

Papua New Guinea economic survey: a comment

Timothy Curtin

Consultant

Satish Chand (2004) provides an insightful survey of the state of the economy of Papua New Guinea in 2003. But the survey's generally critical tone depends rather heavily on some methodologically and factually incorrect assumptions and judgments. These include, first, that the apparent improvement in the growth rate of the country's economy in 2003 owes more to 'good luck' (mainly higher export prices) than to good economic management; second, that as many as 37 per cent of the population lives below the poverty line; and third, that Papua New Guinea has an exceptionally high infant mortality rate of 79 per 1,000 births. There is also some confusion in the discussion of budget deficits on the one hand and inadequate development expenditure on the other.

Chand begins by stating that although Papua New Guinea's real gross domestic product (GDP) increased by 2.4 per cent in 2003, this was due 'in the main to increased prices for commodity exports combined with good weather at home' (Chand 2004:1). This emphasis on the increased prices for Papua New Guinea's exports is a recurring theme throughout. But as textbooks explain, increases in real (that is, adjusted for inflation) GDP necessarily abstract from

changes in prices, 'since it is physical quantities that yield people utility or happiness, it can be very misleading to judge the economy's performance by looking at nominal [GDP]' (Begg et al. 1997:332). Data in Volume 1 of Papua New Guinea's 2004 Budget show that the government's claim for higher GDP in 2003 is based on nominal (that is, current prices) GDP in 2003 adjusted for inflation since 1983. Thus the references by Chand to the faster growth of Papua New Guinea's economy in 2003 as being largely due to the 'good luck' of higher world commodity prices are formally incorrect.

In any event, Papua New Guinea's miners and farmers would hardly have had time in the course of one year to respond to higher world prices by raising output to any significant extent. Mines such as Ok Tedi, Porgera, and Lihir tend to operate at their full capacity regardless of copper and gold prices—subject only to weather and technical factors. Oil palm, coffee and cocoa farmers have little scope for raising output instantaneously with higher world prices (it takes about five years for a coffee tree to begin bearing beans). That there was an increase in the volume of output of non-mineral exports of 14 per cent in 2003, and an even larger increase in minerals of 20 per cent,

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suggests that Papua New Guinea's reported growth in real GDP in 2003 was largely independent of the increases of 8 per cent and 9 per cent, respectively, in the indices of kina prices of its non-mineral and mineral exports. While weather conditions can be important for mines and food production, they rarely impact on the country's oil exports or simultaneously on all of its tree crop exports.

Chand is on firmer ground, however, when discussing improvements in Papua New Guinea's fiscal and exchange rate performance in 2003, as higher export prices do have a more immediate impact on the budget and the balance of payments. The increase in total earnings of the export sector of over 20 per cent, despite the appreciation in the kina during 2003, contributed to a lower budget deficit in 2003 and to the substantial increase in foreign exchange reserves of the Bank of Papua New Guinea. But both of these favourable outcomes also stemmed from the Somare Government's unusually effective restraints on public expenditure, including the revival of the Public Accounts Committee in 2003, which for the first time for many years kept spending within budget ceilings, and from the restrictive money policy applied by the Bank of Papua New Guinea. These tight fiscal and monetary controls were crucial after the blow out (to K800 million) in the fiscal deficit during the first eight months of 2002 that had resulted from the Morauta Government's attempt to buy election victory (see Curtin 2002).

Chand is also wrong in his assertion that 'in 2001 37 per cent of the population lived below the poverty line where the poverty line was set at an income level of K461 per adult' (2004:1). However, he seems to have been misled by his cited sources (Asian Development Bank 2003:8), which drew on an unpublished World Bank report of 2001.¹

The World Bank's data derived from a household survey undertaken in 1996 by

Gibson and Rozelle (1998) (also reported by World Bank 1999 and Gibson and Rozelle 2003). This survey deemed that all people with incomes insufficient to achieve a prescribed minimum food calorie consumption level were living in poverty (Gibson and Rozelle 1998:45; Gibson 2003:161).² The survey set the poverty minimum as a per adult equivalent daily consumption of 2,200 calories. However, that level of consumption is usually considered a normal rather than a poverty level of food consumption. Even the Food and Agricultural Organization (FAO), notorious for exaggerating food deficits, distinguishes between 'average calorie requirement' and 'minimum calorie requirement' (Svedberg 2003:11), with the former at between 2,100 and 2,220 and the latter at between 1,790 and 1,880 calories per day (for various regions of the world). Using FAO minima would greatly reduce the proportion of Papua New Guineans deemed by Gibson and Rozelle to be living in poverty—from 37 per cent to probably less than 12 per cent—as they showed that even the bottom quartile of households enjoyed consumption of 1,955 calories per day per adult equivalent, which is well above FAO minima (Gibson and Rozelle 1998:37; see also World Bank 1999:77).³

Chand again uncritically cites World Bank data on various social indicators that he uses to contrast Papua New Guinea's performance unfavourably with that of some of its South Pacific peers. It is no defence to cite the World Bank as if it was a primary source. Genuine primary sources are to be preferred, as in Sugden (2004:Table 1). Using published census data from 2000 and other primary sources (National Statistical Office 2003), Sugden reports an infant mortality rate of 64 per thousand births in 2000, 19 per cent lower than Chand's 79 per thousand births, not good but not quite so bad either—and even that figure is difficult to square with Papua New Guinea's apparent population

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growth rate of 2.5 per cent between 1990 and 2000 (the highest ever recorded).

Chand's Table 1 also cites data for GDP per capita of Papua New Guinea and its regional peers. Such comparative data are critically dependent on current exchange rates, and produce unreal results such as average income in the Solomon Islands being higher than in Papua New Guinea in the very year its government and economy virtually ceased to exist, leading to its *de facto* recolonisation in 2003 (by Australia).⁴ These comparisons are only meaningful if performed on a purchasing power parity basis, and such data do not exist for the countries in question (other than dubious imputed, not data-based, estimates by the World Bank).

Chand emphasises that

prevailing unfavourable macro-economic conditions in the form of high inflation and high interest rates on borrowing can be linked to the high level of the debt of the public sector and continuing budget deficits that are being financed domestically (2004:17).

It is all too often the fate of economists that their forecasts prove wrong even before they appear in print. By the March quarter of 2004 Papua New Guinea's inflation had dropped from an annualised rate of 20 per cent in the same quarter of 2003 to 2.9 per cent—its lowest level for five years (Bank of Papua New Guinea 2004).⁵ The fall in inflation allowed a large reduction in

Table 1 Budget deficits in Papua New Guinea, 1996–2003 (million kina)

	1996	1997	1998	1999	2000	2001	2002	2003
Total revenue and grants	1,898	2,018	1,991	2,569	3,009	3,185	3,231	3,682
Grants	170	133	114	477	507	719	691	827
Domestic revenue	1,728	1,885	1,878	2,092	2,502	2,466	2,540	2,855
Recurrent expenditure (including interest on debt)	1,611	1,817	1,951	2,066	2,352	2,425	2,542	2,703
Recurrent surplus/deficit (with grants)	287	201	40	503	657	760	689	979
Capital account (including debt repayment)	249	167	176	736	849	1,119	1,140	1,177
Recurrent surplus/deficit (per cent of capital account)	115	120	23	68	77	68	60	83
Total expenditure (including amortisation)	1,860	1,984	2,127	2,801	3,201	3,544	3,682	3,880
Financing requirement (surplus/deficit)	38	34	-136	-232	-192	-359	-450.5	-198
Percentage of GDP	0.55	0.48	-1.73	-2.64	-2.02	-3.61	-4.10	-1.70
Gross domestic product	6,881.3	7,063.7	7,863.4	8,780.8	9,514.6	9,948.2	10,991.9	11,630.8

Source: Bank of Papua New Guinea, 1998. *Money and Banking in Papua New Guinea*, Bank of Papua New Guinea, Port Moresby; Bank of Papua New Guinea, 2000. *Quarterly Economic Bulletin*, Bank of Papua New Guinea, Port Moresby; PNG Budget 2004.

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Treasury Bill rates from 20 per cent for much of 2003 to 8 per cent by May 2004. Chand's survey also fails to mention Papua New Guinea's largest ever recorded annual increase in wage employment—9 per cent between September 2002 and September 2003 (Bank of Papua New Guinea 2004).

Chand's reference to 'continuing budget deficits that are being financed domestically' is misleading in several respects. Papua New Guinea's recent governments have all adhered to the 'golden rule' laid down by the United Kingdom's finance minister, Gordon Brown, that current revenue should cover all recurrent expenditure including debt interest (Table 1). In that sense, Papua New Guinea has not incurred any deficits since 1994. However, all governments in Papua New Guinea, as elsewhere, have borrowed to finance that part of the capital budget (including debt repayments) that has not been covered by the surplus on the recurrent account. This financing requirement has varied from 39 per cent in 1999 to 17 per cent in 2003. Unfortunately, net foreign lending to Papua New Guinea is often negative (that is, new loans fall short of repayments due on previous loans) and that has been the main source of fiscal stress in recent years. The negative inflows in 2002 and 2003 (and appreciation of the kina against the US dollar) produced a net reduction in external debt of K886.1 million between December 2002 and December 2003, while domestic public debt increased by K434.6 million, for an overall reduction in total public debt of K451.5 million. While total public debt of K7.5 billion at September 2003 was 65 per cent of GDP—which is not out of line with the ratio in many industrial countries—the more pertinent external debt ratio was much lower, at 40 per cent. Very few industrial countries financed their infrastructure without any use of debt finance, and it seems inconsistent of Chand

to criticise not only the 'high' budget deficit and the 'high' level of public debt but also the 'low' level of development expenditure. Chand implies recurrent spending could be shifted in favour of the development budget. But at least a quarter of the former is on education, health, and law and order (police and justice), with 21 per cent on debt interest, and the balance on governance. Would it make sense to scale back already understaffed agencies such as the Internal Revenue Department (703 staff), Treasury (166), Statistics (97), Attorney-General's and magistracy (807), Police (5,398), Prison service (1,495), and the departments of Mines (96) and Petroleum (121)?

The above corrections are not meant to detract from Chand's many other sensible comments on economic policy, but to qualify the impression of bias conveyed by his choice of statistics. One would also question whether his recommended 'big push' to tackle the country's law and order problems, presumably by devoting more budgetary resources to law enforcement, whilst necessary, will be sufficient. Chand does mention the need for land reform (2004:14); but it could well be that effective action to facilitate individualised tenure would do more to solve the law and order problem than any other measure.⁶

The overall impression left on this reader at least is one of curiosity that Chand is so critical of a country whose government, since it took office in August 2002, has studiously applied many of the policies he advocates, such as 'policy stability' and 'fiscal sustainability', with the result that inflation has rapidly declined, interest rates have fallen, and private sector employment has increased for the first time in 15 years. Sugden appears to reach a similar conclusion: '...the government deserves credit for beginning to correct an extended period of poor fiscal management' (2004:56).

Notes

- ¹ The reader may well find the World Bank's published country report (1999) more accessible than Chand's references or the survey itself, as it gives a summary of the 1996 household survey.
- ² Gibson and Rozelle (1998) did not measure calorie consumption but derived it from income and price estimates, themselves subject to wide margins of error. Their survey developed three different poverty lines: the upper poverty line of K461 income per adult equivalent per annum, with 37 per cent of the population not achieving this level; the lower poverty line, at K399, with 30 per cent not achieving it; and the food poverty line, at K302, with 14 per cent not attaining it. The first two of these poverty lines included larger and smaller quantities of non-food items, respectively. All three poverty lines maintained 2,200 calories as the poverty minimum. Chand reported only the first of these measures.
- ³ See Svedberg (2003) for a detailed account of statistical flaws in the FAO's derivation of its minimum calorie consumption benchmark. A major defect in the Gibson and Rozelle survey is that it derives monetary valuations of its postulated minimum diet when in reality the majority of Papua New Guineans are subsistence farmers who produce and consume most of their own food which is not priced to cover the costs of transport to and sales in urban areas (including wholesale and retail margins) (Gibson and Rozelle 1998:55). Hence, the stated minimum income per adult (to attain the supposed minimum diet of 2,200 calories at market prices) is likely to exaggerate the cost of minimum subsistence levels.
- ⁴ In US dollar terms, Papua New Guinea's GDP rose by 15.8 per cent in 2003 over 2002, but that was largely due to the 9 per cent appreciation in the average kina/US\$ exchange rate. The Solomon Islands' higher GDP per capita figure largely derived from its unrealistic exchange rate in 2002. At its 2003 exchange rate, its GDP per capita in US dollars declined to well below Papua New

Guinea's. However, the only meaningful comparison would require data on relative prices.

- ⁵ Chand (2004, Table 2) cites only the inflation rate as it was in June 2003, still at 19 per cent, whereas by December 2003 it had already fallen to 8 per cent.
- ⁶ The 2000 Census (National Statistical Office 2002:Table E3) reported that fewer than 30,000 Papua New Guineans owned modern housing, or 3 per cent of all households, whereas one of the first and in many ways most momentous reforms in Mainland China was the introduction of individual home ownership.

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