion). When the banks could buy treasury bills paying 28 per cent in August 1999, the effective lending rate on private-sector overdrafts could exceed 30 per cent (BPNG, *Quarterly Economic Bulletin*, November 1999).

These high interest rates were successful in reversing the extraordinary growth of bank lending and the money supply in 1998 and 1999 (Figure 5). Total lending of K1.7 billion on 2 July 2000 was down by 5.6 per cent from a year before (BPNG, *Statistics Update*, 30 June 2000). As usual in Papua New Guinea, however, the minimum liquid asset ratio of 25 per cent was not in itself relevant, since the banks' actual liquid asset holdings were always well in excess of the minimum, reaching 37.2 per cent in June 2000 (this ratio has not been less than 20 per cent since 1992, and reached 50 per cent in 1997, whereas 5 per cent is the norm in countries such as Australia). The excess implies that the banks have never been able to find enough eligible borrowers to make use of their spare loanable funds.

The main constraint on bank lending remains the structural problem that the agricultural sector accounts for only 8 per cent of total bank lending. The agricultural sector nominally supports over 80 per cent of the total population and contributed 31 per cent of GDP in 1999. By contrast, commerce contributed 8 per cent of GDP and accounts for over 20 per cent of bank lending, mostly as finance for imports. As will be evident below, IMF and World Bank conditions do not address this critical imbalance in the financial structure of the economy, one that will need reform of the traditional land tenure system, which for all practical purposes prevents utilisation of the banking system's enormous lending potential in the rural economy. Papua New Guinea exemplifies de Soto's (2000) observation that the poor are rich in assets over which they have no legal rights—'these assets are vast, much more than the IMF or the World Bank could ever lend to developing countries—but they can't use them as collateral' (see also Chand and Duncan 1997).

A further and related weakness of the financial system is the lack of mortgage-lending institutions. Only the banks lend for housing to any extent, and their total lending for housing was only K90 million at the end of 1999—enough for just 900 houses if the average loan was K100,000. In the absence of even leasehold title in most of the country, it is small wonder that few new houses are ever built. Total loans to the construction industry amounted to only K60 million in December 1999, and its contribution to GDP was only 2 per cent. In a more balanced economy, construction often plays a leading role. Here again the World Bank and IMF appear to overlook the structural problems that explain Papua New Guinea's failure to develop outside its mining enclaves and main towns.

The government took steps early in 2000 to make interest rates more market-determined (reported in the IMF *Memorandum*). Under the previous system, the government paid interest to the central bank at an administered rate on the entire stock of treasury bills. The central bank then paid interest at auction-determined rates to banks and other holders of the bills. Under the new system, all holders of treasury bills are paid auction-determined interest rates on maturity. The central bank is still responsible for conducting auctions and for making over-the-counter sales of government securities, but it now acts primarily as the government's agent rather than its underwriter.

In an earlier move to improve the efficiency of the money market, the central

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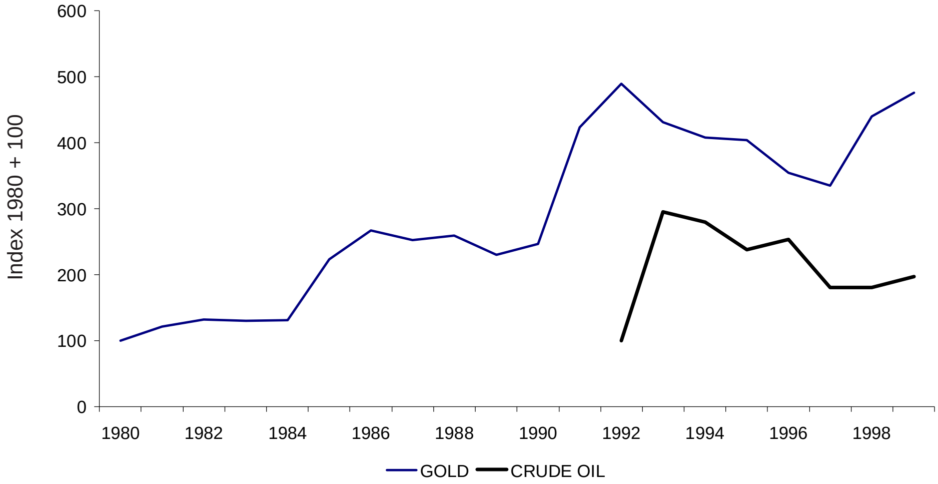
bank introduced a 'tap facility' in 1998, which allows non-bank entities and individuals to purchase treasury bills over the counter from the central bank at the average interest rate obtained during the latest auction. The facility enhances competition for funds, thereby making deposits and lending rates more responsive to changes in treasury bill yields. The improved linkage between treasury bills and deposit and lending rates is expected (by the government and the IMF) to increase the efficiency of monetary policy and help facilitate a downward shift in the entire interest-rate structure as inflation declines over the duration of the IMF facility. As early as May 2000, interest rates had indeed begun to decline, with the treasury bill rate falling from over 28 per cent in 1999 to 20 per cent in May 2000 and to below 12 per cent in mid October.

Mining and petroleum

If fortune favours the brave, Sir Mekere Morauta must be one of them. While the Skate government's erratic 1999 Budget met instant retribution with sharp declines in oil and gold prices in the first quarter of 1999, Sir Mekere's responsible mini-Budget was rewarded with rapidly rising oil prices and some recovery in the gold price. These improved prices, however, masked falling oil production, which dropped to 75,000 barrels per day in 2000 from the peak of 140,000. Higher output from Gobe and Moran has offset only part of the decline at Kutubu (Figure 9). Declining gold output at Misima and Ok Tedi was, however, offset by increased output at Lihir and an unexpected but temporary increase in Porgera's output in the first half of 2000 (its long-term trend is down due to falling grades).

The outlook for mineral exports is not good, with no firm starting date for construction of Highlands Pacific's Ramu nickel and Frieda River copper prospects, and no new oil production in sight. Unusually, Highlands' Ramu project was granted approval of the Mine Development Contract (MDC) by the government in July 2000 before the debt financing (about US$600 million of

Figure 9 **Export volumes, gold (1980=100) and oil (1992=100), 1980–99**



Source: *Quarterly Economic Bulletin*, BPNG.

the initial project cost of US$816.4 million) had been secured. In another new departure, Highlands secured a provision in the MDC guaranteeing stability in the project's fiscal treatment for ten years after beginning commercial production, in effect, for the term of the loan finance. Highlands owns 68.5 per cent of Ramu, with Orogen Minerals as the other main partner. An additional equity holder is being sought.

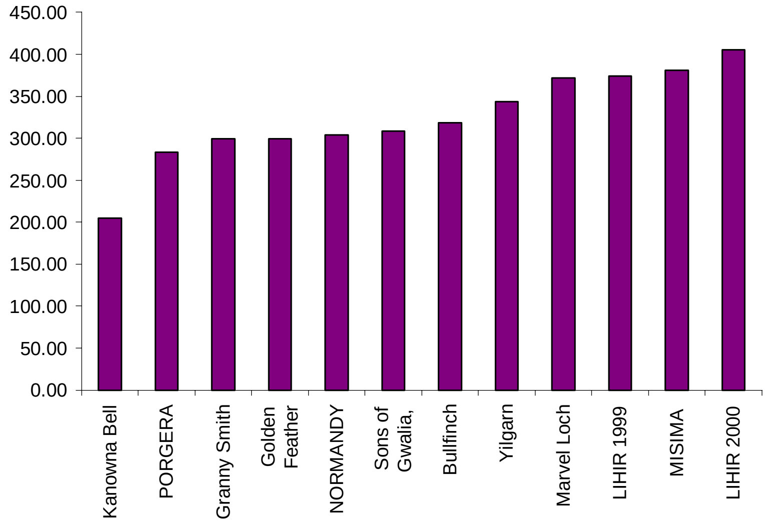
The Queensland gas project is more advanced than Ramu in terms of its financing structure, with the oil major Chevron as the lead developer, but no firm date for construction has been announced. The capacity of Oil Search and Orogen to finance their 30 per cent share of the costs of the infrastructure of what will be by far Papua New Guinea's biggest-ever project is questionable. Arrangements for financing landowner-equity participation also remain to be determined.

The distressed share prices of Papua New Guinea's mineral companies are cause for concern in a country needing to attract foreign investment in its mineral resources. In mid October 2000, shares in Orogen Minerals languished well below the issue price of A$1.70, and those in Lihir were not even half of its issue price (A$1.57). Shares in Oil Search were much the same, trading at less than half their peak price of A$3.40 in May 1998, while those in Highlands Pacific stood at only 17 cents (its issue price in 1997 was A$1.00). In the case of the mines, the main factors are rising unit costs (despite reductions in real wages following the kina's depreciation) and falling grades. The Oil Search and Orogen share prices suffer from falling oil production at Kutubu and delays in bringing the new but smaller Moran field into full production.

Land reform is usually discussed only in regard to agricultural land, but the lack of freehold tenure also creates problems for mining companies. This is not a question of the companies themselves being granted freehold title instead of the perfectly satisfactory long-term leases currently granted, but of helping them to achieve stable relations with the largely putative 'landowners' of mining areas. If land tenure were individualised now, and if that had been the case in Bougainville in 1970, there would not be the spectacle of mining companies paying out compensation and royalties to hundreds of 'owners' of the land they use—possibly more than ever meaningfully occupied the land in question (just 2,500 hectares in the case of Panguna mine according to Denoon (2000)). Ok Tedi was constructed in a largely uninhabited area. In the case of Porgera, however, where 785 individual payments totalling K3.3 million were made in 1992, there was close cultivation, and more than 20 clans/sub-clans had gardens in the 2,228 hectares within the mine lease area. Of this total area, 1,319 hectares were untouched by mining operations (Banks 1999:102, 172).[4]

The need to maintain ongoing compensation payments in addition to well-funded welfare and social infrastructure programs has resulted in Papua New Guinea's mining costs becoming much higher than Australia's. Despite nominally low-cost labour, Lihir's direct cash costs of production per ounce of gold were as high as US$235 in the second quarter of 2000, and Porgera's total cost not much better, at US$225 in the first quarter. These compare poorly with cash costs of Australian peers like Delta Gold and Sons of Gwalia, US$159 and US$195, respectively, or with Delta's all-in cost per ounce of US$212 (Figure 10). When rising landowner payments are added to direct operating costs, Lihir barely breaks even with spot gold prices at less than US$300 per ounce (its prospectus was based on a gold price of US$380 in 1995 growing at 3 per cent per annum on average). Small wonder that Lihir's share price has slumped relative to those of Delta and Sons of Gwalia. This poor performance does little to encourage potential investors in new projects such as Highlands Pacific's Ramu nickel.

Figure 10 **Comparative cash costs of production, selected Australian and PNG gold mines, 1999–2000**



Source: Company reports, 1999–2000.

The ongoing saga of litigation over Ok Tedi's environmental impact is also not helpful. Proposals by BHP—the operator and majority shareholder—to bring forward closure of the mine are being resisted by the government, which is also insisting that Ok Tedi undertake major environmental rehabilitation when the mine does close. Regrettably, little consideration appears to have been given to using the rehabilitation funding for a development program in the Fly River delta, where there is scope for timber, rubber, fisheries and livestock development.[5]

Agriculture, forestry and marine products

Papua New Guinea's agricultural exports recovered in 1999–2000 from the effects of the nationwide drought in 1997, but encountered falling world prices. The effects of world price declines were largely offset by the decline in the kina between 1997 and the first quarter of 2000. Total agricultural exports rose to K1.17 billion in 1999 from K777.2 million in 1997, but declined in US dollar terms from $542 million in 1997 to $457 million in part as a result of lower world prices for coffee, cocoa, tea, logs, copra and palm oil. Despite some modifications to the export tax system, Papua New Guinea's recorded log exports in 1999 were only half the 1996 volume of 2.6 million cubic metres. Prices of palm oil and cocoa continued to decline in the first quarter of 2000. Cocoa output increased somewhat over the year up to the end of March 2000, partly due to an increase in deliveries from North Solomons, the country's largest producer until 1989. Coffee and palm oil had the biggest increases in output since 1975, but both are expected to decline in 2000, and the country's other agricultural exports have generally been stagnant over the long term since independence. The main brake on development of commercial agriculture is once again the land tenure system, which makes it difficult for small-scale producers to mobilise the capital needed for more intensive production. The outcome is the failure of either coffee output (in the Highlands) or cocoa output (in the islands and other coastal areas) to grow faster than the population, when these are the main smallholder crops. Only logging export volumes show growth above that of population (Figure 8); and that will not be sustainable in the absence of land reform.

Papua New Guinea's biggest renewable primary resource is its forests. Closed natural forest still covers 36 million hectares of Papua New Guinea—77 per cent of total land area—ranging from high altitude cloud and montane forests in the highlands to lowland mixed forest and mangroves near the coast (World Bank 1998).[6] The prime logging areas are estimated at 7.25 million hectares (16 per cent of total land area), of which only 712,000 hectares had been logged by 1993 (Filer 1997). Here, too, the absence of an operational land tenure system prevents efficient exploitation of the resource. It is all too easy for foreign loggers to strike deals with often unrepresentative 'landowners', while at the same time, their chief incentive is literally to cut and run, for without effective long-term tenure, there is no incentive either to log sustainably or to replant (Wood, in Filer 1997).

Adding to the disincentives for sustainable logging is the progressive export tax system imposed by the World Bank in 1996, which removes the surplus from high log prices necessary over the price cycle to attract long-term investment in the industry (Levantis and Livernois 1998). The logging contract system, moreover, prevents the 'landowners' from sharing in profits when log prices are high (Duncan 1994). The upshot is that the majority of Papua New Guinea's population is denied beneficial access to its main resource—recorded log exports in 1999 totalled 1.3 million cubic metres (only one-third of the estimated sustainable level), worth just K255 million (about US$21 per head of total population), and amounted to only 5 per cent of total exports.

With its total land area of nearly 500,000 square kilometres scattered over a much larger area of ocean (3.1 million square kilometres), Papua New Guinea has one of the world's largest marine fisheries, but here also the yield is woefully low. Furthermore, the main benefits accrue to foreign fleets that pay only nominal, if any, licence fees (access fees paid to all Forum countries were US$60 million in 1993, with landings of some 1 million tonnes worth US$1.7 billion (Hunt 1998)). The successful prawn-fishing venture owned by Prime Minister Morauta's family remains the only substantial nationally-owned operation and just as the Investment Promotion Authority often seems bent only on preventing investment (notably in a wide range of activities from which foreign investment is excluded), so also the Fishing Authority's dead hand seems to restrict more than promote new ventures. While BPNG data suggest that exports of marine products increased to K30 million in 1999 (US$21 million), this works out at just US$4.5 per head of population (of whom over half—58 per cent in 1980—live in maritime provinces).

Manufacturing

Papua New Guinea's manufacturing sector has suffered with the rest of the economy from the uncertain investment climate of the last three years, showing negligible real growth, although employment in this sector increased by 37 per cent over the decade as a whole, the second largest increase in Papua New Guinea after mining. That performance tends to confirm the importance of addressing the land tenure issue if the rural sector is to develop, because most industries are located in the country's urban areas—the only part of Papua New Guinea (apart from the special mining leases) where effective leasehold title is available.

The main new industrial project is the long-delayed oil refinery to be constructed at Napa Napa (on the west side of Port Moresby's Fairfax Harbour). The promoters (Interoil) have listed on both the Port Moresby and Australian stock exchanges, but have yet to finalise the debt finance (US$85 million) they need for what remains a questionable project, given Papua New Guinea's declining oil reserves and domestic demand that is less than half of the refinery's projected capacity of over 30,000 barrels per day. If the refinery is successful in exporting its surplus, it will have a powerful demonstration effect, showing others that Papua New Guinea, with its relative proximity to the large Australian market, can offer some advantages over more distant industrial locations with higher labour costs.

The recent sale of the government's 50 per cent stake in PNG Halla Cement could lead to a similar outcome. The company's factory is, however, merely a finishing touch industry, grinding and packing clinker imported by the other 50 per cent partner and operator, Halla Cement of Korea. The plant provides minimal local employment and the domestic market for cement is still less than half of the plant's capacity of 240,000 tonnes. If, however, PNG Halla can develop exports—to Australia, for example—beyond the present token sales to New Caledonia and the like, it would demonstrate potential for investment in development of Papua New Guinea's vast limestone deposits, such as those at Sankwep not far from the Halla clinker plant in Lae.

Port Moresby Stock Exchange

The Port Moresby Stock Exchange began operations in July 1999 after narrowly escaping nationalisation by the Skate government before it had even opened trading. With only 59 trades in July 2000—its best month to date—its viability might seem doubtful. But with ten companies now listed, already more than had been projected by the initial feasibility study for the end of the first year, together with the scope for joint listings on the Australian Stock Exchange, such doubts are premature.[7] The recent poor record of the country's mining companies on the Australian market will also have discouraged speculative trading in what should have been the new exchange's star performers: Lihir, Oil Search and Orogen. If margin trading becomes available, and as sophistication develops in the longer term, the exchange should assist in deepening the present very limited capital market.

Papua New Guinea's Letter of Intent to the IMF

The new directions charted in the 2000 Budget encouraged the IMF to invite the government to endorse a new Letter of Intent (to meet IMF and World Bank conditions for extending new program loans). Drafted as usual by the IMF, the *Memorandum on Economic and Financial Policies* (International Monetary Fund 2000) attached to the letter was duly signed by the Prime Minister and the Governor of the BPNG, Wilson Kamit, on 20 March 2000. The letter describes the economic program the government intended to pursue during 2000–01, in particular it foresaw

- a sustainable fiscal position in 2000
- a reduction in inflation
- an increase in international reserves
- significant structural reform.

In support of this program, the government requested a 14-month stand-by arrangement (SBA) of SDR 85.54 million (65 per cent of Papua New Guinea's IMF quota).

The *Memorandum* is a manifesto that, if diligently complied with by the government, is intended to lay new foundations for prudent and efficient management of the economy for at least the first five years of the millennium. Because of the *Memorandum*'s importance, this article summarises its main provisions with comments on possible errors and omissions, and lists the detailed performance criteria with which the government is expected to comply.

The *Memorandum* begins with references to the previous World Bank Structural Adjustment Programme (SAP) (1995–97) and IMF stand-by arrangement (SBA), admitting that, apart from a degree of macroeconomic stabilisation, there had been little success in implementing structural reform, with very few commitments fulfilled by the end of 1997. The *Memorandum* notes that the fiscal deficit began increasing in 1998 and widened to about 3.5 per cent of GDP in the first half of 1999, financed almost entirely by the central bank, in breach of statutory ceilings (in the Central Banking Act). Interest rate policy, liquid asset reserve requirements and intervention in the foreign exchange market by the BPNG failed to counter the strong downward pressure on the exchange rate. Gross official reserves of the central bank fell by half during 1998 (to US$187 million) and by half again (to US$89 million) during the first half of 1999. Over the same 18-month period, the kina depreciated by 32 per cent relative to the US dollar, and inflation jumped to double-digit rates.

Papua New Guinea's commitments to the IMF

The *Memorandum* sets out the government's crucial commitments to adjustment and reform, which are aimed at achieving real GDP growth of about 4.5 per cent in 2000, a reduction in inflation to about 5 per cent by the end of the year, and a doubling of official gross international reserves to some US$379 million (3.6 months of non-mining imports). The target for the overall government budget deficit is 1.5 per cent of GDP in 2000. The government also committed itself to structural reforms that include

- strengthening the expenditure monitoring and control system
- reviewing tax policies and improving tax collection and debt management
- introducing new legislation to strengthen central bank independence and improve the supervision of banks and non-bank financial institutions
- implementing privatisation and civil-service reform.

Fiscal policy

The target for the overall budget deficit in 2000 is 1.5 per cent of GDP. If one-off structural adjustment expenditure (0.9 per cent of GDP) and the clearance of all remaining domestic arrears (1 per cent of GDP) were excluded, there would be a small underlying surplus. Total revenue and grants are projected to increase by 0.5 per cent of GDP in 2000. The *Memorandum* claimed that the government's VAT estimate of 3.1 per cent of GDP in 2000 was on track as of March 2000 and that revenues flowing into the MRSF would increase following the rise in export prices in the first quarter of 2000. Quarterly targets for both non-MRSF and MRSF revenues are set out in Table 2 of the *Memorandum* (reprinted here as Table 5).

As always, the IMF tends to be more concerned with the deficit than with the proper level of public funding of basic services in a developing country. It is also too accommodating of the natural reluctance of the Treasury and Reserve Bank to address Papua New Guinea's very poor tax performance. At 20 per cent of GDP, the tax burden can hardly be considered onerous—a 10 per cent increase in revenue, achievable by a 10 per cent increase in the average rate of income tax and an increase in the basic rate of VAT from 10 per cent to levels in, say, the European Union (at least 17 per cent in most cases), would be enough to double either health or education spending (or increase both by 50 per cent) and still result in a deficit at the approved level.

Public expenditures on health, primary industry, education, law and order, infrastructure maintenance and fiscal management (including tax administration) are supposedly exempted from the general freezing of appropriations for goods and services for other departments, with overall recurrent expenditures set to decline by 1 per cent of GDP in 2000.

The claimed exemption of health and education from the general cuts is more apparent than real. The provision for teachers' salaries is at best static (despite the need for expansion of the number of schools and teachers) (see Table 4). Education 'subsidies' (the government's very small contribution to the running costs of schools other than teachers' salaries) are down in kina terms on 1998 and are down by one-third from the 1998 level in the Australian-dollar terms that apply to the cost of most teaching materials. A similar situation prevails for the government contribution to the rural health services managed by the churches.

The 2000 Budget will have more serious long-term consequences for the development of the country's human capital with its replacement of the Natschol awards by a sliding scale of tuition fees that are dependent on performance and contribute nothing to defraying students' living costs, combined with the promised provision of student tuition loans only at some time in the future. Whether restricting access to tertiary education to those for whom up-front fees are affordable is potentially socially divisive is arguable, but what is unquestionable is that, in countries such as the United Kingdom and Australia, graduates' contribution to both income and consumption taxation is out of all proportion to their share of the labour force.[8] This indicates both automatic cost recovery through the tax system (Curtin 2000b) and an excellent return to the government that is being forgone in Papua New Guinea, where tertiary enrolments are little more than the rate needed to replace mortality of the existing stock of graduates.

The *Memorandum* requires the government to pursue a 'prudent external debt policy in 2000–01'. To this end, the government agreed to limit the contracting or guaranteeing of new long-term non-concessional external debt by the public sector in accordance with cumulative limits on such debt set out by the IMF (Table 1 in the *Memorandum*, see Table 5 here).

There is some irony in the latter requirement because the new loan package of US$300 million amounts to a rather large increase (22 per cent) in the country's external debt. The periods of grace (as in Japan's loan) will delay, but not avoid, the onset of repayment in due course, to say nothing of the annual interest payments of around K46 million initially.

Public-sector wages

The *Memorandum* commits the government not to exceed the K851.2 million budgeted for salaries and wages for the public sector. Wage increases or new hirings in 2000 are to be fully accommodated within this envelope. To guard against over-runs on the wage bill, the general hiring standstill imposed in November 1999 will remain in force until the planned public-sector reform is implemented. Exceptions to the hiring ban will be granted only to priority departments and only after consultation with IMF staff.

At only 7.1 per cent of GDP, the public-sector wage bill hardly warrants the IMF's reiterated concern and arguably constrains public services of all kinds far below the minimal needs of the country. Both national and provincial government wages and salaries have fallen as a proportion of the country's exports—from 35 per cent in 1990 to 15 per cent in 2000—and as a proportion of GDP (see Figure 2).

The *Memorandum*'s restrictions on public-sector wage increases soon ran into

Table 5 **Papua New Guinea: performance criteria and indicative targets under the IMF stand-by arrangement, 2000–01**

	Stock at 31 Dec. 1999	Indicative targets 31 March 2000	Performance criteria 30 June 2000	Performance criteria 30 Sep. 2000	Indicative targets 31 Dec. 2000	Indicative targets 31 March 2001
			(million kina)			
I Quantitative performance criteria						
Ceiling on net domestic assets of the central bank[1, 2]	183	251	226	83	-144	-198
Ceiling on net domestic financing of the government[2, 3]	1,706	59	133	101	-123	-159
			(million US$)			
Floor on net international reserves of the BPNG[2, 4, 5]	181	130	150	214	307	328
Cumulative ceiling on the contracting or guaranteeing of new non-concessional external borrowing by the public sector with a maturity of over one year[6, 7]	14	-	-	-	-	-
Cumulative ceiling on the stock of public and publicly guaranteed non-concessional short-term foreign debt[5, 6, 8]	-	-	-	-	-	-
No accumulation of external payments arrears by the public sector				Ongoing		
II Structural performance criteria						
Completion of financial and managerial audits of the two major pension funds: the Public Officers' Superannuation Fund(PSOF) and the National Provident Fund (NPF)				By end-March 2000		
Passage by Parliament of the Central Bank Act				By end-April 2000		
Passage by Parliament of the Bank and Financial Institutions Act				By end-April 2000		
Presentation of recommendations on design and timetable for a comprehensive public-sector reform program				By end-June 2000		
Finance Pacific Group brought to the point of sale				By end-December 2000		

Notes: [1]Defined as reserve money less net foreign assets of the central bank. [2]The floor on the NIR of the BPNG will automatically be increased by the full extent to which the cumulative receipts of the following items exceed the program targets: (i) MRSF tax receipts, as recorded in the BPNG foreign exchange cash flow; and (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow. Corresponding downward adjustments will be made to the ceilings on net domestic assets of the central bank, and net domestic financing of the government in an amount equal to the domestic currency value of the adjustments to the NIR floor. Automatic adjustments in the opposite direction will be made with respect to: (i) shortfalls in exceptional external financing; up to a maximum adjustment of $70 million, with no further adjustments made after this ceiling is reached; and (ii) net domestic assets and domestic financing up to a maximum of K20 million, with no further adjustment after this amount is reached. Additionally, the floor on the NIR of the BPNG will be increased, and the ceiling on the NDA of the BPNG decreased, by the amount of any foreign currency-denominated receipts from net asset sales in 2000 (revenues net of costs of sale). [3]The ceilings on net domestic financing of the government will be adjusted downward by an amount equal to the sum of: (i) domestic and foreign currency-denominated receipts from net asset sales in 2000 (revenues net of costs of sale); and (ii) 80 per cent of non-MRSF tax revenue in excess of the quarterly inflow projection. No downward adjustment will be made with respect to revenue shortfalls in the first half of 2000. [4]Valued at the program exchange rate. [5]Defined to include off-balance sheet assets and liabilities (e.g., swaps and forwards). [6]Cumulative flow since the beginning of the year. [7]The public sector is defined to include the national and provincial governments, and statutory authorities. Excluded from the limits on external borrowing are the use of Fund resources, loans from the World Bank, the Asian Development Bank, and other multilateral and official bilateral donors; loans contracted for debt rescheduling on refinancing (provided the terms of the new loans are at least as concessionary as the terms of the debt being rescheduled or refinanced); and credits that are regarded as concessionary. [8]Loans with initial maturity of up to one year, excluding normal import-related trade credit.
Sources: IMF and Government of Papua New Guinea.

trouble when school teachers resigned *en masse* in July 2000 in support of a 200 per cent wage demand. The average annual salary of the country's 26,000 teachers in 1998 was only K9,423 (see Table 3), about A$6,000. That is not much in a country whose cost of living on a purchasing power parity basis is not less than Australia's. The teachers were eventually awarded an increase of 5 per cent, backdated to 1 January 2000, with a further 'work-value' increase of 2 per cent to be paid from 1 January 2001, but backdated to 1 January 2000, together with increases in allowances for teachers in remote areas. These increases are well below the inflation rate since 1997, which was still running at an annual rate of over 19 per cent as late as the March quarter of 2000. The implied increase in the wage bill for 2000 is manageable at about K13 million, but what is more problematic is whether the increase will be sufficient to get all teachers to return to work, or whether the already widespread absenteeism in rural areas will increase.

Monitoring of the public-sector payroll

The *Memorandum* notes that the government already has procedures for tracking central government employment and wage expenditures on a bi-weekly basis and that these 'are sufficient to monitor whether the spending ceilings on the wage bill are being met', but commits itself to 'integrating the separately executed payroll systems for education and civil aviation into the central payroll by end-March 2000, and defence by end-June 2000'. The *Memorandum* also commits the government to 'development and implementation of a system able to meet the needs of budget planning, execution and control, human resources management, and public service management [that] will, therefore, have high priority in the government's public sector reform program'.

These are largely cosmetic changes, however, and the government's claim in the *Memorandum* that 'budget management has been hampered in the past by a lack of a forward-looking centralised information system capable of linking information on approved positions and employees paid' is not valid—a fully computerised payroll system already exists even if it is not much used as a management tool. Underlying the *Memorandum* here is again the IMF's unfounded belief that public-service wages are a growing burden on the economy (see Table 1 and Figure 2). The real problem has not been an out-of-control wage bill but insufficient control over the non-wage elements of departmental budgets. Ironically, that control was weakened when the present Prime Minister was Secretary for Finance and introduced relaxation of line-by-line control of departmental spending in the early 1980s. That relaxation is now normal in countries like Australia and New Zealand, but in Papua New Guinea, it has resulted in departmental spending that all too often bears no relation to the original budget, with funding for overseas travel by ministers and departmental heads replacing spending intended for operating costs of the departments. Manning (1999) cites the use of road maintenance funds to sway votes in Parliament in July 1999. However, the main mechanism for meeting the extra-budgetary demands of previous governments has been for the Treasury to create 'savings' by withholding releases of goods and services appropriations for the departments. Furthermore, the willingness of political appointees heading the Treasury to indulge their masters has been the main cause of the so-called 'arrears' that characterise the end of year out-turn of all recent budgets. Arrears develop when departments make reasonable commitments to suppliers that cannot be honoured because the Treasury once again fails to release budgeted quarterly allocations to the departments when they are due.

Thus, the government's fiscal management commitments will likely remain a dead letter—if not with the present government, then under its successors—unless the Treasury is given the same autonomy that has been granted to the BPNG by the amendments to the Central Banking Act, beginning with the establishment of a Secretary of Treasury as an advertised statutory appointment with, say, ten-year terms (there were seven changes of Secretary from 1990 to 1999). It is also vital to amend the Public Finances Management Act to eliminate the very considerable discretionary expenditure and loan approvals available to the minister. Here again, the *Memorandum*'s blind focus is wide of the mark.

Development expenditure

The public investment program is budgeted to increase by 0.8 per cent of GDP in 2000, but this mainly reflects the shift in Australian aid flows from general budgetary support to project grants. In addition, the *Memorandum* notes that the 2000 Budget identified and appropriated K101 million to cover some of the one-off costs of privatisation, public-sector reform (including the associated retrenchment payments), conducting the census, and strengthening the National Forests Authority, the Ombudsman's Office and other government oversight agencies.

Regrettably, virtually none of the US$300 million loan package assembled by the Friends of Papua New Guinea will be used to finance capital investment projects, raising serious doubts that the various loans will generate the tax revenues needed for interest and repayment. Here the IMF appears preoccupied with macroeconomic and fiscal aggregates, and not with the substance of the approved expenditures (apart from the usual requirements for downsizing the public sector). But US$300 million would, for example, be more than enough to

- link the country's biggest population centre (easily the region with the greatest demand for electricity) with its under-utilised hydroelectric resource at Yonki (estimated cost in 1990 was US$80 million, and, say US$100 million at current prices)
- build a road link between the southern provinces and the central highlands
- launch a land registration program.

Instead of such income-generating projects, the loans seem likely to be dissipated in large numbers of soft projects, often comprising provision of consultants who tend to be the only beneficiaries. Ironically, some of these technical assistance projects are aimed at strengthening the very public service from which 7,000 staff (25 per cent) are to be retrenched.

Transparency and accountability

A key commitment in the *Memorandum* is the government's planned reform of the Rural Development Program (RDP). The new RDP is intended to be a mechanism for providing government services at the district level. The government is committed in the *Memorandum* to refrain from funding the RDP until new accounting systems are in place and fully operational.

The Morauta government has done remarkably well to maintain its support in parliament given its commitment to change the management of ministers' discretionary funds of K1 million. The new guidelines establish trust accounts for the 89 open electorates whose MPs each receive K1.5 million a year, of which K250,000 is for project funding at their discretion, K250,000 is for support grants for the district councils, and K1 million is for district development projects. Although accounting is important even well-meant allocations by individual members of parliament are often scattered thinly and make no contribution to the running costs of basic services like schools and clinics.

Monetary policy

The Letter of Intent and the *Memorandum* commit the BPNG to 'containing broad money growth to 8.8 per cent in 2000, consistent with bringing inflation down to about 5 per cent by the end of the year'. To achieve this objective, the BPNG expects to restrain the growth of reserve money through a substantial decline in net credit to government. For the banking system as a whole, the *Memorandum* projects that net domestic credit to the government will decline by 11.5 per cent, and that credit to the private sector will grow at 9.2 per cent, 'which would be sufficient to support the growth objective in the non-mineral sector'.

At the end of July 2000, the level of M1 (currency and cheque deposits) was 1.7 per cent up on the year since July 1999, but the broad money supply (M3) was 9.7 per cent above the level in July 1999, at K3.27 billion (A$2.13 billion), and therefore outside the IMF's ceiling for the year. Net credit to government in 2000 had already fallen substantially (42 per cent) from January to May, while private-sector credit was up by 12.8 per cent (BPNG, *Statistics Update*, 14 July 2000). Evidently, the government was under-shooting the IMF's maxima for public-sector credit and over-shooting the ceilings for broad money supply and private-sector credit, of which the latter ought not to be a concern given the low levels of investment through the second half of the 1990s. One supposes that the IMF will not penalise the government for the increase in private credit given the under-shooting by the public sector.

Public expenditure management and reform

The *Memorandum* commits the government to overhaul its budget planning process and 'establish clear guidelines that will translate government priorities into appropriations for spending agencies, while staying within the available macroeconomic resource constraint'. To improve fiscal transparency, the government is committed to publish a mid-year budget report, including estimates for the first half of the year and updated projections for the year and present an annual development budget report alongside the budget. The *Memorandum* refers to the new public expenditure review that was initiated in March 2000 with assistance from the World Bank. It is intended to help

- prioritise government functions
- evaluate human resource requirements
- identify functions that can be contracted out to private enterprises
- determine adequate funding requirements for functions and agencies.

Recommendations from the review were due to be issued by the end of June 2000, endorsed by cabinet by the end of August 2000, and incorporated into the 2001 Budget.

The *Memorandum* also commits the government to embark on yet another public sector reform program, with assistance from the Asian Development Bank (ADB), the World Bank and AusAID.

Readers should not hold their breath waiting for what would be a unique accomplishment if this reform program were to succeed in defining 'the optimum size of the public service'. Using past public-sector reform programs imposed on Papua New Guinea as a guide, there will once again be emphasis on downsizing, even though many central government agencies are already below functional minima (for example, the Departments of Employment and Environment had only 197 and 148 posts respectively in 1998), while the numbers of police, health workers and teachers are far fewer than optimal (Curtin 2000a; O'Connor 2000). For example, there are 26,000 teachers in Papua New Guinea serving a population of over 4.5 million, of whom nearly 2 million are of school age—a ratio of 77 per teacher (the ratio for those actually at school is much lower at about 30).

The government's Central Agencies Coordinating Committee produced its first report on the required review of the public sector in August 2000, and the Cabinet approved this in September. The report was deemed to meet the IMF/World Bank structural benchmark even though it completely lacked any specific proposals for 'making the public sector work'.

Taxation review

The *Memorandum* refers to the review of the tax system that began in 1999, aimed at

- enhancing fairness in the tax system by ensuring that all taxpayers are treated in an equitable fashion
- improving the competitiveness and efficiency of the tax system
- simplifying and enhancing the transparency of the tax system to reduce the cost of compliance.

The taxation review is due to be presented to cabinet by the end of September 2000, in time for incorporation in the 2001 Budget.

At the time of writing, the taxation review had not been delivered. A key issue of the review is whether it will have tackled Papua New Guinea's rather low income tax base, with its lenient treatment of high earners and especially their often substantial fringe benefits, for that low base is the main constraint on sensible public-sector development. For example, the top rate of income tax only takes effect at K100,000, equivalent when it was introduced at A$100,000, whereas Australia's top rate of 47 per cent takes effect at A$50,000. The effective top threshold rate is still a relatively high A$66,000 (in Australian-dollar terms), and many fringe benefits are either untaxed (for example, overseas school fees) or taxed only very lightly.

Another important issue that needs to be addressed is the international competitiveness of Papua New Guinea's mineral tax regime. The industry naturally argues that it faces more stringent taxation than in other countries, including its home countries, chiefly Australia, the United Kingdom and the United States. This argument has some force given that the petroleum industry faces a flat 50 per cent profit tax rate in addition to the admittedly low royalty rate of 2 per cent (part of which is rebatable). Papua New Guinea's tax advisers need to consider the effective profits tax rate on the shareholders of the companies to which it looks for investment. In the 1970s, when top marginal rates of income tax in most OECD countries were well in excess of 50 per cent, the petroleum tax rate was not unattractive. That is no longer the case; the top marginal rates in Australia and the United Kingdom are now 47 and 40 per cent, respectively. The effective tax rate on the mining companies is also relatively high, with a corporate rate of 35 per cent raised to 46 per cent for non-residents subject to the dividend withholding tax. Past reviews of comparative mining tax regimes have focused too much on effective rates in the competing mining countries and not enough on personal income tax rates in the capital-exporting countries from which the funds for new projects are generally. There is no point taxing at less than marginal tax rates of the average investor, and much to be lost in taxing more severely (losing the benefit from double taxation arrangements).

Central Banking Act

Under the Central Banking Act enacted in March 2000, the powers and independence of the central bank and its governor have been significantly enhanced. They still fall short of ensuring full autonomy because the governor will still be appointed by the cabinet, albeit for a defined term of five to seven years (renewable for up to 14 years). The governor will have sole discretion over recruitment of all central bank staff and over the choice and use of monetary policy instruments. Aside from granting an operating overdraft of up to K100 million (subject to CPI adjustment), the central bank is prohibited from lending to the government for budgetary purposes. The *Memorandum* requires the BPNG to publish a semi-annual report in the form of a statement by the governor detailing monetary policy developments, policy stance and prospects for the coming six months. The first of these reports was duly issued on 14 July 2000 (*Post Courier*, 15 July 2000).

The new Act allows the BPNG to buy, sell and hold any quantity of government securities required for monetary management purposes, and the government is still able to borrow from commercial banks, one of which it still owns outright (the PNGBC). This could allow a less responsible future government to borrow 'at the back door', since there is apparently nothing to stop it borrowing from the PNGBC, nor that bank in turn borrowing from the BPNG (as lender of last resort). Thus, it is cause for regret that the opportunity was not taken in the new Act to adopt the main elements of a currency board regime, since provisions for granting overdrafts to the government remain open-ended and subject to abuse in future as much as they were in 1998 (Duncan and Xu 2000).

Banks, financial institutions, insurance and superannuation

The *Memorandum* commits the government to improving supervision of banks and other financial institutions. New legislation was to be submitted to Parliament by the end of March 2000, passed by the end of April 2000, and certified on 7 June 2000 (this Act enabled the BPNG to take control of the PNGBC in August 2000, as described above). The *Memorandum* also commits the government to introduce a new Act to regulate the pension and insurance industries, noting that the operations of these funds 'have been subject to extensive political influence, resulting in an underperformance of their investments'.

The new Banks and Financial Institutions Act was duly certified on 7 June 2000. The need for reform in this case was well demonstrated by the Ombudsman's Report (1999) into the purchase of the Cairns Conservatory by the Board of the Public Officers' Superannnuation Fund (POSF) in 1994. That purchase involved paying A$19 million for a building to an Australian financier who had bought it just a few weeks previously for only A$8 million, and showed the limitations of the Public Finances Management Act, since the purchase was nominally consistent with it. The Act allows the Treasury Minister to set aside the Treasury's own provisions for tendering too easily. Regrettably, the IMF did not use its leverage to insist in the *Memorandum* on the government acting on the recommendations of the Ombudsman, and many of those censured in his report remain in office (*National*, 3 December 1999).

The new Act should prevent a repetition of the mismanagement revealed during June–August 2000 by the Barnett Inquiry into the National Provident Fund (NPF). In this case, the Treasury had again failed to prevent its Minister from endorsing contraventions of the Public Finances Management Act, such as when the NPF began borrowing K36 million from the PNGBC in breach of all legal limits in both its own Act and the Public Finances Management Act. Unless the independence of the public servants charged with administering the legislation governing the superannuation industry is assured, there will be every possibility of some future irresponsible government allowing the NPF to repeat its adventures in bankruptcy of 1997–99 (see *Post Courier*, August 2000, for accounts of the inquiry into the NPF).

Privatisation

The IMF *Memorandum* commits the government to secure privatisation of at least one large state enterprise before the end of

2000. In January 2000, the prime minister convened a meeting of the Privatisation Commission, the International Advisory Group and other experts from New Zealand, the Australian Asset Management Office and the World Bank Group to make recommendations for bringing Finance Pacific Group (the umbrella company for PNGBC, Motor Vehicles Insurance Trust and the Rural Development Bank) to the point of sale by the end 2000. The privatisation process will proceed in two stages: a trade sale of controlling interest to be brought to financial closure by the end of March 2001, and a public offering of the balance of the shares within 12–18 months of the closing of the trade sale. The proceeds of this and future sales will be used for a further reduction of net government debt beyond what is in the baseline program, but realistically, not much can be expected from these largely bankrupt organisations. For example, the PNGBC has, in addition to its non-performing loans to private clients, unsecured loans to Air Niugini of over K100 million, and its loan of K36 million to the NPF for its high rise office building may have to be written-off because the NPF Board was not authorised to raise this loan (*Post Courier*, 22 August 2000). Funding for the Privatisation Commission is to be provided under the World Bank's structural adjustment loan. Parliamentary approval was obtained in April for amendments to the Privatisation Commission Act necessary to enhance accountability.

To pave the way for their privatisation and halt their drift into bankruptcy, the government belatedly adjusted tariff rates for Elcom in 1999 and Telikom in early 2000. The *Memorandum* fails, however, to require the government to exempt these so-called commercial statutory authorities from the price controls that have prevented them from operating profitably. Their accumulated losses have already reduced potential sales proceeds to vanishing point. But, in a surprise move that was not foreshadowed in the *Memorandum*, parliament approved the government's new aviation policy in August 2000, widening access on international routes to competitors with Air Niugini and deregulating the domestic market. If implemented, this policy will further reduce the attractiveness of Air Niugini to a potential buyer (if any) in the short term, but in the long run could well generate increased tourism, which is currently deterred somewhat by the absence of cheap fares (Levantis 2000).

More generally, the IMF again appears to overlook the disadvantages implied for the economy if privatisation merely involves changing ownership without changing the structure of unwieldy monoliths like Elcom and the Harbours Board. Neither of these is a 'natural monopoly', nor are there any obvious synergies between generation and distribution on the mainland and power consumption in the country's 700 or so inhabited islands. Elcom might even be construed as dedicated to preventing supply of electricity to the islands and to rural communities generally, when so few of the many populous parts of the country in such proximity to the Ramu hydroelectric grid have been connected. Creating a private-sector monopoly is unlikely to do much to expand supply very far from Port Moresby, whereas regionally-based private power companies are likely to be more active in expanding their consumer base. Similarly, the Harbours Board creates no economies of operational scale at ports scattered hundreds of kilometres apart, so meaningful privatisation implies giving autonomy to the management of each port.

Balance of payments 1999–2000

Taking into account purchases from the IMF and other financing from donors, the government's foreign exchange earnings and payments, and planned net market purchases of foreign exchange by the central bank (US$12 million), the level of gross official reserves is projected by the *Memorandum* to increase to $379 million (equivalent to 3.6 months of non-mining imports) by the end of 2000. Strong export performance and sluggish imports contributed to good progress in the first half of the year, and reserves stood at about US$260 million at the end of June. The external current account was expected by the IMF to register a small deficit in 2000, mainly reflecting significantly increased investment associated with the nickel and gas projects.

There is no prospect of the nickel and gas projects proceeding in 2000, and quite possibly not until 2002 at the earliest. Highlands and its partner Orogen cannot command either the financial or technical resources to develop Ramu and, as yet, they

Table 6 **Papua New Guinea: quantitative and structural benchmarks under the IMF Stand-By Arrangement, 2000–01**

	Stock at 31 Dec. 1999	Indicative targets 31 March 2000	Performance criteria 30 June 2000	Performance criteria 30 Sep. 2000	Indicative targets 31 Dec 2000	Indicative targets 31 March 2001
			(million kina)			
I Quantitative benchmarks						
Central government wages and salaries[1,2]	763	144	377	570	814	161
Central government recurrent expenditures[1,3]	1,990	436	1,006	1,515	2,077	420
Payment of pre-1999 domestic arrears reduction[1]	149	37	77	99	109	-
Non-MRSF tax revenue[1]	..	393	842	1,318	1,825	468
			(million US$)			
MRSF receipts[1,4]	131	5	43	74	115	6
Exceptional external financing flows[1,4]	..	-	36	81	180	10
II Structural benchmarks						
The self-assessment questionnaire on good fiscal management will be completed and submitted to the Fund					By end-March 2000	
The Privatisation Commission will have identified candidates for privatisation and will have formulated a detailed schedule and methodology to be employed					By end-March 2000	
Actuarial reviews of the NPF and POSF will have begun					By end-April 2000	
Endorsement by cabinet of the recommendations on the Public Sector Reform Program					By end-August 2000	
Endorsement by Cabinet of the recommendations of the Public Expenditure Review (PER)					By end-August 2000	
Cabinet approval of the tax system review					By end-September 2000	
Ongoing effort to close down remaining pyramid schemes					Ongoing	

Notes: [1]Cumulative flow since the beginning of the year. [2]Defined as sum of national and provincial department expenditures on wages and salaries (including wages and salaries for teachers of provincial governments) but excluding retrenchment allowances, contributions to superannuation funds, and other PEs (leave benefits and overtime). In 2000, includes K30.2 million that is consolidated in time. [3]Gross expenditure (includes K30.2 million of double counted appropriations for Department of Works. [4]As recorded in the foreign exchange cash flow of the BPNG.
Sources: IMF and Government of Papua New Guinea.

have not been able to attract a partner with the necessary capabilities. In addition, there is a world surplus of nickel, reflected by prices that are presently not much above financial break-even point. The gas project is more advanced in terms of financing, but less so in terms of technical and engineering design, which means that construction is not likely to begin before 2002.

The first balance of payments data for 2000 were not released by the BPNG until August (*Statistical Update*, 14 July 2000) (see below for the IMF's comments on data problems in Papua New Guinea). The official kina data for 1997–99 are restated in Australian dollars in Table 7. In all three years there was the usual large surplus on visible trade that is nearly offset by the deficit on invisibles (for example, freight and insurance). The overall current account surplus in 1999 and net inflows of official capital (mainly the Australian loan) were sufficient to offset the outflow of private capital and unrecorded outflows, resulting in the increase in reserves to K551 million.

Merchandise exports in the March quarter 2000 surged to K1.5 billion—more than double the level of two years previously—reflecting the fact that oil prices more than doubled between 2000 and 1998, when Papua New Guinea's oil exports averaged US$14 per barrel. Imports increased at a slower rate to K718 million; up from K518 million in the March quarter 1998. The current account surplus was again offset by a large outflow of private capital, most of which results from corporate debt retirement, especially by Lihir Gold Limited. Foreign reserves fell from K551 million in December 1999 to K460 million in March 2000 (US$202 million and US$158 million, respectively), but recovered to around US$260 million in June 2000. Such levels are low for an economy prone to natural disasters that can have severe effects on its relatively limited array of exports, such as the 1997 drought that sharply reduced both mineral and agricultural exports.

External trade and tariffs

The *Memorandum* commits the government to a 'liberal trade and exchange system'. In 1999, it began implementing a seven-year Tariff reform program, under which the average nominal tariff rate will be reduced to 6.4 per cent (or an average trade-weighted rate of 4.7 per cent) according to a schedule containing four main rates (0, 15, 25 and 45 per cent).

The previous average nominal rate was 21.9 per cent (average trade-weighted rate of 14.3 per cent) with a schedule of five main rates (0, 15, 11, 40 and 55 per cent) and a few prohibitive rates ranging from 75–175 per cent. Rates of around 80 per cent for plywood and sugar were needed in the absence of anti-dumping legislation, as both these projects are competitive at the effective internal prices in countries like Australia, if not at so-called world prices, which are below the cost of production in even the most efficient producers. The introduction of VAT in 1999, with its exemptions for exports, will further encourage more outward-oriented industrial development.

Structural benchmarks

The IMF's *Memorandum* sets out so-called 'structural' benchmarks to be satisfied for continuation of scheduled drawdowns from the loan (Table 6). Some were already in place, and the government has so far broadly complied with the rest. Sadly, none address the real structural issues, such as land tenure reform. More useful stipulations could have included outsourcing the land registration functions of the Lands Department to the private sector.

- The self-assessment questionnaire on good fiscal practices will be completed and submitted to the IMF by the end of March 2000.
- The Privatisation Commission will have identified candidates for privatisation

and will have formulated a detailed schedule of the timing of actions with respect to privatisation and the methodology to be employed by the end of March 2000.

- Actuarial reviews of the NPF and POSF will have begun by the end of April 2000.
- Recommendations of the public expenditure review will be endorsed by Cabinet by the end of August 2000.
- The public-sector reform program will be approved by Cabinet by the end of August 2000.
- A report on the tax review will be approved by Cabinet by the end of September 2000.
- The government will continue to pursue all available means to close down pyramid-type schemes.
- The government will abide by quantitative lower limits on MRSF receipts, non-

Table 7 **Papua New Guinea: balance of payments, 1997–2000**

	1997	1998	1999	Q1 2000
		(kina million)		
Current account				
Exports	3,079.00	3,707.00	5,006.00	1,554.00
Imports	2,129.00	2,231.00	2,760.00	758.00
Balance of trade	950.00	1,476.00	2,246.00	796.00
Net invisibles	-1,204.00	-1,539.00	-1,929.00	- 452.00
Net transfers	87.00	187.00	50.00	9.00
Current balance	-167.00	124.00	367.00	353.00
Capital account				
Official	-89.00	-92.00	119.00	-45.00
Private	134.00	-189.00	-305.00	-375.00
Other	-15.00	-83.00	16.00	30.00
Capital balance	30.00	-364.00	-170.00	-390.00
Other, errors, omissions	14.00	-36.00	-37.00	-54.00
Overall balance	-123.00	-276.00	160.00	-91.00
	1997	1998	1999	Q1 2000
		(A$ million)		
Current account				
Exports	2,883.48	2,857.36	3,046.65	863.33
Imports	1,993.81	1,719.65	1,679.74	421.11
Balance of trade	889.68	1,137.70	1,366.92	442.22
Net invisibles	-1,127.55	-1,186.26	-1,173.99	-242.22
Net transfers	81.48	144.14	30.43	5.00
Current balance	-156.40	95.58	223.36	196.11
Capital account				
Official	-83.35	-70.91	72.42	-25.00
Private	125.49	-145.68	-185.62	-208.33
Other	-14.05	-63.98	9.74	16.67
Capital balance	28.10	-280.57	-103.46	-216.67
Other, errors, omissions	13.11	-27.75	-22.52	30.00
Overall balance	-115.19	-212.74	97.38	-50.55

Source: Bank of Papua New Guinea, 2000. *Quarterly Economic Bulletin*, March, Port Moresby.

MRSF tax revenue, and domestic arrears reductions.

- The government will abide by upper limits on exceptional financing flows, central government recurrent expenditure, and wages and salaries.

The government's Chief Secretary was able to claim by the end of August that most of these 'benchmarks' had been, or were in the process of being, complied with, albeit without being specific on points 4 and 5. The public expenditure review and reform were due to have been cleared by the end of August (*Post Courier*, 30 August 2000).

Finally, the *Memorandum* signals the government's (long overdue) recognition 'that there are many weaknesses in the economic statistics of Papua New Guinea, especially in national accounts, price statistics, government finance and balance of payments statistics', but contains no specifics or timetable for dealing with these shortcomings. These deficiencies include the fact that the estimates for the subsistence economy's contribution to GDP have not changed since the 1960s, there has been no change in the weights of the consumer price index since 1977, there have been no trade statistics at all since the 1980s, and no direct estimates of monetary GDP since 1993. Given the importance of GDP as the denominator of the IMF's all-determining deficit–GDP ratio, the government should seriously consider contracting out some of the functions of the largely moribund National Statistical Office, which had only 91 staff in 1998, for it could well be that estimated GDP is considerably lower than the actual level, resulting in overstated deficit–GDP ratios and all that that entails for IMF ceilings on public expenditure that fall well below the country's needs and capability (given its level of exports).

Conclusion

The government of Sir Mekere Morauta has achieved more in just over a year than any of Papua New Guinea's external critics and internal supporters could have hoped for. Much remains to be done, and the main challenge is to get the country's foreign donors to adopt a more positive approach to the real needs of a backward country than is visible in the IMF-sponsored *Memorandum on Economic and Financial Policies.* That document never raised its vision beyond setting a ceiling for the fiscal deficit relative to a fixed quantum of public spending. Yet the same level of deficit would be consistent with the much larger tax effort and level of public spending that are justified in a country with Papua New Guinea's resource base and social needs. In particular, the time has come to reverse the declining real unit of fiscal resources made available for public services of all kinds and especially for education and health. Only when that is done will the country begin to develop its main renewable resource—its people—to their considerable potential.

Notes

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1 The PNGBC, the Rural Development Bank, and the Motor Vehicles Insurance Trust are part of the state-owned Pacific Finance Group whose Chair is Rimbink Pato, reputed to be the highest-paid chief executive officer anywhere in Oceania, including Australia (*Post Courier*, July 2000). The BPNG appointed a new board for the PNGBC on 11 September, 2000, headed by G. McIlwain. The other new

directors are Flora Carruthers, Deputy Governor of BPNG, Judith Day, a lawyer, and Mete Kahona of the Treasury Department.

2 The IMF accepts the PNG Treasury's definition of the overall budget deficit as being net of amortisation payments on the public debt, projected at K405 million or 3.6 per cent of GDP in the 2000 Budget, down from K627 million in 1999.

3 Mining taxation accrues in the first instance as foreign exchange to the BPNG. The original aim of the MRSF, as its name suggests, was to 'sterilise' the counterpart kina revenue and to retain part as a 'reserve' against future fluctuations in mineral revenue. Money, however, is fungible and the IMF always treated total MRSF inflows as part of annual revenue irrespective of smaller nominal drawdowns to public account. The MRSF was never seen as a fund to be used for developing other revenue earning assets to replace mines when they cease operations.

4 For a comprehensive account of landowner compensation see Filer et al. (2000).

5 In the late 1940s, the Canadian mining company Placer embarked (with funding support from the then colonial government) on a major afforestation program before winding down alluvial gold-mining operations at Bulolo in the late 1960s. The trees planted under that program now directly and indirectly support a much larger population in the Bulolo Valley than was resident during mining, based on the logging and plywood operations of PNG Forest Products Ltd.

6 The World Bank's project documentation (1998) for its current forestry loan to Papua New Guinea makes some inaccurate statements. First it claims that 'log exports average 3 million cubic metres p.a.'. In fact, the most ever exported was 2.9 million cubic metres in 1994. Second, forestry does not 'contribute around $USD 270 million to GDP annually'. Total exports are not the same as contribution to GDP, which comprises only the incomes generated by an industry, not its total output. Third, it claims that 'some US$85 million accrues to the Government of PNG in the form of export taxes and other levies', but this is not the case following the fall in log prices and the World Bank's progressive tax system coming into effect—the 2000 Budget projects only US$32 million in total export taxes.

7 In September 2000, the listed companies were Dome Resources, Highlands Pacific, Macmin, Mosaic Oil, Oil Search, Orogen, Pacrim, Lihir, Steamships and Interoil.

8 In the United Kingdom, graduates, although numbering less than 10 per cent of all taxpayers, contributed no less than one-third of total income tax paid by all taxpayers in 1992–93 (Curtin 2000c).

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