



4

THE PAPUA NEW GUINEA MINERAL RESOURCES STABILIZATION FUND

This description of the PNGMRSF by the editors of the *Bulletin* is largely based on the article by Dr James Guest, 'Problems in managing the Mineral Resources Stabilization Fund' in Bank of Papua New Guinea, *Quarterly Economic Bulletin*, June 1987 issue.

The Papua New Guinea Mineral Resources Stabilization Fund was established in 1974 to minimize the fluctuations in government revenue arising from the variability of income taxes (including additional profits tax), dividend withholding taxes, and dividends on government equity in mining enterprises, that result from the high variability in international prices for metals. So far, Bougainville Copper Limited is the only company liable for company tax, but Ok Tedi Mining Limited will be required to make company tax contributions to the Fund when it passes the capital recovery stage. If mining develops over the next decade as some commentators are forecasting (see K.G. Gannicott, 'Current economic trends in the South Pacific' in this issue), the Stabilization Fund could become an important instrument in allocating the mineral resource rents to stabilizing (and perhaps

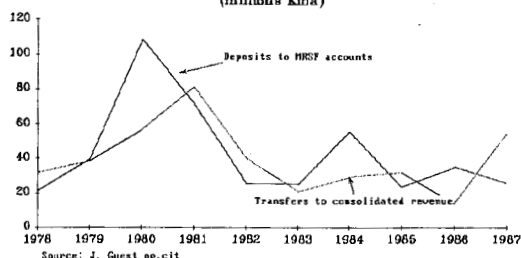
extending) the government's revenue, including receipts available for development expenditure.

The Fund should also tend to sterilize the domestic effects of changes in the value of mineral exports. In years of high metal prices, it will accumulate kina balances that will be matched by increases in Bank of Papua New Guinea's international reserves, and in years of low metal prices its kina balances and BPNG reserves will be run down.

The various tax, royalty, and dividend payments by designated mining enterprises are paid to the Fund rather than to the consolidated revenue and held by the Fund in segregated accounts with the Bank of Papua New Guinea. Thus, in the first instance, these transfers have no impact on government revenue (or expenditure) nor on the general liquidity of the economy. The board of management of the Fund is required to make annual forecasts of the prospec-

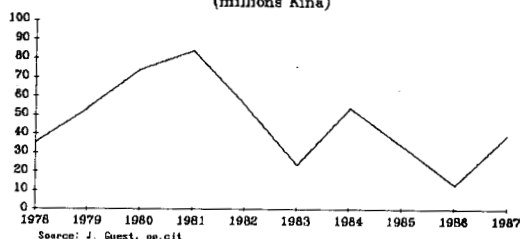
*Dr Guest is a consultant in the Economics Department of the Bank of Papua New Guinea. The views expressed in his original article are his responsibility. The responsibility for this summary rests with the editors.

Chart 1

Deposits to and transfers from MRSF accounts
(millions Kina)

Source: J. Guest op.cit

Chart 2

Forecasts by MRSF of sustainable
drawdowns
(millions Kina)

Source: J. Guest, op.cit

Source: J. Guest, 'Problems in managing the Mineral Resources Stabilization Fund' in Bank of Papua New Guinea, *Quarterly Economic Bulletin*, June 1987.

tive receipts of the Fund over the following eight years, and to recommend transfers to the consolidated revenue that will lead to a rather constant flow in real terms to the government's income (allowing for inflation forecasts over the succeeding five years).

As might be expected, the receipts by the MRSF have been highly variable (Chart 1). On the other hand, transfers from the account to consolidated revenue have also been highly variable. Over the period 1978 to 1987, average annual deposits (K43 million) were slightly in excess of drawdowns (K40 million). It must be admitted that part of this variability results from changing forecasts of the Fund's future revenues.

Chart 2 indicates the forecasts made each year of the Fund's expected annual revenues over the following five years.¹ (The average annual forecast was K47 million, but the variation in this estimate averaged K23 million from year to year.) In so far as the drawdowns reflect these strongly fluctuating forecasts of future sustainable revenues, their variability is understandable. This reflects the extreme difficulty of making forecasts of mineral revenues over a period as short as five years ahead. They provide an argument for a stabilization fund that follows policies not based on

short-term changes in prospects. In the past, the variability of revenue forecasts have arisen largely from changes in forecasts of gold and copper prices. If mining develops on a large scale in Papua New Guinea and more mines become required to make MRSF contributions, output forecasts will make revenue projections even more tentative. An alternative policy of determining drawdowns could enable the government to stabilize revenues and contribute to the rational use of the country's resource rents, thereby contributing to policies that will prevent a dissipation of the country's mineral income and limit the harmful effects of rapidly rising mineral incomes on more traditional activities.

One hypothetical proposal (put forward by Dr Guest) is that the drawdowns from the Fund in any one year should reflect changes in the Fund's prospective revenues over the next five years, thereby enabling the government to benefit from its hoped-for increase in income from resource development. However, instead of tying drawdowns to the total change in estimated revenue, the drawdown in any year should reflect only one-fifth of that year's estimated change in income over the next five years. If such a policy had been followed from 1978 to 1987, the average drawdown would have been K42 million (slightly larger than the actual drawdowns), but it would have varied by only K6 million (approximately one-third of the

¹ The 1987 projection is an estimate made by Dr Guest.

average variation experienced).

If mineral revenues increase markedly, a policy along lines similar to those proposed here would allow the government to adjust its expendi-

tures smoothly to a possible rapid increase in total revenues. If mineral resources were depleted later, the fairly slow decline in its revenues would enable an easing of the adjustment process.