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Papua New Guinea, from stabilisation to growth?

Satish Chand

After a surge of growth from 1990 to 1994, the Papua New Guinea economy regressed. The 1994 crisis, however, has left a determination to chart the course back to sustainable growth. A number of initiatives including fiscal reform, monetary tightening and structural change are in progress. The short-term pains of these actions have been ameliorated partially through loans from international institutions and financial assistance from donor agencies. This paper documents this dynamic policy period in Papua New Guinea and anticipates the future rewards for the economy.

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Papua New Guinea has embarked on an extensive reform program to usher the economy back onto a sustainable growth path following the liquidity crisis of 1994. The external conditions are favourable for reform and, should the current momentum of reform be maintained, returns should materialise in the medium term. If the reforms are successful in achieving a restructured, open and internationally competitive economy, the current climate of booming world trade should assist Papua New Guinea to return to steady and sustainable growth within the medium term. Papua New Guinea is blessed with abundant natural resources and lags behind in its use of frontier technology—both factors should work in favour of its growth prospects.

The international setting

The global economy is poised for sustained growth over the next decade (World Bank 1996a). The World Bank forecasts for the next decade include: an increase in the pace of international integration; steady and moderate real interest rates; and an annual growth in volume of world trade at 6 per cent, the highest recorded since 1960. According to the World Bank, the stable international economic environment will help outward-oriented developing economies achieve high and stable growth rates in the next decade.

Over the 1991 to 1995 period, world trade grew on average at 6.1 per cent per annum, private capital flows to developing

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countries quadrupled, inflation in the OECD countries has remained under 3 per cent, real short-term interest rates in the G-7 countries averaged under 2 per cent, and real non-oil commodity prices have stabilised (World Bank 1996a).

Papua New Guinea can add a number of other external factors in its favour. Neighbouring Asia is still the fastest-growing region in the world with East Asia growing, on a per-capita basis, at 8 per cent per annum and South Asia at 2.2 per cent.

Commodity prices, particularly for Papua New Guinea's exports, have stabilised. Gold, copper and silver, as of 1995, constituted more than seventy per cent of Papua New Guinea's total exports. Gold prices peaked in February 1996 at US$405 per troy ounce (toz)—the World Bank sees the price firming within the range of US$390 to US$400 per toz. Copper prices have been on a slide from US$3076 per metric tonne in July 1995 to US$2538 in February 1996. Forward prices for copper are deeply discounted in expectation of a build-up of stocks. Prices of both copper and gold are forecast to remain stable around current levels within the short to medium term (World Bank 1996b). Papua New Guinea's non-mineral commodity exports of logs, coffee and cocoa each comprised 13, 6 and 1 per cent, respectively, of total 1995 exports. Log prices on the Tokyo market are on the rebound at US$222 per cubic metre as of September 1995. Coffee prices are showing some recovery after a continual decline in 1995, with the March 1996 quarter price at US266 cents per kilogram. Cocoa prices are likely to remain depressed after record harvests in Ghana and the Ivory Coast. Though non-mineral export prices are more volatile than mineral prices, the greater weighting of the latter in total exports is likely to minimise the adverse impacts of swings in world non-mineral commodity prices.

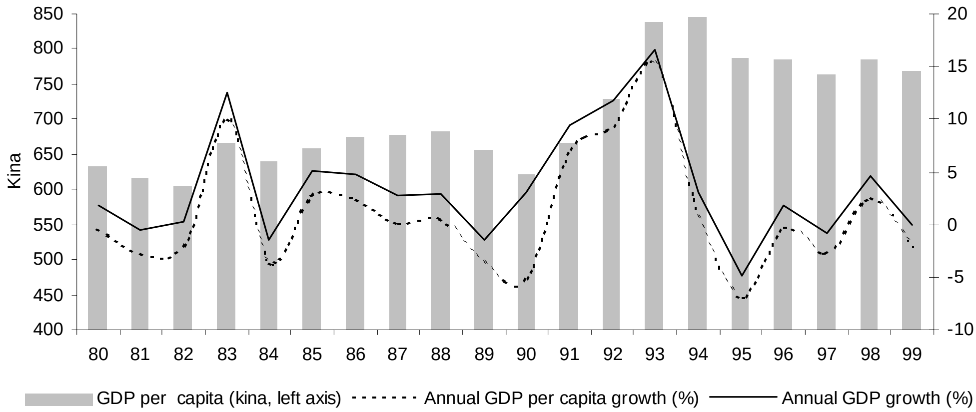
A global climate of rapid growth, stable prices, and low interest rates is opportune for Papua New Guinea's reform agenda in its pursuit of macroeconomic stability, maintenance of an internationally competitive real exchange rate, and an investment program geared to building new and strengthening existing infrastructure. Opening up to international trade in goods and factors of production in the current global climate of trade expansion —assuming the policymakers are successful in creating a stable domestic economic environment—should yield significant and favourable returns in the medium term.

The Papua New Guinea economy

The PNG economy experienced strong growth in the early 1990s (Figure 1) as a result of a booming mineral sector accompanied by strong growth in agriculture—forestry in particular. The growth rate declined sharply following the crisis in 1994; the projected growth rate for 1996 is 1.8 per cent, up from the -2.9 per cent experienced last year. The sharp fall in growth rates has been attributed to a number of causes, the two principal ones being the failure of the economy to adjust to the closure of Bougainville Copper Mine and a loss of private sector confidence in the policy stability of government and, in particular, the sustainability of the budget deficits (see Mawuli 1996). (The decline in foreign aid, in real terms, has also contributed to the economic contraction.) Subsequent liquidity problems created the will and the resolve to change. As a result, a number of initiatives have been undertaken to return the economy to a sustainable growth path.

Inflation has been kept at reasonably low levels; the kina was devalued by 12 per cent in September 1994 and then floated a

Figure 1 **GDP: level and rate of growth, 1980–99**



Source: South Pacific Economic and Social Database, National Centre for Development Studies, The Australian National University, Canberra. The figures beyond 1994 are based on Papua New Guinea, 1996. *Economic and Development Policies: the 1996 Budget*, Government of Papua New Guinea, Port Moresby:155.

month later. The short-term effect of this devaluation, followed by the sharp depreciation of the kina, was a jump in inflation, but this should return to low levels within the medium term. A number of initiatives are being taken towards structural reform. These include moves to wage deregulation, privatisation and corporatisation of a number of public enterprises, sale of government equity in mining ventures, and public sector reforms, including proposals for significant downsizing of the bureaucracy. The last will be controversial and difficult, given the strength of the country's public sector unions.

Table 1 **Papua New Guinea: basic economic indicators, 1994–96**

	1994	1995[P]	1996[P]
Per capita GDP (kina)	1254	1323	1467
Population (million)	4.0	4.1	4.2
Inflation rate (per cent per annum for CPI change)	2.9	17.3	17.4[a]
Budget surplus (per cent of GDP)	-2.8	0.1	-1.0
Average annual investment (per cent of GDP)	16.0	18.0	24.0

[P] provisional
[a] March quarter compared to corresponding quarter of 1995.
Sources: International Economic Databank, The Australian National University, Canberra; Bank of Papua New Guinea, *Current Economic Bulletin*; South Pacific Social and Economic Database, National Centre for Development Studies, The Australian National University, Canberra.

Some macro aggregates and the macroeconomic adjustment program

According to the Bank of Papua New Guinea (1996), economic activity for the first three months of 1996 remained subdued. In the first quarter of 1996 the government achieved a fiscal surplus of K48.5 million, some of which is attributed to delays in the passage and implementation of provincial governments' budgets; the CPI rose by 3.4 per cent in the March quarter relative to the previous quarter; the trade account recorded a surplus of K324 million compared to a surplus of K394 million for the corresponding period in 1995; the balance of payments deficit rose by K4 million to K74 million compared to the corresponding period of 1995; and foreign reserves at K283 million were sufficient (2.1 months of total imports).

Employment

Population growth of 2.2 per cent per annum, high by developing country standards, places a severe strain on labour absorption. The Bank of Papua New Guinea estimates suggest a downturn in seasonally adjusted employment in the last quarter of 1995. The maximal opportunities for employment creation, as suggested by survey data of the Employers Federation, is in the agricultural sector, where 20.8 per cent of the formal sector jobs were created in the first half of 1995 (Papua New Guinea 1996).

Balance of payments

The trade account for 1995 showed an improvement, resulting from increased export revenues and declining imports. The surge in export revenues was the result of higher-than-expected prices of export commodities offsetting the declines in export volumes of coffee and logs. Imports have been weak as a result of the devaluation of the kina, the downturn in the economy, and the earlier shortage of foreign exchange.

The Budget

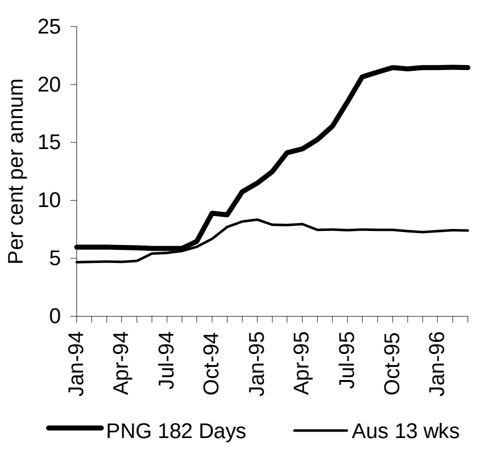
A number of steps have been taken to rein in the budget deficit, including the introduction of tighter expenditure controls, close monitoring of public expenditures and additional revenue raising initiatives. Several government enterprises have either been, or are in the process of being, privatised (corporatised). For example, Roadco has been sold to Ok Tedi Mining, 5.1 per cent of the government's equity in Porgera gold mine has been sold to the landowners and the Enga provincial government, and part of the Mineral Resources Development Corporation is in the process of being floated.

The government, in collaboration and with financial and advisory support from the World Bank, International Monetary Fund (IMF), Japanese Exim Bank, European Union and the Australian government, has instituted a macroeconomic adjustment program to ease the country's current crisis. Other than some minor hitches (see box, page 6), progress made on this front is encouraging. The fiscal and monetary tightening, together with the structural reforms, is necessary to usher the economy back onto a path of sustainable growth. In the short term these actions are contractionary, with associated economic pains. The challenge for policymakers is to strike a balance to achieve long-term goals. Additionally, expenditure cuts must be made in the context of preserving the most growth-enhancing government activities. The upturn in commodity prices—coffee and palm oil in particular—during this period of adjustment has ameliorated some of the contraction.

Current estimates indicate that GDP fell by 2.9 per cent in 1995. Interest rates have been increasing steadily. For example, the 182-day treasury bill rate peaked at 21 per cent in early November 1995 from a level of 5.88 per cent in August 1994. The tightening of monetary policy accompanied by a loss in confidence of international commercial banks has culminated in a subdued growth of credit to the private sector, which should be of concern to policymakers.

Australia is still Papua New Guinea's largest single trading partner—in 1990, Australia accounted for 50 per cent of total imports and 36 per cent of exports (Bank of Papua New Guinea 1996). The bulk of Papua New Guinea's foreign direct investment also originates from Australia. A substantial divergence in Papua New Guinea's 182-day treasury bills rate and Australia's 13-week treasury bills commenced in September 1994 (Figure 2). As of March this year the difference between these rates exceeded 14 percentage points. Most, if not all, of this difference can be attributed to sovereign risk, an issue that has to be addressed if Papua New Guinea is to attract foreign investment. Foreign investors will need to be made reasonably confident that the kina will stabilise and not depreciate any further before they are likely to hold kina-denominated deposits.

Figure 2 **Treasury bill rates, 1994–96**



Source: Bank of Papua New Guinea, 1996. *Quarterly Economic Bulletin*, March:Tables 7.2 and 7.3.

Investment in physical and social infrastructure

One disturbing feature of the fiscal contraction has been the disproportionate decline in public investment. Anecdotal evidence suggests that the country is in need of a significant injection of capital into maintenance and expansion of both social and physical infrastructure. A large proportion of existing roads are in urgent need of repair and the current road network for each urban centre permits trade between major cities via sea and air only. Existing road networks need to be expanded in order to enhance trade between provinces and cities. This expansion could have significant social returns. The growth of the food crop sector is currently restrained by high transportation costs, lack of distribution networks, and high perishability—all of which could be resolved via a good road network—which in turn would lead to a more active private sector.

The other side of the coin to the declining share of public investment in the budget is the large proportion of total government revenue being used to finance recurrent expenditure. Adverse fiscal pressure is generally translated into cuts in capital expenditure due to the difficulty of adjustment in recurrent commitments, the bulk of which is public servants' salaries.

The figures for quality of life in Papua New Guinea are also disturbing and perhaps are a reflection of the rundown in

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The Structural Adjustment Program saga

Considerable media coverage has recently been given to the stand-off between the World Bank and the PNG authorities and the alleged failure of the government to satisfy the conditions of the structural adjustment program (SAP). At the time of publication, the Bank had withheld the second tranche of $US25 million for the SAP and the two parties were back at the negotiating table. Though the media and some government officials have been signalling a probable withdrawal of the Bank from Papua New Guinea and an end to structural reform in the country, this is highly unlikely. The only possible outcome is a continuation of the reform process with the support of the Bank. This is obvious if the current negotiations are analysed in a simple game theoretic framework.

The pay-off matrix for Papua New Guinea and the World Bank

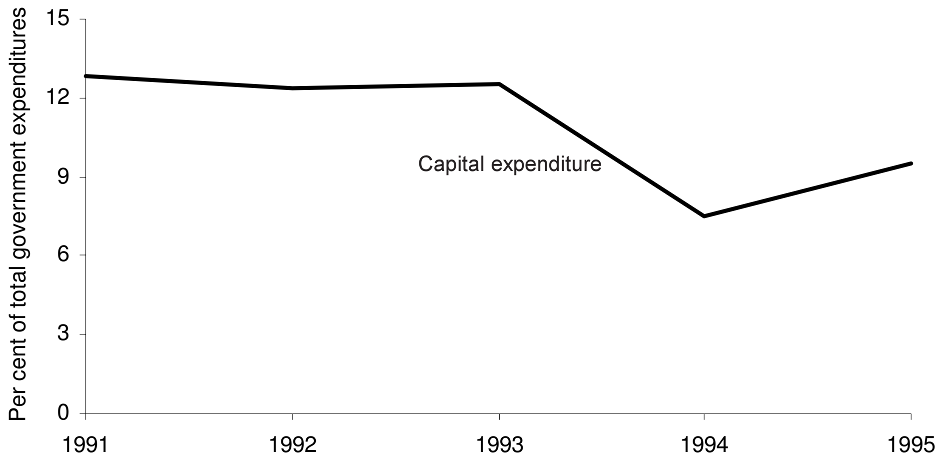
		World Bank	
		Support SAP	Withdraw
Papua New Guinea	Reform	(-, + +; +)	(- -, ++; 0)
	Not Reform	Not Feasible	(0, -; 0)

Note: The signs in parentheses indicate qualitative pay-offs. The double signs indicate larger pay-offs, the sign(s) before the comma indicate short-term pay-off, while that following the comma indicates the long-term pay-offs for Papua New Guinea. The sign after the semicolon indicates the pay-off for the Bank.

For Papua New Guinea, both the short and long-term pay-offs are listed while for the Bank only the overall pay-off is given since the latter does not face the same liquidity constraints.The only equilibrium is given by the top left-hand cell where the reform is undertaken with World Bank support. In this equilibrium Papua New Guinea suffers some short-term pains of re-structuring with significant long-term gains. The Bank also gains since its reputation is held intact and the loans are paid off. The remaining cells do not constitute an equilibrium. For example, if the reforms are undertaken but without Bank support then the top right-hand cell gives the pay-off to the two players. The PNG economy goes through greater pains of re-structuring—to the extent that the reform process may be in jeopardy—but the Bank also loses. The pay-off for the Bank here is at least zero since it makes no gains and its reputation may also be damaged as a consequence. It can similarly be shown that the bottom two cells do not constitute equilibriums. The unambiguous conclusion from this analysis is that the reforms would be undertaken and with Bank support.

The game here is played with perfect information, hence the players are fully aware of the above pay-off matrix. The question then is why the confrontation exists when the final outcome is so obvious. The reason is that the PNG authorities know that the reforms will take place with Bank support, so their aim is to minimise the short-term pains (both financial and political) by gaining concessions. The Bank, on the other hand, is trying to protect its own financial interest and credibility, since this game will be repeated with other players. A more detailed analysis of the SAP, including the quantification of the above pay-offs, is left as part of future research. For now, we think that the reforms will take place and with Bank support.

Figure 3 **Capital expenditure: apportionment of total government expenditure, 1991–95**



Source: South Pacific Economic and Social Database, National Centre for Development Studies, The Australian National University, Canberra.

public investment in education and health. The paradox in Papua New Guinea is that despite significant gains in per capita GDP since independence, all quality of life indices have displayed slow or even negative growth. Papua New Guinea's performance in comparison to neighbouring developing countries in terms of improvements in the quality of life is extremely poor. The 1993 average life span in Sri Lanka, an economy that has half (for Indonesia, three-fifths) the per capita GDP of Papua New Guinea, is 72 (for Indonesia, 66) years compared to 56 in Papua New Guinea. Per capita GDP, life-expectancy, and the infant mortality rate, all indexed to their 1970 levels, are shown in Figure 4. These indicators could be expanded to include crime rates and access to clean water and health facilities, but doing so would not alter the central perception that the quality of life does not mirror the average level of income for the country.

Papua New Guinea has a dualistic economy, one comprising the extractive sector that has enjoyed significant growth; while the remainder, which is mainly agriculture, has enjoyed minimal growth (Hamidian-Rad 1996). The impact of the differential in growth rates of the two sectors is compounded by differentials in rural and urban population growth rates. Eighty-five per cent of the population live in rural areas, where there are few employment opportunities outside of agriculture. This sector absorbs a disproportionately large quantity of labour relative to the contribution it makes to GDP (Figure 5). There is high population growth in the low output growth sector, to the extent that population growth has outstripped output growth in this sector for some years at least.

While diminishing returns in gains to quality of life indicators as a result of increased per capita income are expected, the low indices of life expectancy and high infant mortality in Papua New Guinea can be improved at significantly lower resource costs than would be possible in either Fiji or Sri Lanka. Papua New Guinea can also learn from the experiences of other developing economies which have fared well in the indicators in which Papua New Guinea lags. The Fijian experience in the delivery of health and education services is a notable example.

Stabilisation—a precondition for growth

Although there is no guarantee that macroeconomic stabilisation will lead to growth (it could, for example, lead to stagnation), it is generally agreed that stabilisation is necessary to long-run growth. The design of a stabilisation program comprises five key ingredients

- a post-stabilisation inflation target
- fiscal stabilisation
- appropriate monetary policy
- an appropriate exchange rate
- an incomes policy (Dornbusch 1990).

Policymakers in Papua New Guinea have attended to most of the above. A low inflation target has been set. Steps have been taken to rein in the budget deficit, by curtailing recurrent expenditure and raising revenues. Tight monetary policy has been pursued subsequent to the float of the kina. The nominal exchange rate has been devalued. The challenge is to maintain a competitive real exchange rate by pursuing accompanying reforms, including trade deregulation and micro-economic reforms (Garnaut 1996). The maintenance of a competitive real exchange rate—one that leans towards being under as against being over-valued in the interim period while supply responses take effect—necessitates use of an incomes policy in addition to the policies being pursued now. In Papua New Guinea, where public-sector unions have a track record of success in raising wages for their members, an incomes policy that restrains demand (including wages) in the short-run while supply effects take hold could relieve some of the pressure for a real exchange rate appreciation.

For a substantial supply-side response to the new macroeconomic settings, the economic environment has to be conducive to investment. The challenge for government is to let market signals determine resource allocation such that maximum output can be realised. Interventions should only be undertaken in the event of clear market failure, and in such circumstances the intervention should be just sufficient to correct the market failure. Identification of market failures and the design of corrective action are difficult issues and require ongoing research.

Structural reform involves the removal of market distortions so as to allow market signals to have a complete role in resource allocation. In Papua New Guinea these distortions arise out of domestic taxes, subsidies and border controls. Reforms are being undertaken to remove these distortions as well as strengthen the mechanisms for delivery of public services. The administrative framework of the public sector has to be strengthened—in quality rather than quantity—the cost of public utilities has to be made internationally competitive, and the law and order problems have to be brought under control.

The short-term costs of stabilisation and restructuring can be heavy. As is being experienced in Papua New Guinea, budget correction can lead to contraction in demand leading to a drop in employment and investment. Resources released by fiscal austerity are not automatically absorbed elsewhere in the economy. A real depreciation as a result of exchange rate correction can lower real income and

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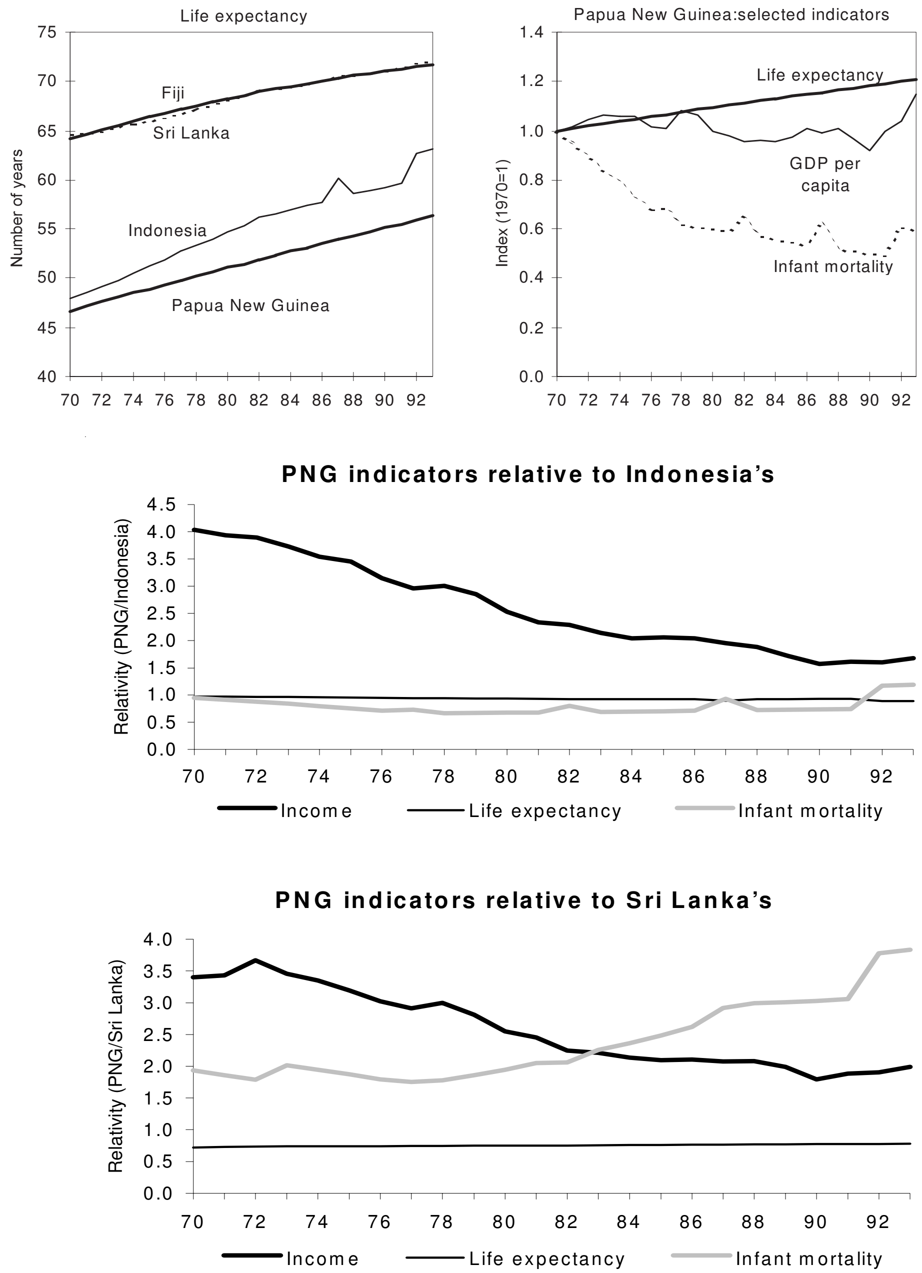
Figure 4 **Comparative income and quality-of-life indicators: Papua New Guinea, Fiji, Sri Lanka, and Indonesia, 1970–93**



Source: World Bank Social Indicators of Development, International Economic Databank, The Australian National University, Canberra.

dampen consumption to the extent that serious hardships may be felt. Threats to reform arise when the population perceives that the immediate pains of restructuring outweigh the future gains from such efforts. On the other hand, too slow a pace of reform may not deliver significant results. The challenge for policymakers is to strike a balance between these two extremes. The international community can assist during the adjustment process by providing short-term financial assistance when the will and resolve to change are strong.

Charting the way back to prosperity

A number of policy initiatives have been taken to return the economy to sustainable growth. These include

- a proposal to introduce a national value-added tax in 1998 to broaden the tax base and reduce the heavy reliance on mining and petroleum taxes for government revenue
- devolution of responsibility for provision of basic public services from the national to provincial governments under a chief-executive model
- establishment of accounting and administrative procedures such that it becomes difficult to divert funds from capital to recurrent expenditure
- trade and tariff policy reform that involves the replacement of quantitative controls with tariffs followed by phased reductions in these tariffs when the value-added tax is introduced. The effect of this tax and tariff reform on net budget revenues is to be neutral.

A National Planning Office has been established to ensure continuity in reforms and, in particular, to see that the reforms are free of short-term policy switches that run in tandem with political cycles. The establishment of the National Planning Office is a serious step towards de-politicising long-term policymaking in Papua New Guinea.

Growth of non-mining sectors

Growth in the extractive sectors is sensitive to the establishment of mining projects, mineral and oil discoveries, and fluctuations in world mineral prices. A heavy bias in composition of GDP in favour of the extractive sectors implies that volatility in this sector flows on to the rest of the economy. Given the geographical specificity of the presence of natural resources, extractive industries have created 'enclave' developments, the benefits of which are alleged to seep minimally beyond the immediate periphery of the activity (Moaina 1996). At times, disenchantment with perceived minimal benefits from mining industries has been exacerbated by pollution from such activities that flows far beyond the immediate beneficiaries. Despite these tensions, it is hard to argue against the cumulative benefits to the national economy from mining.

There is considerable room for growth of small enterprises that could complement the mining industry and be a source of much-needed employment. The non-mining sector for the period 1991–94 displayed consistent growth averaging in excess of 5 per cent per annum. Should the share of this sector rise in GDP, some of the volatility in the extractive sectors will be cushioned. The Lik Lik Dinau Abitore Trust argues that there is considerable room for growth of small enterprises in a conducive environment (see Fleischer, this issue). Such an environment constitutes interest rates that are internationally competitive, low inflation rates, an internationally-competitive real exchange rate, a climate of policy stability, and an absence of biases (as protection) against the growth of small to medium-sized enterprises and the informal sector. If the embarked-upon reforms materialise, small business and the informal sector have both a bright future as well as a significant contribution to make to the economy.

Seventy-five per cent of the population depend on small-scale agriculture, constituting subsistence farming and cash-cropping, for their livelihood. Papua New Guinea has low population density and a large supply of fertile land. The basis for growth of agriculture exists but depends on raising productivity in this sector. This, in turn, requires the adoption and adaptation of international best practice. One of the impediments to growth and commercialisation of agriculture has been insecure property rights, a feature inherent to most of the Pacific island communities that traditionally have had a communal system of living (Chand and Duncan 1996). Strengthening security of access to land for agricultural purposes and prompt processing of land titles at the Department of Lands and Physical Planning could provide immediate returns in terms of higher outputs from, and greater investments in, the sector.

An increase in food production, accompanied by gains in productivity in the agricultural sector, should lead to improvements in nutrition, particularly that of children and child-bearing women. Such gains would be reflected in an improvement in quality-of-life indicators. Growth of the agricultural and fisheries sectors, accompanied by productivity growth in these sectors, will raise incomes and reduce the disenchantment with the current pattern of income distribution. In so far as low income levels are a cause of low literacy rates in the rural sector, income growth in the primary sector could also provide the basis for better health and education opportunities for the next generation of citizens and policymakers.

Bad weather and natural calamities, both of which Papua New Guinea has had more than its fair share, have adverse effects on primary sector output. Policymakers have little influence over these events, but there are areas where action could result in increased yield. For example, a return to normalcy in the North Solomons and East New Britain provinces could provide a boost to output in the sector. Further transition from subsistence to cash cropping has significant potential for gains from specialisation and trade. The establish-ment of a competitive financial sector that encourages both savings and investment and acts as a conduit for the two would be of significant importance for growth.

An important message from these prospective policy initiatives is that substantially improved equity in income distribution can be achieved via growth-enhancing policies and thereby avoid the perils of using policy to redistribute income with the inherent risk of stalling the growth process altogether.

The future

The current initiatives, together with the resource potential of Papua New Guinea, point to a cautiously optimistic future for the economy. Should Papua New Guinea complete the reforms being undertaken and in the process achieve policy stability and responsible governance, the economy should be able to realise substantially better and more equitably distributed growth. The discovery of depletable resources is on the rise, hence resource depletion is not an issue of serious concern for the short to medium-term.

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Mineral prospects are good

Mineral exploration activities are ongoing and essential for the long-term viability of the extractive sector which has an average production lag of approximately eight years. Geologically, Papua New Guinea is considered to be highly prospective for further mineral and petroleum discoveries. Assuming the sovereign risks of investment are kept low, exploratory investments are likely to continue and fresh mining projects are likely to come on stream for some time. Gold production from the Lihir mine is to come on stream next year. Frieda Copper and Ramu Nickel are hoped to follow soon after (Moaina 1996).

The favourable prospects for further growth of the extractive sector does not mean that management of the revenues from these depletable resources can be neglected. To the contrary, it demands responsible and astute management of resource flows such that the non-extractive sectors of the economy are not penalised and neither are the rights of future generations of Papua New Guineans to this wealth.

Papua New Guinea's other potentials

Should the government be successful in instilling policy stability via conservative fiscal management, and should the international community regain confidence in the PNG economy and commence re-investing there, the non-extractive sectors could grow at least as fast as the extractive sector. Any visitor to the country quickly realises its beauty, including the cultural heritage and the rich flora and fauna, all of which have significant tourism potential. Papua New Guinea is located on the periphery of Asia, the growth nucleus of the Pacific region. Port Moresby airport is being upgraded and would soon be able to handle significantly greater volumes of air traffic. Should the social problems be significantly reduced, particularly those relating to Papua New Guinea's 'crime' image, the country would be in a position to attract significant investment into the tourism sector. The role of government here is only in the provision of the infrastructure and establishing the climate for growth—issues that the current policymakers have taken on board. In sharp contrast to the many 'doomsday' predictions of Papua New Guinea's future, this paper cautiously sees a return to prosperity in the medium term.

A cautious outlook

Papua New Guinea is blessed with rich natural resources, a low population density, vast areas of undisturbed terrestrial and marine environment, and a rich and diverse culture. But it still has significant negative factors: social problems are on the rise; management of liquidity in the economy and international investor confidence is a challenge to policymakers; improvements in the quality-of-life are lagging behind income growth; and there is a consensus that both physical and social infrastructure in the country are in urgent need of maintenance and expansion, the funds for which are scarce.

There is a resolve amongst senior policymakers to set the economy on a higher, sustainable growth path. A number of initiatives have already been taken and a number are in the process of being implemented. The agenda should aim not to be too innovative, but to maintain the reform process until the fruits of reform appear. In developing countries it is not unusual for reform processes to be brought to a halt prematurely, and even be reversed, because the pains of reform become unbearable. The dose of reform has to be right to set the economy on course, but not excessive to the extent of killing the process.

It is a delicate balance with low margins for error. However, the international community can be of assistance through lending financial and advisory support in the adjustment period. The 1996/97 Budget (released in December) confirms many of the propositions made in this paper—a detailed analysis of this Budget will be published in *Pacific Economic Bulletin* 12 (1), June 1997. Papua New Guinea is fortunate in being able to learn from the experiences of others.

The macroeconomic variables that need to be watched closely include the real exchange rate, domestic inflation, domestic nominal interest rates, growth in private domestic credit, and the level of budget deficits. Investment, particularly in physical and social infrastructure, must remain a high priority. Responsible governance, together with effective administration that maintains the above aggregates in check and has the patience to see the reforms take effect, is bound to produce the goods.

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