



Structural adjustment in Papua New Guinea

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This article was written prior to the election of the government of Paias Wingti who, together with his Cabinet colleagues, has introduced policies which vary markedly from those of the previous government. It reports on an important stage in the recent economic history of Papua New Guinea: the immediate aftermath of the closure of the Bougainville mine—a situation compounded by civil disorder and rapidly falling terms of trade. The Namaliu Government's response to this scenario was a structural adjustment package which enabled Papua New Guinea to weather the Bougainville storm and promote longer-term growth and economic efficiency. A number of factors that continue to frustrate progress are identified: factors which will have to be addressed by the new Wingti Government.

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In 1989, after four years of sustained increases in its per capita GDP, Papua New Guinea underwent a major economic crisis. In May of that year, the mine at Bougainville closed. Considering that the mine in question had recently accounted for some 35 per cent of the country's total exports, 15 per cent of government revenue and 8 per cent of GDP, its stoppage clearly dealt the economy a devastating blow. The mine closure was accompanied by two other factors which compounded the country's woes. The first one, associated with the civil disorders of the time, entailed the complete disruption of the North Solomons

Island's cocoa industry which yielded between 45 and 50 per cent of Papua New Guinea's total cocoa output. The second factor which was no less significant, relates to a 15 per cent fall in the country's terms of trade caused by large drops in the prices of coffee (30 per cent), cocoa (23 per cent), copra (8 per cent) and palm oil (11 per cent) (Stein 1991:Chapter 2).

Obviously, a strong and concerted government response was required. Had there been no official reaction, the World Bank surmised that the country would have faced a 1990 balance of payments deficit in excess of US\$350 million (10.5 per cent of GDP) and

Support for the preparation of this paper was funded by the Australian International Development Assistance Bureau. The views contained in it are those of the author alone who would like to express his indebtedness to Mr Mark Fleeton for his help and encouragement.

only a slightly smaller one (of US\$300 million) by 1991 (World Bank 1991:ii). Fortunately, an appropriate structural adjustment package was soon formulated and applied. As with most structural adjustment schemes, the program had two main components: one concerned with the attainment of macroeconomic stability in the very near future, and the other geared towards structural adjustment measures which would lay the foundations for efficient resource allocations (and thereby for enhanced development), the fruits of which could be expected to be borne over a longer time horizon.

Macroeconomic stabilization

Essentially, the stabilization measures consisted of a devaluation, proposals to curtail government outlays and to raise revenue, wage restraint, a moderation of the growth of credit, and finally, curbs on public borrowing from foreign commercial sources.

Devaluation

The kina was devalued by 10 per cent in January 1990. By the year's end, the real effective rate had depreciated by 7.5 per cent. Whereas the government is committed to maintaining free currency convertibility, it does not wish the kina to depreciate by too far in case cost push inflation is encouraged. In this respect, the alteration of exchange rates has been of minor significance in the context of the country's structural adjustment strategy. This contrasts with many other developing countries where very often large and highly contentious devaluations have been the order of the day.

Proposals to curtail government outlays and increase receipts

A total government outlay of K1,082.3 million was originally budgeted for 1990. Early in that year, the amount was reappraised in the light of an immediate need to initiate some expenditure restraint as part of the adjustment program. Accordingly, it was determined that K70.1 million was to be deducted from the expenses that were first foreshadowed. 'However, the actual out-turn was K1,089.1 million due to fiscal slippages' (Papua New Guinea, Government of 1992:12). An increase in total wage payments (stimulated by the employment of more personnel in law enforcement agencies and education) and higher than expected retrenchment allowances were

critical factors accounting for the small budget blowout.

On the revenue side, receipts totalling K988.8 million fell short of the K1,046.3 million originally anticipated. This discrepancy largely reflected reduced tax intakes due to a fall in employment levels and imported goods. All told, the 1990 budget deficit rose to K100.3 million, representing 3.3 per cent of GDP. By contrast, the preceding deficit was only K35.2 million. For 1991, the government set its sights on lowering the budget deficit to about 1.8 per cent of GDP. However, at the year's halfway mark, a combination of pressures from the expenditure side and continued revenue shortfalls prepared the way for the deficit actually to widen to 4 per cent of GDP. In July 1991, in response to the worsening fiscal situation, the government capped the level of aggregate expenditure at K1,100.1 million and imposed additional revenue raising measures.

To a large extent, the difficulties encountered in achieving targeted budget deficits emanate from unsuccessful attempts to reduce the size of the government bureaucracy. Generous retrenchment packages were offered to entice a reasonable number of civil servants to terminate their employment. A figure of around 1,250 was hoped for but in fact some 2,500 availed themselves of the rather generous early retirement packages on offer. Unfortunately, among the early retirees were many of the relatively more competent employees who subsequently either had to be rehired or to be replaced (Fallon 1992: Chapter 3). Considering that during the same period, the personnel establishment in both the security and education sectors was increased, the size of the overall civil service basically remained intact. However, on account of the retrenchment payments, total employee remunerations rose.

The government set upon the streamlining of its administration. This entailed the abolition or merger of some departments, as well as a phased introduction of program budgeting in conjunction with departmental reviews.

Wage restraint

In the realm of public sector wages, the government in fact succeeded in introducing real declines. In 1990, as a result of an agreement

with the Public Employees Association entailing a scaled discount from the Minimum Wages Board Determination, real wages fell by 4.4 per cent. By contrast, real 1990 wages in the private sector fell by the lesser amount of 3.9 per cent.

Moderation in the growth of credit

As for keeping a tight rein on credit growth, the issue turned out to be one of encouraging a moderate spate of private sector investment borrowing. At first, that is, during the early months of 1990, liquidity conditions were tight. To stimulate private investment borrowing, the government eased up by reducing the minimum liquid asset ratio by one percentage point. As it happened, private sector credit increased by only 1.6 per cent, reflecting a combination of a slowdown in economic activity with a more cautious lending approach by the commercial banks. A situation of enhanced liquidity in the face of limited borrowing caused lending rates on large deposits to sink to their lowest level in five years. Compared with the general experience of other developing countries undertaking structural adjustments, the downward movement of interest rates in Papua New Guinea was an aberration. Usually, the International Monetary Fund (IMF) endorsed programs entailing vigorous attempts to ensure substantial real interest rate increases. In fact, the IMF generally regards credit tightening as an indispensable loan condition (Stein 1992). In 1991, the Bank of Papua New Guinea set a credit growth target of 11–14 per cent for the non-mining private sector. This turned out to be fairly realistic for a growth of 12.9 per cent was actually attained. The upsurge in borrowing stimulated by improved economic conditions was facilitated by an accommodative monetary stance which prevented interest rate increases. Between December 1990 and December 1991, the weighted average lending rate actually declined by 1.1 percentage points (Papua New Guinea, Bank of 1991:4).

Structural adjustment measures

Apart from wage restraining measures and efforts to upgrade the process of central government administration, both of which have already been mentioned and which of course straddle the macro- and microeconomic

aspects of the structural adjustment process, the authorities also turned their attention to trade liberalization, the encouragement of foreign investment, agriculture and manufacturing, the privatization of public corporations, and law and order reforms.

Wage restraint

Wages in Papua New Guinea are unduly high, a reflection of the influence of the previous Australian administration, the presence of a rather large expatriate workforce and of the fact that subsistence agricultural pursuits provide living standards that generally surpass those available to the rural poor in other developing countries. In many instances, non-agricultural wages in Asian countries are on average less than 25 per cent of Papua New Guinea ones. Even in countries with substantially higher per capita incomes (such as Korea and Singapore) labour costs are lower (McGavin 1991:128). To a large extent the government can take credit for falling real wages by virtue of its influence over the Minimum Wage Board, which no longer upholds universal full wage indexation. The Board has also determined that in future wage determinations, a firm's ability to pay will be taken into account. Even if real wages do continue to fall, real wage costs in Papua New Guinea are likely to remain above those of other regional states. This is primarily due to poor standards of education which translate into low productivity levels. The government is acutely aware of the problem and allocates a reasonably high proportion of its budget to the education sector. Unfortunately, returns to education are not what they should be. Currently, there are moves afoot to widen the primary school intake and to rationalize the higher education system but these steps even if successfully implemented, will take years to bear fruit.

Trade liberalization

In the main, Papua New Guinea has had a fairly liberal trade regime where, with a few exceptions (mostly in food), measures to provide across-the-board import protection have not been adopted. Tariffs have mainly been imposed with a general revenue raising function in mind and have been negligible with regard to inputs and basic food items. Within the framework of its structural adjustment

program, the Namaliu government is committed to phasing out existing import bans. Tariff rates on a large number of items used as inputs to the manufacturing, agricultural, fishing and tourist industries, have been abolished.

Encouragement of foreign investment

To facilitate the inflow of foreign finance, the National Investment Development Authority, which has been widely perceived as having impeded rather than promoted investment, has been replaced by a new body, the Investment Promotion Authority. Hopefully, future investment applications will be determined promptly so that authorizations can be attained within 60 days of being sought. As a means of liberalizing investment conditions, foreign enterprises have been redefined to cover firms embodying less than 50 per cent of national equity rather than 75 per cent. Furthermore, restrictions on the employment of foreign personnel are now less stringent.

Privatization

In terms of the government's privatization plans, it has been decided in principle to privatize as many public enterprises supplying goods and services as is feasible. While presently there are some 30 state owned commercial enterprises, the absence of a stock market (among many other factors) limits the privatization process. For state enterprises not likely to be involved, it is hoped that commercial practices will become the norm.

Manufacturing

A very significant economic constraint within Papua New Guinea is the extreme shortage of individually owned land. Approximately 97 per cent of land is commonly owned, with proprietary interests being vested in groups with customary claims to specified sites. Apart from the obvious handicaps that this presents to agricultural advancement, it also impedes the manufacturing sector. The problem may possibly be circumvented through the establishment of industrial estates. Such estates might afford ready access to land, labour, transport, power and communications. Plans are now afoot to establish a pilot project in Lae. However, as such estates have long-term pay off periods, observers warn of the danger of rapidly transforming them into export

processing zones which may be even more financially hazardous (Hughes 1984).

Agriculture

With regard to agriculture, Papua New Guinea acceded to loan stipulations by the Asian Development Bank that it winds down its budgetary support to existing commodity price stabilization schemes (AIDAB 1990). Such a commitment was elicited as it was felt that the schemes (which applied to coffee, cocoa, copra and palm oil) impose a large drain on government revenue without contributing to macroeconomic stabilization. Furthermore, they are believed to have 'dampened incentives to innovate and expand during long periods of high prices', and thereby could well have reduced investments in agriculture (AIDAB 1990:12). Accordingly, the government is phasing-out loans to the stabilization funds and is intent on establishing agricultural commodity corporations to provide research, extension and marketing services. Agricultural extension services recently reached an all time low. This reflects a critical dearth of adequately trained advisers. In addition, transport problems, landownership forms and the resulting credit constraints all require official intervention. The 1990 10 per cent devaluation may have assisted by yielding 'a modest improvement in the profitability of plantations and the welfare of smallholders' (Elek 1991:29), but unless some more tangible structural changes are introduced, the agricultural sector, which provides an income to some 85 per cent of the population, is not likely to grow rapidly.

Law and order

Not only is Papua New Guinea faced with a need to rectify resource allocative distortions (as exemplified by high wages rates, inappropriate land institutions and government regulations) but a fair semblance of the rule of law is yet to be attained. The country is confronted with a growing crime wave which is threatening the security of individuals and of property alike. The increasing severity and incidence of unlawful behaviour is highlighted by an inept law and order apparatus. The outbreak of crime has become so serious that it now discourages investment across a broad spectrum of activities embracing manufacturing, agriculture and tourism. Normally,

security matters are not considered in conjunction with structural adjustment programs but in Papua New Guinea's case, unless the crime menace is eradicated, the government's plans may come to naught. The problem has received official recognition but in practice the reactions have been mixed. On the one hand, the effectiveness of police operations is being enhanced and some tangible results have already been obtained. On the other hand, although crime has been escalating, allocations to law and order in the 1992 Budget (as a proportion of the total) are much the same as they were in 1988.

Growth and balance of payments

Real GDP fell by 1.4 per cent in 1989, the year in which the country's crisis began. A year later, it fell by a further 3.7 per cent. On account of a massive upsurge in mining activity (estimated at growing by 46 per cent), the economy in 1991 was able to attain a significant turnaround, with GDP rising by 9 per cent in real terms. The non-mineral private sector, spurred by favourable trends in construction, transport and manufacturing, rose by 4.8 per cent. Most of this growth of course could be attributed to the mining boom. To the country's credit, inflation did not get out of control, neither when the economy was depressed nor when it recovered. For the years, 1989, 1990 and 1991, inflation rates were 4.5, 7.0 and 6.5 per cent respectively. In this respect, Papua New Guinea is almost unique. Within most developing countries, significant drops in per capita incomes are almost invariably accompanied by bouts of accelerating inflation. It would then seem that the official response to the country's crisis was a responsible and well measured one.

On the balance of payments front, the situation at first turned out to be very satisfactory. The overall balance moved from a K52.5 million deficit in 1989 to a K43.1 million surplus in 1990. Contributing factors included the successful mobilization of official capital (a favourable by-product of framing an appropriate adjustment strategy), a large influx of private investment in the oil and mining sectors and a large fall in imports. The import decline ensured that the trade balance moved from a negative to a positive amount.

Regrettably, the provisional figures for 1991 indicate an overall balance of payments deficit amounting to K76 million. The government attributes this to large increases in imported goods and services in connection with the highly prolific gold mine at Porgera and the oil project at Lake Kutubu. Another contributory factor was a lower than expected drawdown of official capital transfers, especially from the European Community.

General comments

At one level of analysis, one might conclude that Papua New Guinea's structural adjustment strategy has been successful. After all, real GDP growth rates have risen, inflation has basically been kept under control and the balance of payments has recovered.

Compared with the experiences of other developing countries, the adjustment process has been relatively painless. Although the Bougainville crisis was a very severe one, the country was blessed in having new and even more productive mineral projects in the pipeline. These projects are currently attracting large amounts of foreign investment. This contrasts sharply with say Zambia, which has not been able to tap alternative export sources in the face of sharp falls in the price of its copper. Furthermore, Papua New Guinea, unlike many African countries, is largely food self-sufficient.

Most of the steps taken have elicited little, if any, significant public hostility. The tariff reductions in question have threatened only a limited number of existing local enterprises, a positive consequence of having a very small manufacturing base. Furthermore, they have partly moderated the potentially inflationary thrust of the original 10 per cent devaluation. In contrast to other developing countries, there have been no serious cut-backs in welfare components of the budget. For instance, within Papua New Guinea, there is no issue relating to widespread food subsidies and their reduction or abolition, a factor which frequently threatens the effective execution of many developing countries' adjustment programs. Not only did the Papua New Guinea government commit itself to the strengthening of the education sector but it also initiated a 'Special Interventions Program', to generate

employment in urban areas and to provide basic services for disadvantaged groups and in poorer areas.

The civil service was expected to bear the main brunt of the austerity measures, but in fact, as mentioned above, no net reduction of its workforce was accomplished. Sacrifices in the form of lower real wages fell largely on the shoulders of wage and salary earners in both the private and public sectors. However, considering that Papua New Guinea wage levels were relatively high in the first place, the sacrifices were neither unduly onerous nor inappropriate.

It could be argued that the adjustments undertaken succeeded in containing a possible extreme macroeconomic disequilibrium. However, success resulted more from a perception among private investors and official aid agencies that the Papua New Guinea Government was adopting an appropriate response which was reassuring to them, and less as a direct consequence of the measures themselves. At this point of time we could conclude that Papua New Guinea has weathered the Bougainville and terms of trade crisis. Furthermore, it has adopted certain policies which ought to engender economic efficiency. But that does not guarantee that appropriate structural adjustments will actually be realized. The mining boom may provide a transient bounty but unless productivity is enhanced throughout all economic sectors, economic development will neither be realized nor sustained. A number of factors continue to frustrate progress in Papua New Guinea. First and foremost is the law and order problem which has become so serious that Australian diplomats now require substantial 'danger' pay before accepting assignments there. Second, the land tenure system has to be changed. Aside from these two factors, sustained economic development in Papua New Guinea requires a relatively non-corrupt administ-

ration, political stability and national cohesion. An adequate social economic superstructure must be provided, and along with an educated, industrious and disciplined workforce, self-reliant and enterprising managers are needed. It will take many years for all these conditions to be realized and until then autonomous economic progress will not easily be attained.

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