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COUNTRY ECONOMIC REVIEW

PAPUA NEW GUINEA

June 2000

CURRENCY EQUIVALENTS
(as of 12 April 2000)

Currency Unit	–	Kina
K1.00	=	$0.3670
$1.00	=	K2.7248

ABBREVIATIONS

ADB	–	Asian Development Bank
BPNG	–	Bank of Papua New Guinea
CPI	–	consumer price index
DDP	–	District Development Program
GDP	–	gross domestic product
HDI	–	human development index
IMF	–	International Monetary Fund
m^3	–	cubic meters
MLAR	–	minimum liquid asset requirement
MRSF	–	Mineral Resources Stabilization Fund
MTDS	–	Medium-Term Development Strategy
NPF	–	National Provident Fund
PNG	–	Papua New Guinea
SBA	–	Stand-By Arrangement
SRP	–	Structural Reform Program

NOTES

(i) The Government's fiscal year (FY) ends on 31 December.
(ii) In this report, "$" refers to US dollars.

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EXECUTIVE SUMMARY

Some economic and social progress has been made since Papua New Guinea's independence in 1975, but the people remain poor by regional and international standards. Thirty one percent of the population lives below the international poverty line of $1 per capita per day. Most of the poor are in rural areas, especially the north coast and highlands provinces. Women are worse off than men, even having a lower life expectancy. The fundamental development challenge is still to translate natural resource richness into broad-based, sustainable economic growth and social development.

Real gross domestic product (GDP) grew at an average annual rate of 3.4 percent during the period 1978–1998, or about 1.1 percent in per capita terms. This growth was led by the mining and petroleum sector. Per capita GDP in the nonmining economy grew at just 0.2 percent during the same period. In the late 1990s, growth performance was adversely affected by severe drought, the Asian economic crisis, macroeconomic mismanagement, and a deterioration in the governance environment. Real GDP declined in 1997 and grew in 1998 and 1999 only because of a recovery in mining and petroleum output. Formal employment in the nonmining private sector remained stagnant in the 1990s; and there was a diminished resource mobilization effort as the government budget moved in to deficit.

The overall fiscal position deteriorated from a small surplus in 1997 to a deficit of 2.1 percent of GDP in 1998 and 3 percent of GDP in mid–1999. The deficits largely were funded by borrowing from the central bank in excess of legal limits, resulting in inflationary and balance of payments pressures. As primary product export revenue fell and private capital outflows grew, efforts to support the currency failed. The kina depreciated from 1.35 to the US dollar at the end of 1996 to 2.70 at the end of 1999, while gross official reserves fell from $549 million to $181 million. Yields on Treasury bills rose from 9 percent to over 20 percent, and the inflation rate accelerated from 5.3 percent to 13.2 percent. There was some recovery in the fiscal and external accounts in the latter half of 1999, following the formation in July of a new administration committed to macroeconomic stabilization and implementation of a Structural Reform Program (SRP), recovery in the oil price, and financial assistance from the Australian government.

The 2000 budget lays the foundations for macroeconomic stabilization. The projected deficit will be comfortably financed by financial assistance from the International Monetary Fund, the World Bank, and other external funding agencies. Remaining government arrears will be paid, substantial public debt retired, and expenditure reallocated towards the priority areas of health, education, infrastructure, primary industry, fiscal management, and law and order. Growth is forecast to accelerate to 4.5 percent in 2000, foreign reserves to grow to in excess of $360 million, the kina to appreciate slightly, inflation to drop to 5 percent, and Treasury bill yields to fall to around 10 percent. Medium–term growth of 5 percent is expected, assuming two major projects in the mining and petroleum sector commence on schedule.

The Medium Term Development Strategy 1997–2002 and the SRP spell out the strategies for achieving broad-based, sustainable economic growth and social development. Effective implementation based on good government is required. A promising start has been made by a new administration working within an inherently unstable political system to address many interlocking issues. Paramount among these is the crime and personal insecurity problem, which is the biggest obstacle to private sector development, and which must be attacked directly.

I. RECENT ECONOMIC DEVELOPMENTS

A. Poverty and Human Development

1. After 25 years of political independence and some economic and social progress, most of the people of Papua New Guinea (PNG) remain poor by regional and international standards. During the period 1978–1998, real gross domestic product (GDP) grew at an average annual rate of approximately 3.4 percent, and at 1.1 percent in per capita terms.[1] The human development index (HDI) rose from 0.325 in 1970 to 0.507 in 1995, with life expectancy rising from 40 to 54 years.[2] Still, gross national product per capita was $890 in 1998, compared with $990 for East Asia and the Pacific and $1,710 for lower middle-income countries;[3] PNG's HDI score for 1995 placed the country in 129th position on a list of 174 developing countries; and the HDI score for 1998 placed it last on the list of Pacific developing member countries.[4] In the area of health, there was some evidence of regress in the 1990s.[5]

2. The human poverty index for PNG is at the level of Burundi and Mali, which are among the most poverty afflicted nations in the world. On the evidence from a 1996 household survey, 31.0 percent of the PNG population live below the international poverty line of $1 per capita per day.[6] This incidence of poverty is high compared to countries with similar income levels. Using a slightly higher country-specific poverty line, 37.5 percent of the population is living in poverty, with their average consumption level being two-thirds of the poverty line consumption level of 461 kina (1996 prices) per adult equivalent per year.[7] Approximately 17 percent of the PNG population cannot meet the basic requirement of 2,200 calories per day per adult equivalent, even if they spend all their income on food.

3. Poverty coexists with wealth. The richest 10 percent of the population account for 36 percent of consumption, whereas the poorest 50 percent account for just 20 percent. The Gini coefficient of 0.461 is high by comparison with countries of similar income levels. This is in large part a reflection of the dualistic pattern of growth since independence. Growth has been led by a capital-intensive minerals sector generating state revenues that substantially have been used to support consumption by an urban, public sector elite. The semi-subsistence sector on which the vast majority of the population depends has shown little intensive growth.

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1 Based on data for 1978-1998 presented in Department of Planning and Monitoring. 1999. *Papua New Guinea: National Population Policy 2000-2010.* Table A. 18. Port Moresby: Government Printer; and in Budget Papers 2000*, Volume 1, Economic & Development Policies*. Port Moresby: Government Printer.

2 *Ibid.*, Table A7; UNDP, *Human Development Report 1998*. New York: Oxford University Press.

3 World Bank data (Atlas method).

4 UNDP. *Human Development Report 1998*. New York: Oxford University Press; UNDP. 1999. *Pacific Human Development Report 1999: Creating Opportunities*. Suva, Fiji: In the former report, the HDI is calculated using real GDP per capita in purchasing power parity dollars. In the latter report, real GDP per capita in dollars converted at market exchange rates is used, thus generating lower GDP per capita and HDI numbers.

5 UNDP. 1999. *Papua New Guinea Human Development Report 1998*. Port Moresby: Office of National Planning, Government of Papua New Guinea..

6 The World Bank. 1999. *Papua New Guinea: Poverty and Access to Public Services*, Report 19584-PNG, 28 October. Washington DC: World Bank. The $1 a day is at 1985 prices converted to the national currency at a purchasing power parity exchange rate. Section A draws heavily on the World Bank report.

7 Children 6 years of age and below are treated as equivalent to 0.5 of an adult. The amount of 461 kina is the national weighted average expenditure needed to ensure an intake of 2,200 calories per day per adult equivalent, and to meet basic nonfood expenditures.

Per capita real GDP in the non-mining economy grew at the average rate of just 0.2 percent per annum during the period 1978–1998.[8]

4. Poverty in PNG has an important regional dimension. The vast majority of the poor (93.5 percent) live in rural areas. The Momase-North Coast region exhibits the highest incidence of poverty, with 45.8 percent of the population living below the poverty line. Poverty rates in the regions of Papua-South Coast, the Highlands, and the New Guinea Islands are 33.2 percent, 35.8 percent, and 33.6 percent, respectively. Momase-North Coast and the Highlands together account for 73.8 percent of the poor. The urbanized National Capital District (NCD) has a poverty rate of 25.8 percent, and accounts for just 3.8 percent of the poor. Comparisons of poverty rates at the provincial level are not possible due to lack of data, but provincial human poverty and human development indixes have been calculated and are presented in Table 1. These show that poverty and low levels of human development are especially problematic in two north coast provinces (West and East Sepik) and the five highlands provinces (Southern, Western, Simbu, Eastern, and Enga).

Table 1: Provincial Development, 1996

Province	Human Poverty Index	Human Development Index	Gender-Related Development Index
West Sepik	60.0	0.262	0.234
Southern Highlands	56.7	0.274	0.244
Western Highlands	55.5	0.282	0.261
Simbu	54.1	0.320	0.298
Eastern Highlands	53.9	0.325	0.297
Enga	52.4	0.283	0.243
East Sepik	47.3	0.304	0.282
Madang	43.4	0.336	0.313
Gulf	40.0	0.331	0.312
Manus	39.4	0.421	0.393
Morobe	39.3	0.389	0.330
New Ireland	36.6	0.396	0.376
Oro (Northern)	36.5	0.386	0.356
Western	32.2	0.472	0.381
West New Britain	31.9	0.394	0.368
East New Britain	31.8	0.431	0.395
Milne Bay	31.4	0.420	0.387
Central	30.9	0.408	0.384
National Capital District	14.5	0.758	0.506
National	**43.7**	**0.363**	**0.318**

Notes: Data for Bougainville Province are not available. HDI numbers are not comparable with numbers presented in the UNDP human development reports referred to in footnote 4 because domestic factor income is used in the calculations, rather than GDP.
Source: UNDP. 1999. *Papua New Guinea Human Development Report 1998.* Port Moresby: Office of National Planning, Government of Papua New Guinea. (The report uses the term human deprivation index, rather than human poverty index).

5. Poverty and low levels of human development also have an important gender dimension (Table 1). Although improving over time, the Gender-related Development Index is

8 Footnote 1.

lower than the overall HDI at the national level and for all provinces, demonstrating that women's life expectancy, income, and educational levels are universally below men's. Indeed, PNG is probably the only country in the world where women have a lower life expectancy than men. While women are under-represented in senior positions in the private and public sectors, the professions, and politics, they do a disproportionately large amount of work in rural areas.[9]

6. In addition to the fact that they mostly are located in relatively inaccessible rural areas, poor households exhibit some notable characteristics that suggest areas of potential poverty-alleviating interventions. Almost 52 percent of the poor live in households whose head has never attended school. The poverty rate for these households is 51 percent. A further 23 percent of the poor live in households whose head has not been educated beyond grade 6. The poverty rate for these households is 41 percent. Clearly, there has been little, if any, human capital investment in three-quarters of the poor households. Girls' enrollment rates are significantly influenced by the education level of adult females in the household, so that there is a vicious circle of low enrollments–low levels of schooling–low enrollments that will be broken most effectively by targeted intervention.

7. The incidence of poverty is also linked to the ability to earn cash income to pay for nonfood items, to vary and improve diets, and to permit savings for times of economic difficulty (e.g., drought). Almost 17 percent of the poor population live in households whose heads earn no cash income, relying entirely on subsistence production (and perhaps gifts of cash). The poverty rate for these households is 47 percent. Almost 8 percent of the poor are in households whose main source of cash income is hunting, gathering, and fishing. The poverty rate for these households is 57 percent. Poverty rates are also above the national average for households that earn cash income from tree crops (44.0 percent) and commercial agriculture (42.7 percent). These households account for 42.5 percent and 19.0 percent of the poor population, respectively. Where household heads earn cash income from running a business or wage employment, poverty rates are much lower (at 25 percent and 17 percent, respectively). Although the latter households collectively account for 29 percent of PNG's total population, they account for only 14 percent of the poor population. In general, increased provision of opportunities for earning secure cash incomes is needed to reduce the incidence and severity of poverty.

8. Both the extent of income-earning opportunities and the ability to respond to such opportunities are determined to a significant degree by access to the basic public services of transport, utilities, health, and education. The PNG population as a whole expressed considerable dissatisfaction with access to services in 1996, and the degree of dissatisfaction is very likely to have increased during the late 1990s as a result of a widely-acknowledged deterioration in service provision. Table 2 shows that the poorest 25 percent of the population is the most dissatisfied quintile overall, and that dissatisfaction is highest in the Highlands and Momase-North Coast regions where the majority of the poor live. Poverty alleviation requires improved service delivery to rural areas. This was the intention of provincial and local government reforms introduced under the Organic Law of 1995, but effective devolution has been limited by capacity and funding constraints.

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[9] In the coffee-growing Highlands, women work nearly twice the hours that men do. Economic Insights, 2000. *The Economy of Papua New Guinea, Macroeconomic Policies: Implications for Growth and Development in the Informal Sector*. AusAid International Development Issues No.53. Canberra: Pirie Printers: 9.

Table 2: Perceptions of Public Service Delivery
(percent of population believing access is inadequate compared to family needs)

	Health Care	Children's Schooling	Public Transport
Consumption Quartile			
Poorest	64	59	75
Second	63	55	78
Third	60	50	66
Richest	50	44	48
Region			
NationalCapital District	36	28	25
Papua/South Coast	50	45	81
Highlands	63	61	67
Momase/North Coast	65	57	68
New Guinea Islands	46	30	62
PNG	59	52	67

Source: The World Bank. 1999. *Papua New Guinea: Poverty and Access to Public Services*, Report 19584-PNG, 28 October. Washington DC: World Bank.

9. The fundamental and long-recognized development challenge for PNG is to achieve sustained economic growth with equity. The poorest 40 percent of the population must participate in, and benefit from, the growth process if poverty is to be alleviated. There are severe development constraints, including the rugged terrain of PNG's 462,000 square kilometers of land, the complexity of land tenure systems, the dispersal of 4.5 million people collectively speaking well over 700 languages, limited and deteriorating physical infrastructure, a major crime and personal insecurity problem, and the low level of human resource development (paras. 1-5). Just before independence in 1975, only 0.1 percent of the PNG population had been educated to secondary level.[10] Additionally, the concepts of nationhood and parliamentary democracy are relatively recent introductions, with the system where the winning candidate is the one who received the most votes tending to underpin chronic political instability, as a growing number of candidates promise potential voters that they will be rewarded for their support with development projects, which may not necessarily be well planned.[11] Nonetheless, some key development constraints can be eased over time through appropriate government action.

B. Growth, Employment, Savings, and Investment

1. Aggregate Growth

10. The average real GDP growth rate of 3.4 percent recorded during 1978–1998 conceals considerable year-to-year variation, which has resulted from various combinations of external economic shocks, natural disasters, and economic mismanagement. Real GDP declined in 1981, 1984, 1989, 1990, 1995, and 1997; and in other years it increased by rates ranging between 0.3 percent (1982) and 17 percent (1993). There has been little growth in the latter half of the 1990s, with real GDP in 1999 barely 3 percent higher than the 1994 level (Appendix 1, Table A.1).

[10] *Ibid.*, 19.
[11] The number of candidates for 109 seats in the national parliament rose from 880 in 1977, to 1,645 in 1992, to 2,368 in 1997. *Ibid.*, 21.

11. The recession that characterized the late 1980s and early 1990s resulted from a terms of trade deterioration and the closure of the Bougainville copper mine due to civil strife. An unsustainable fiscal expansion, exacerbated by a weakening of mineral export prices, led to a balance-of-payments crisis in 1994. A new government had to cut public expenditure, devalue and then float the currency, and commit to an economic reform program developed in consultation with the International Monetary Fund (IMF), the World Bank, and other external funding agencies. Real GDP increased by 1.9 percent in 1994, but fell by 2.6 percent in 1995. Concerns over the government budget and forestry and trade matters delayed release of IMF and World Bank funds until the end of 1996, but tighter macroeconomic policy and one-off receipts of taxation and privatization revenue restored economic stability. Led by construction activity, agricultural production, and log exports, real GDP increased by 2.9 percent in 1996 (Table 3).

12. The economy again went into recession in 1997, with real GDP declining by 2.4 percent (Table 3). A severe drought adversely affected agricultural production, and caused the temporary closure of the Ok Tedi copper mine and the Porgera gold mine because of the lack of water for processing and transportation. In addition, depletion of reserves caused a 30 percent drop in production at the Kutubu oil field; several large construction projects had been completed; prices for gold, copper, and oil fell; and log export prices began a precipitous drop as a result of the Asian economic crisis. The terms of trade declined 5.9 percent. Agricultural output fell 4.2 percent, construction fell 8 percent, and mineral GDP fell 23.5 percent. Real nonmineral GDP rose 1 percent, largely because of the performance of the manufacturing, commerce, and transport sectors.

13. A modest growth rate of 1.4 percent was registered in 1998 only because mining recovered from the effects of the drought, with mineral GDP increasing by 19.1 percent despite further falls in oil and copper prices (Table 3). Nonmineral output fell by 2.7 percent, with agriculture, forestry, and fishing contracting by 6.1 percent. The ongoing effects of the drought, which ended early in the year, still affected tree crop production in particular; and log export prices dropped to half the 1997 level, causing a substantial drop in log production and export. Manufacturing and wholesale and retail trade also contracted. Simultaneously, macroeconomic management weakened amid growing political uncertainty, a deteriorating governance environment, and a loss of private sector confidence. In 1998, the fiscal deficit reached 2.1 percent of GDP, the yield on treasury bills rose to 23.9 percent (from 14.6 percent in 1997), net foreign reserves dropped to 1.5 months of nonmining imports (from 4.9 at the end of 1996), and the kina depreciated 19 percent from its end 1997 rate against the US dollar (Table 3).

14. In 1999, real GDP is estimated to have grown by 3.8 percent (Table 3). Mining and petroleum output increased by 14.1 percent, while nonmineral GDP rose by just 0.9 percent. Agriculture, forestry, and fishing again contracted (by 2.0 percent), and construction activity fell by 12.4 percent. Signs of intensified macroeconomic instability became apparent early in the year, when the kina came under pressure at a time of seasonal downturn in export revenue. The pressure arose primarily from substantial unbudgeted public expenditure in December 1998 and January 1999, and the Government's failure to secure anticipated external finance from commercial sources and from the IMF and the World Bank. The Government relied instead on borrowing from the Bank of Papua New Guinea (BPNG) that exceeded legal limits. Further deterioration in the already poor governance environment remained a fundamental concern, with Parliament suspended until 13 July and government business conducted in a nontransparent, unpredictable manner. The kina depreciated to a historic low of $0.3480 on 1

June, foreign exchange reserves dropped to a dangerously low level of one month of nonmineral imports cover, and inflation accelerated to an annual rate of 16 percent.

Table 3: Key Economic Indicators, 1996–1999

	1996	1997	1998	1999
Growth (percent)				
Real GDP	2.9	-2.4	1.4	3.8
Mineral	-11.8	-21.0	19.1	14.1
Nonmineral	8.3	3.2	-2.7	0.9
Gross Investment (percent of GDP)	27.8	27.1	30.3	29.3
Inflation Rate (average annual, percent)	11.6	3.9	13.6	14.9
Inflation Rate (end period, percent)	5.3	5.3	21.8	13.2
Money and Credit (percent)				
Broad Money	31.3	6.8	1.8	8.9
Domestic Credit	5.8	22.7	17.1	-0.7
Private Sector	-7.8	36.3	29.0	0.3
Government	19.2	22.7	15.4	11.1
Interest Rate (treasury bills, average)	9.2	14.5	23.9	20.4
Government Finances (percent of GDP)				
Revenue and Grants	26.1	29.4	25.8	24.6
Expenditure and Net Lending	26.5	29.2	27.9	25.8
Budget Balance	-0.3	0.1	-2.1	-2.4[1]
Domestic Financing	0.2	1.0	3.2	1.3
Foreign Financing	0.1	-1.2	-1.1	1.2
Balance of Payments				
Current Account Balance (percent of GDP)	5.4	-5.0	0.5	1.4
Overall Balance (percent of GDP)	7.1	-3.9	-4.1	1.1
End-Year Gross Official Reserves ($ million)	549	355	188	170
Months of Nonmineral Imports (c.i.f.)	5.4	3.3	2.2	1.5
End-Year Net International Reserves ($ million)	532	328	139	181
Months of Nonmineral Imports (c.i.f.)	4.9	2.8	1.5	1.8
Exchange Rates				
Kina per $ (end-period)	1.35	1.75	2.08	2.70
Nominal Trade-Weighted Rate (% change)	0.1	-5.4	-24.8	-20.9
Real Trade-Weighted Rate (% change)	3.2	-1.8	-11.2	-8.7
Memorandum Item:				
Nominal GDP (Kina million)	7,033.1	7,496.1	8,901.2	10,601.3

Note 1: Includes 1.2% "residual deficit" = difference between identified revenue and expenditure, and financing.
Source: Papua New Guinea authorities; Bank of Papua New Guinea. 1999. *Quarterly Economic Bulletin*, December. Port Moresby: Government Printer; Budget Papers 1999 and 2000, *Volume 1, Economic & Development Policies*. Port Moresby: Government Printer.

15. A new administration gained office on the 14th of July 1999, promising to restore integrity to state institutions, stabilize the kina, restore stability to the national budget, privatize public enterprises where appropriate, and ensure ongoing peace on Bougainville. A supplementary budget was introduced on the 10th of August that gained the endorsement of the IMF. This budget provided for cuts to the national Government's development expenditure; cessation of lump-sum payments for retrenchments under the poorly planned civil service reforms of the previous administration; and revenue-raising increases in gaming taxes, log export taxes, and excises on petrol, alcoholic beverages, tobacco, and luxury motor vehicles. The aim was to bring the overall fiscal deficit for 1999 down to 1.6 percent of GDP.

16. The 2000 Budget presented to Parliament on 30 November 1999 elaborated the Structural Reform Program (SRP) intended to achieve the macroeconomic stabilization and structural adjustments necessary for sustained, broader-based economic growth. The SRP is summarized in Box 1. Both the budget and the SRP gained widespread support from the PNG and international communities and, if implemented successfully during 2000–2001, would considerably improve medium-term growth prospects.

Box 1: Structural Reform Program

The structural reform program (SRP) 2000 was first outlined when the current Government won office on 14 July 1999. Domestically-designed, and subsequently endorsed by the World Bank and the International Monetary Fund along with other external agencies, the SRP's objectives and associated policy actions were presented in the 2000 budget papers (approved in November 1999). These objectives and policy actions are:

- **promoting good governance** through improved policy making procedures; greater transparency of decision-making; strengthening of the capacity for drafting legislation; placement of legislation on the Government's web site; review and enforcement of Government procurement procedures; extension and enforcement of requirements for public sector agencies to report to Parliament, strengthening of key governance agencies (Auditor-General, the Ombudsman Commission, the Parliamentary Accounts Committee); strengthening of the capacity of the National Statistics Office; enforcement of a code of conduct for the public service; and introduction of a moratorium on all new forestry licenses, extensions, and conversions;

- **sustaining macroeconomic stability** through strengthening debt management, enacting legislation ensuring the independence of the central bank to manage monetary policy and the exchange rate, and improving public financial management and expenditure controls;

- **improving public sector performance** through a public expenditure review; design and gradual implementation of a public service reform program; reviewing and strengthening of provincial and local government roles; increasing coordination between government at all levels; and narrowing of the scope of the Rural Development Fund and linking it to district development plans; and

- **removing barriers to investment and economic development** through continuation of tariff reform and trade liberalization, deregulation to stimulate agriculture and informal sector activity, completion of a taxation review, simplification and streamlining of business registration and work permit approvals, increase of the scope for competition in coastal shipping and aviation, privatization of public enterprises, and financial sector reforms including actuarial reviews of the National Provident Fund and the Public Officers' Superannuation Fund and introduction of legislation to improve regulation and supervision of the banking and insurance industries.

2. Sector Growth

17. The disappointing aggregate growth record of the late 1990s has reflected outcomes in the key resource sectors of (i) agriculture, forestry, and fishing; and (ii) mining and petroleum. Real output from these sectors in 1999 was lower than 1994 levels, when they accounted for 27.0 percent and 28.1 percent of GDP, respectively. The next largest contributor to GDP in 1994 was community, personal, and social services (14.8 percent), followed by wholesale and retail trade (10.1 percent), manufacturing (7.4 percent); transport, storage; and communication (4.6 percent); finance, real estate, and business services (3.6 percent), construction (3.1 percent); and electricity, gas, and water (1.2 percent). Only three of these sectors recorded sustained increases in output during 1994–1999: electricity, gas, and water; finance, real estate, and business services; and community, social, and personal services. The last sector, which includes public administration, grew at an average annual rate of 7.1 percent, increasing its share of GDP to 20.3 percent (Appendix 1, Table A.1).

a. Agriculture

18. Agriculture is key to improving the living standards of the majority of the population, since approximately 85 percent of Papua New Guineans are engaged in production of food crops for their own consumption and cash crops for domestic sale or export. Smallholder production accounts for almost all domestically produced food, more than 70 percent of coffee output, two-thirds of cocoa and copra output, and 35 percent of palm oil production.[12] Unfortunately, food and tree crop output was hit hard by the 1997–1998 drought. In the second half of 1997, over 250,000 people suffered life-threatening food shortages that necessitated a food relief effort involving external agencies. Subsistence production recovered in 1998, but tree crop production continued to decline. Overall the drought reduced real output of agriculture (excluding forestry and fisheries) by 2.5 percent in 1997 and 18.5 percent in 1998 (although the latter figure may be an exaggeration resulting from an underestimation of coffee output).[13] In 1999, cocoa, copra, and palm oil export volumes increased, but the coffee export volume declined. Coffee still retained its position as the primary agricultural export (32 percent of the total value of agricultural exports), followed closely by palm oil (31 percent).

19. All smallholder agricultural activity involves the use of customary land, which accounts for 97 percent of the total land area (the other 3 percent having been alienated during the colonial period). Women provide between 45 and 70 percent of the labor, depending on the region. Access to land for commercial use has long been regarded as problematic, but innovative solutions are possible: plantation-based palm oil production has expanded on the basis of subleasing customary land that has been leased from traditional owners by the Government.[14] Utilization of land and (predominantly male) labor surpluses in principle would permit an increase in agricultural production and rural living standards, but limited access to markets acts as a major constraint. About one-quarter of the 20,000 kilometers of nonurban roads in PNG are either impassable or cannot be used continuously through the year; and the

[12] World Bank. 1996. *Papua New Guinea: Accelerating Agricultural Growth – An Action Plan*. Washington DC: World Bank, quoted in Economic Insights, footnote 9, 40.
[13] World Bank. 1999. *Papua New Guinea: Improving Governance and Performance*, Report 19388-PNG, October. Washington DC: World Bank: 6.
[14] Economic Insights, footnote 9, 23.

poor quality of the remainder significantly adds to transport costs.[15] Road rehabilitation accordingly has been identified as a priority area in recent budgets.

b. Forestry

20. Exploitation of PNG's accessible hardwood forest of about 15 million hectares almost entirely takes the form of harvesting by foreign companies for log export, with some logs sold locally for building and processing into sawn timber. The rate of extraction accelerated in the early 1990s, peaking at a log export volume of 2.94 million cubic meters (m^3) in 1994 (compared with 0.99 million in 1990). As a result of the Asian economic crisis, the export volume dropped to 1.07 million m^3 in 1998; but it increased to 1.30 million m^3 in 1999 as log export prices recovered. In the latter year, log exports accounted for just over 5 percent of total domestic exports by value. Relatively little revenue from logging has reached local communities, and then has been consumed rather than invested. The 1991 Forestry Act provides the legislative framework for the management of forest resources as a renewable asset, and for genuine landowners to acquire a greater share of revenue. However, harvesting at unsustainable rates and inequitable distribution of benefits from logging remain major concerns. The SRP provides for an immediate moratorium on all new forestry licenses, extensions, and conversions as the first step in improving governance in this sector.

c. Fisheries

21. PNG's exclusive economic zone of 3.12 million square kilometers contains abundant tuna estimated at 20 percent of the total Pacific stock, and a prawn stock. Tuna harvesting by foreign-based vessels has been at or above the sustainable rate of approximately 250,000 tons per year and, aside from access fees, has created limited direct benefits to the economy, with processing and sales conducted overseas (although a tuna cannery began operations in Madang in 1997, creating over 1,000 jobs for women). There is an understandable desire in Government to increase local participation and benefits to the PNG economy; but careful policy formulation is needed to avoid costly interventions that prove ineffective. Potential benefits from coastal fisheries have not been realized, despite considerable foreign aid in support of Government programs. Poorly developed port facilities, inadequate support services, and weak marketing and distribution networks have restricted development. Institutional weaknesses persist within the National Fisheries Authority and at the provincial and local government levels, where responsibility for fisheries development and extension now lies. An Asian Development Bank (ADB) institutional strengthening program seeks to address these issues, and to help formulate a policy framework that will facilitate private sector-led development.

d. Mining and Petroleum

22. In 1999, mining and petroleum accounted for 24.3 percent of GDP and 71.7 percent of total domestic exports. Gold is produced at five mines (Lihir, Misima, Ok Tedi, Porgera, and Tolukuma); copper at Ok Tedi; and oil at Gobe, Kutubu, and Moran fields. The sector has contributed about one-quarter of total Government revenue since 1993.[16] In addition, mining and petroleum have provided royalty payments, employment opportunities, and health services for local populations. Infrastructure development associated with exploration and production

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[15] *Ibid.*, 25.
[16] Footnote 13, 262.

has also generated external benefits. However, environmental degradation has resulted from mineral sector growth. The Ok Tedi mine's use of the Fly River for waste disposal may cause the mine's closure. The future of the mine, 30 percent owned by Government, remained uncertain in early 2000.

23. The most notable recent developments include the Ramu nickel project near Madang, which is expected to produce 30,000 tons per annum over a 35–40 year period; and the PNG–Queensland gas project, which will involve collecting and processing gas in the Highlands fields and transporting it by pipeline to markets in Queensland, Australia. The gas project requires a consortium investment of about $2.8 billion, and is targeted to commence in 2002. Prospects of further discoveries of minerals are good, but exploration activity has declined from about $80 million per annum in the late 1980s to $12 million in 1999 because PNG has been seen as an increasingly risky country to invest in. This perception in turn reflects the growing crime and personal insecurity problem, political instability, closure of Panguna mine on Bougainville in 1989, attacks at Mt Kare mine in 1991 and 1992, the Government's unilateral decision to acquire equity in Porgera in 1992, and changes in the tax regime and legislative framework affecting the subsector.[17] The tax regime will be reviewed under the SRP, but much remains to be done to restore investor confidence and thus exploration activity.

e. Industry

24. Manufacturing accounted for 7 percent of GDP in 1999, down from its post independence high of 11 percent in 1989 (Appendix 1, Table A.1). The sector consists largely of food, beverage and tobacco, basic metals, and timber and wood products firms. These enterprises collectively sell around 90 percent of output to a small, protected domestic market; rely heavily on imports of raw materials and intermediate goods; and are generally capital-intensive in their production techniques. Sector growth has been constrained by high unit labor costs resulting from relatively high wages and low productivity. In the early 1990s, these costs rose above those in the United States as labor productivity fell.[18] The growing crime and personal insecurity problem also adds to costs, directly through the outlays required for security services, and indirectly through preventing the night-time transport of goods and staff and operation of plants. A sustained improvement in labor productivity is fundamental to the future development of manufacturing, which will occur in a more liberalized trading environment. The Pioneer Industries Act, which aimed at encouraging industries through discretionary incentives such as tax holidays, was repealed in the 1999 budget; and under the SRP, the Government has committed to a five-year program of tariff reduction (although specific tariffs on items like canned fish and processed sugar remain high). Implementation of this program, combined with the real depreciation of the kina in 1998–1999, will encourage efficient manufacturing for export and import replacement, provided the real depreciation is not eroded by domestic inflation. Food and wood processing for export offer the best prospects.

25. The output of construction is characterized by considerable year-to-year variation because of the impacts of the beginning and end of large individual projects, mostly associated with mining. Construction contributed just 1.9 percent to GDP in 1999, compared with 3.1 percent in 1994. Some stimulus will come from construction of an oil refinery near Port

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[17] Economic Insights, footnote 9, 49.

[18] R. Duncan and T. Lawson. 1997. *Cost Structures in Papua New Guinea*. Port Moresby: Institute of National Affairs, Discussion Paper No. 69: 45.

Moresby in 1999. Significant future expansion will occur with the commencement of the PNG–Queensland gas pipeline and the Ramu nickel project.

26. Electricity, gas, and water increased its share of GDP from 1.2 percent in 1994 to 1.4 percent in 1999. However, the public utilities in this subsector continued to be criticized by the business community for being high cost and unreliable. In particular, frequent breaks in power supply and large fluctuations in voltage have been cited as raising business costs.[19]

g. Services

27. Services as a whole increased its share of GDP from 33.1 percent in 1994 to 39.7 percent in 1999 (Appendix 1, Table A.1). The shares of wholesale and retail trade, and transport and communications, fell during this period, but were outweighed by rapid growth in finance, real estate, and business services, and in community, social, and personal services. The finance sector's share of GDP rose to 5.5 percent in 1999, while the share of community, social, and personal services rose to 20.3 percent. Approximately 40 percent of output in the latter sector is attributable to the Government, which in 1997 was estimated to account for 14 percent of GDP.[20] Under the 1995 Organic Law, provincial and local-level governments have been given greater financial autonomy and the responsibility of ensuring service delivery, where possible using the private sector and nongovernment organizations as the actual service providers.

3. Employment and Wages

28. Total employment in the formal, nonmining private sector has been virtually stagnant since 1989 (Table 3) – a period during which approximately 50,000 people joined the labor force each year. In line with the sectoral growth record, employment in agriculture, forestry, and fishing fell, while employment in finance and business services increased substantially, albeit from a small base. Employment in manufacturing also increased, although most of the rise occurred in the early 1990s behind protective barriers. Employment in mining rose through the 1990s until a drop in 1999, but only accounts for a small percentage of total formal private sector employment.[21] The latter is estimated to have to expand at the impossible sustained annual rate of about 28 percent in order to absorb all new entrants to the labor force.[22] The estimate assumes no growth in public sector employment for the sake of argument. In fact, the latter grew from 50,309 in 1990 to 61,759 in 1998, prior to an ill-considered 1999 civil service retrenchment program that has been stopped by the current Government in favor of a more considered approach to public sector reform.[23]

29. Negligible formal sector employment growth has caused a marked increase in unemployment. The urban unemployment rate rose from 9 percent in 1980 to 35 percent in 1990, and has risen further in the 1990s as rural-urban migration has continued. The rural

[19] *Ibid.*, 38.
[20] Footnote 13, 4.
[21] Footnote 18, 10. Mining and quarrying employed 4,237 people in 1990, out of a total of 157,475 employed in all industrial activities.
[22] ADB. 1998. *Improving Growth Prospects in the Pacific*. Pacific Studies Series, Manila: ADB: 75.
[23] Footnote 13, 129. The figures include employment in national departments, provincial departments, the teaching service, statutory bodies, and the police and defense forces.

unemployment rate rose from 21 percent in 1980 to 38 percent in 1990.[24] Given that only 15 percent of the labor force was in wage employment in 1990, making inroads on the unemployment problem and creating job opportunities for future new entrants to the labor force will require development of the informal sector in urban and, particularly, rural areas. The focus must be on semi-subsistence agriculture.

30. Before 1992, an urban minimum wage indexed to the inflation rate was seen as a major reason for unemployment, both because the minimum was above the market wage rate, and because it encouraged the adoption of capital-intensive methods of production. However, in 1992 the Minimum Wages Board replaced the urban minimum wage with a national minimum wage that was set at 37 percent of the urban minimum, was no longer indexed to inflation, and was applicable only to new employees. Wages above this minimum of K22.96 per week were to be set according to productivity. The Minimum Wages Board was reactivated in late 1999 to review the minimum wage, which has not been adjusted since 1992; but the minimum wage has been, and seems likely to remain, non-binding as it is below the market rate. In a 1996 survey, only 11 percent of firms felt the minimum wage was too high.[25] The vast majority of firms were paying above the minimum for unskilled labor, and complained most about the difficulty and cost of acquiring (mostly foreign) managerial, professional, and technical personnel.

31. Market-determination of private sector wages occurs with reference to public sector wages, which have been contained by Government policy since the kina float of 1994. Nominal wage rises for permanent civil servants have been awarded in 1994 (1.5 percent), 1995 (3 percent), 1996 (7.2 percent, 3.2 percent of which was backdated to January 1995), 1997 (5 percent backdated to 1996), and 1998 (4 percent). However, during 1994–1998, the consumer price index rose by 71 percent, so that real public sector wages fell by approximately 28 percent. Through its effect on private sector wages, wage restraint in the public sector has ensured that the nominal depreciation of the kina has led to a real improvement in international competitiveness (Table 3). Pay rises have been awarded in 2000 for defense, police, and correctional services personnel, but real wages are likely to fall again in 2000.

Table 4: Indexes of Employment by Industry, 1980–1999 (June 1989 = 100)

Industry	1990	1995	1996	1997	1998	1999 (Sept.)
Retail	87.8	92.6	94.8	103.9	111.1	119.2
Wholesale	87.3	82.3	82.1	82.7	81.7	86.0
Manufacturing	94.8	110.2	114.7	119.2	123.1	125.2
Building and construction	106.8	69.6	89.4	85.8	72.0	71.5
Transport	111.5	89.6	96.5	99.0	96.4	89.4
Agriculture, Forestry, and Fishing	89.0	87.4	90.8	83.3	74.5	78.0
Financial and Business	109.2	111.0	116.1	127.3	135.9	150.7
Total	**94.6**	**93.5**	**100.5**	**100.3**	**96.8**	**100.6**
Mining	100.7	112.2	116.2	116.7	136.0	135.5

Note: These indexes may understate employment growth because of deficiencies in the sample survey.
Source: Bank of Papua New Guinea, *Quarterly Economic Bulletin*, December 1999.

[24] Economic Insights. 1999. *Papua New Guinea: Coping with Shocks and Achieving Broad-Based Economic Development.* AusAID International Development Issues No.52, Canberra: National Capital Printing: 16.
[25] Footnote 18, 20.

4. Savings and Investment

32. Minerals led investment in the 1990s. Investment rose to 28 percent and 27 percent of GDP in 1996 and 1997, respectively, largely because of the development of the Gobe oil field and the Lihir gold mine (Table 5). Investment also rose in these years because of the publicly funded construction of a new airport and the Poreporena Highway in Port Moresby. However, nonmining investment remained around 9 percent of GDP in 1996–1998, reflecting the poor circumstances of agriculture, exhausted opportunities for investment in import-substituting manufacturing, and a general decline in investor confidence that continued into 1999. Public investment continued to be much lower than is the case in other mining and oil-producing economies: only 16 percent of mineral windfalls is invested, compared with 35 percent in mining countries and 50 percent in oil-producing countries.[26]

33. Investment is financed either by national or foreign savings. Domestic savings averaged only 15 percent of GDP in the 1980s, but increased significantly in the 1990s, reaching 32 percent of GDP in 1996 (Table 5). Much of the increase has been used to repay foreign debt. The balance of national savings comes from net factor income and net current transfers, with interest and dividend payments arising from minerals development constituting a net outflow and external aid being a significant inflow. Overall, in the late 1990s there appears to have been a greater reliance on foreign savings as the domestic resource mobilization effort has diminished (as shown in the shift from a negative to a positive resource gap). A crucial aspect of this reduced effort is the Government dissaving in 1998 and 1999 (Table 3). A major aim of the SRP is to reverse this trend by working toward a balanced budget over the medium term.

Table 5: Domestic Investment and Gross National Savings 1995-1998
(percent of GDP)

Item	1995	1996	1997	1998 (est.)
Gross Domestic Investment (GDI)	19.3	27.8	27.1	30.3
Private Fixed Investment	15.7	24.2	21.6	23.3
Of which				
Mining Investment	7.2	15.3	12.1	14.5
Nonmining Investment	8.6	8.9	9.5	8.9
Public Investment	3.6	3.7	5.4	6.9
Gross Domestic Savings (GDS)	28.9	32.1	23.0	28.3
Gross National Savings (GNS)	37.3	33.2	24.3	30.7
Foreign Savings	-18.0	-5.4	2.8	-0.4
Resource Gap (GDI-GDS)	-9.6	-4.3	4.1	2.0

Notes: GDS equals GDP less private and public consumption. GNS equals GDS plus net factor incomes and net current transfers, and is calculated here as a residual. Foreign savings equal the current account balance in the balance of payments, a negative figure indicating a current account surplus, and vice versa. GDI equals GNS plus foreign savings. For the sake of consistency in estimation, data used are those presented in the source.
Source: World Bank. 1999. *Papua New Guinea: Improving Governance and Performance*, Report No. 19388-PNG, October. Washington DC: World Bank.

[26] Footnote 13, 13.

C. Fiscal Developments

34. Despite the economic recession in 1997, the fiscal outcome surpassed expectations, at least in regard to the overall budget balance. Expenditure was slightly above, and revenue well above, budget estimates, leading to a surplus of 0.1 percent of GDP instead of the projected deficit of 0.9 percent (Table 3). On the expenditure side, overruns caused by unbudgeted spending on military operations, the 1997 elections, and drought relief were offset by interest savings, general cuts in departmental goods and services budgets, and failure to fully implement the public investment program. One-time back payments of mineral taxes, asset sales, and more effective personal income tax collection accounted for the bulk of the improvement in revenue. The improved fiscal balance thus was attributable largely to temporary revenue gains, rather than to better public expenditure management.

35. The fragility of Government finances became evident in 1998, when a projected budget deficit of 1 percent of GDP—to be financed entirely by external borrowing—expanded to 2.1 percent because of substantial shortfalls in asset sale proceeds and tax receipts. Log export taxes, import duties, and tax receipts by the Mineral Resources Stabilization Fund (MRSF) were all down because of the effects of the Asian economic crisis, the drought, and a general decline in commodity prices. On the expenditure side, recurrent spending was 14 percent below the budgeted level, primarily because interest payments on debt were K121 million below the budget estimate, despite the yield on treasury bills reaching 24 percent (compared with a budgeted figure of 15 percent). This lower interest payment occurred through below market rate payments on central bank holdings of bills, on the nontransparent basis of advancing the central bank dividend. Simultaneously, unbudgeted expenditures totaling around K120 million were made late in the year, most notably a K12,000 bonus per civil servant plus a 4 percent wage rise backdated to January 1998. Development expenditure, which included some project grants previously excluded and road maintenance expenditure previously recorded in the recurrent budget, came in 9 percent above the budget estimate. Anticipated financing from the World Bank and IMF (K192 million) and from a European banking syndicate ($120 million) did not materialize, and the fiscal deficit was financed entirely by borrowing from the central bank that exceeded legal limits.

36. The 1999 budget presented to Parliament in November 1998 optimistically projected a reduction in the deficit to 0.9 percent of GDP, to be financed through external concessional loans (Table 3 and Appendix 2, Table A.2). The latter were assumed to be forthcoming on the basis of the Government's reaffirmation of a commitment to the stalled medium-term structural reform program begun in 1994 with IMF and World Bank assistance—although relations between Government and these multilaterals continued to be strained. A value-added tax and tariff reform were to become effective on 1 July 1999, while a public service downsizing was to be the primary source of a 19 percent drop in noninterest recurrent spending, which in turn would facilitate an expected 60 percent expansion in development expenditure. Included in the increased development spending was a one million kina allocation to each of the 89 districts under the Rural Development Program to be supervised by the new Office of Rural Development and administered by Joint District or Provincial Planning and Budget Priorities Committees chaired by members of parliament. This arrangement aimed at improving service delivery to rural areas, but raised a concern that political slush funds could be augmented. There was also a concern in the mining industry over the introduction of a 4 percent levy and a 15 percent interest withholding tax; and a community concern over the decision to abolish, or eliminate funding to, research institutions and universities.

37. By mid-1999, the budget deficit had expanded to 3 percent of GDP. In the context of a breakdown in budget control, the wage bill had increased to 24 percent above budget provisions, despite limited implementation of a poorly planned and inadequately costed retirement and retrenchment scheme. Interest costs had been seriously underestimated (on the assumption that treasury bill rates would drop to 13 percent, when in fact they rose to 27 percent); while development expenditure was running at about one-fifth of the budgeted level and the revenue take was below the projected level. In a bid to generate external funds, the Government obtained an independent credit rating and attempted a potentially costly Eurobond issue. This proved unsuccessful, and in early July the Prime Minister reportedly negotiated a money-for-recognition deal with Taipei, China. On the 14th of the month, however, he lost office to a coalition that quickly withdrew recognition. As noted in paragraph 14, the new administration reviewed the fiscal situation, confirmed its seriousness, and introduced a supplementary budget on 10 August that gained the endorsement of IMF. Cuts to the national Government's development expenditure and revenue-raising measures were expected to generate a surplus in the second half of 1999, leaving a deficit for 1999 as a whole of 1.6 percent of GDP, funded by external borrowing. The interest withholding tax was removed. Government initiatives received the support of the international community at the November Consultation Group meeting chaired by the World Bank.

38. In the event, although a small surplus was realized in the latter half of 1999, the outcome for the entire year was a deficit of 2.4 percent of GDP (Table 3 and Appendix 2, Table A.2). Half of the deficit was a residual calculated from financing requirements and could not be explained by recorded revenue and expenditure data available at the end of the first quarter in 2000. The data showed that revenue in fact was 5 percent above the budget projection because of higher tax revenue and grant receipts (with the Australian budget support grant for 2000 being advanced). However, recurrent expenditure (inclusive of pre-1999 arrears) was 17 percent above the budgeted level. Development expenditure was 13 percent down. Financing of the deficit was split roughly equally between domestic financing and extraordinary foreign financing. The Australian government approved a concessional loan of $80 million on 15 December 1999, subject to agreement between the PNG government and IMF on a proposed IMF Stand-By Arrangement (SBA).

39. The 2000 budget lays the foundations for macroeconomic stabilization. An overall deficit of 1.9 percent of GDP is projected, inclusive of outstanding Government arrears of 1.0 percent of GDP and one-off structural adjustment expenditure of 0.9 percent of GDP. Net foreign financing equivalent to 3.0 percent of GDP would permit a reduction in net domestic credit to Government of 1.1 percent of GDP. Such a reduction is basic to restoring fiscal balance and policy flexibility. The domestic public debt stock grew from 14.4 percent of GDP in 1997 to 16.1 percent in 1999, with interest as a percentage of recurrent expenditure rising from 11.3 percent in 1997 to 13.1 percent in 1999. In December 1999, the remaining balance in the MRSF was used to cancel Government debt held by the central bank, and MRSF revenue henceforth drawn down into the consolidated revenue fund. Tax revenue above budget projections and revenue from any privatization completed in 2000 is earmarked to further reduce public debt.

40. Revenue and grants is projected to rise 11.2 percent in nominal terms (to 25.1 percent of GDP), primarily because of higher petroleum export prices, the full-year impact of the value-added tax and the August 1999 supplementary budget measures, and the central bank dividend. Nominal recurrent expenditure is projected to rise by just 1.9 percent (falling to 18.8

percent of GDP), as the hiring freeze introduced in November 1999 remains in force pending implementation of public sector reforms, and a freeze is imposed on all goods and services expenditure outside of the areas of health, education, law and order, and infrastructure maintenance. Development expenditure is projected to rise by 27 percent (to 7.9 percent of GDP), exclusive of the structural adjustment expenditure to be funded by a World Bank loan. World Bank technical assistance was provided in January 2000 to design a system for greater accountability and transparency in the use of funds provided under the Rural Development Program (to be transformed into the District Development Program).

41. The expected impact of the 2000 budget on macroeconomic stability is reflected in forecasts of exchange rate stability, much lower inflation, a drop in treasury bill rates, and a substantial increase in gross official reserves. Given that IMF and World Bank financial assistance is likely to be forthcoming, that consequently other external assistance will also materialize, and that measures to improve public expenditure control have been taken, there is cause for cautious optimism about the outcomes in 2000.

D. Monetary Developments and Prices

1. Monetary Developments

42. The objectives of monetary policy presented in the 1973 Central Banking Act are to promote monetary stability (defined as exchange rate, interest rate, and price stability, together with international credibility); to promote a sound financial environment; and to support sustainable medium-term growth in the nonmineral private sector. In the late 1990s, policymakers have had to confront the macroeconomic instability induced by external economic and natural disasters, and by fiscal mismanagement. Monetary policy became increasingly subordinated to financing the fiscal deficit.

43. Early in 1998, the kina came under severe pressure as primary product export revenue fell and perceptions of political instability led to private capital outflows. The Bank of Papua New Guinea (BPNG) intervened in the foreign exchange market to support the currency, and purchased treasury bills in an attempt to ameliorate the consequent monetary tightening. The yield on treasury bills nonetheless rose to 21 percent in August, from 9 percent a year earlier. During the same period, the stock of bills held by BPNG rose from K402 million to K1,273 million, whereas the stock held by commercial banks fell from K1,051 million to K458 million. The withdrawal of commercial banks from the government debt market despite the higher yields available demonstrated how strong the perception of country risk had become. As a further means of monetary tightening without adding to the Government's debt servicing costs, commercial banks were required from August 1998 to place 10 percent of deposits in a noninterest bearing account with BPNG (the Cash Reserve Requirement). The PNG Banking Corporation, which had extended substantial credit on a non-commercial basis, was also directed by BPNG to stop new lending. In an attempt to increase competition in the money market, BPNG allowed nonbank entities and the public to purchase treasury bills over the counter at average prices from the latest auction (the "tap facility"). Over the year as a whole, the broad money supply increased by 1.8 percent, with net foreign assets falling and domestic credit growing by 17.1 percent. Net credit to the Government increased by 15.4 percent, while credit to the private sector grew by 29.0 percent (Table 3 and Appendix 3, Table A.3). Treasury bill rates at the end of the year remained high at 24 percent, and commercial bank weighted average lending rates had risen from 12.3 percent in January to 20.2 percent in December.

44. During the first half of 1999, the monetary authorities adopted an accommodative monetary policy stance, while making disconcerting changes to the direct instruments of monetary control. The Cash Reserve Requirement was suspended on 31 December 1998, abolished on 12 January 1999, and reintroduced on 15 January 1999. It was then reduced to 5 percent on 16 March, when the Minimum Liquid Assets Ratio (MLAR) was reintroduced at 15 percent after being reduced to zero in August 1998. On 10 June, the MLAR was increased to 20 percent and the Cash Reserve Requirement excluded as an allowable element of the MLAR, so that MLAR effectively became 25 percent. A kina deposit facility was also introduced as a means of absorbing liquidity, given the disinterest in treasury bills.

45. The new administration that took office in July 1999 made no changes in the monetary policy environment until September, when it raised the MLAR to 25 percent and abolished the kina deposit facility. The expansionary fiscal policy and precarious balance-of-payments position precluded any immediate prospect of easing monetary policy. Indeed, in January 2000, BPNG sold treasury bills in order to reduce reserve money. Broad money grew 8.9 percent in 1999 because of a recovery in the balance of payments. Credit extended to the private sector stagnated, while net credit to Government grew by 11.1 percent (Table 3 and Appendix 3, Table A.3). Treasury bill rates stood at 20.4 percent in December 1999 and 22.0 percent in February 2000, and the commercial bank weighted lending rate at 18.6 percent and 18.0 percent, respectively. In real terms, commercial bank interest rates had dropped from 5.3 percent at the end of 1997 to 1.3 percent at the end of 1999 because of accelerated inflation. However, a depressed and uncertain economic climate had swamped the price effect.

46. Under the SRP, financial sector reforms are in process. A new Central Bank Act was passed in April 2000 that increases the independence of BPNG. The Banks and Financial Institutions Act is being reviewed to strengthen BPNG's powers of supervision, regulation, and licensing of financial intermediaries. Pyramid schemes that had developed in early 1999 with the approval of Government are no longer condoned by the new administration, which has initiated action leading to the liquidation of the two largest schemes and will outlaw them under the revised Banks and Financial Institutions Act. In addition, regulation and supervision of the pension and insurance industries will be strengthened through a new Insurance and Superannuation Act. The Public Officers' Superannuation Fund and the National Provident Fund (NPF) have been, and remain, major means of mobilizing savings, facilitating private sector investment, and providing a social safety net; however, they have been underperforming because of poor governance and political influence over decision-making. These funds are being reviewed in order to produce a plan for improvement, but it is already established that the NPF is confronting serious financial problems.

2. Prices

47. PNG's inflation rate is measured by an urban-focused consumer price index (CPI) based on outdated weights from a mid-1970s survey. Following the restoration of macroeconomic stability in 1995-1996, the rate fell to 3.9 percent in 1997. It then accelerated to 13.6 percent in 1998 and 14.9 percent in 1999 as the kina depreciated (Table 3). Consumption has a high import content, and inflation tends to track the kina-US dollar exchange rate. Introduction of a value added tax in mid-1999 had a one-off impact on the CPI that was offset in part by tariff reductions. Removal of price controls remaining on around 25 products, which may occur under the SRP, would also have an impact on the CPI.

E. External Trade and the Balance of Payments

48. After being in deficit in 1991–1994, the balance of payments moved into surplus in 1995 as exports reached a record level of $2.83 million. The surplus increased further to 7.1 percent of GDP in 1996 because of sustained export performance and the reversal of the large private capital outflows of the previous three years (Table 3 and Appendix 4, Table A.4). However, the exogenous shocks and economic mismanagement of the subsequent three years (paras. 12–14) led to a deterioration in the balance of payments.

49. In 1997, the current account moved into deficit (5 percent of GDP) as drought-affected mineral exports fell 16 percent from their 1996 level, and log exports declined 12 percent. Agricultural exports actually increased by 34 percent because of strong pre-drought harvesting of tree crops. The capital account surplus dropped slightly: a rise in private portfolio capital inflows was outweighed by official outflows and a drop in direct foreign investment. A balance-of-payments deficit of $204 million (4 percent of GDP) was recorded, and gross official reserves fell to $380 million, from $586 million at the end of 1996. Nonmineral import cover fell to 3.3 months from 5.4.

50. In 1998, another balance-of-payments deficit of about 4 percent of GDP was recorded, despite a small surplus on the current account of 0.5 percent of GDP. The latter improvement largely reflected lower imports and services payments by the mineral sector. Mineral exports fell a further 7 percent because of declining commodity prices, while nonmineral exports fell 29 percent as the effects of the drought on agriculture became evident. The capital account registered a deficit of $167 million because of private capital outflows and official loan repayments. Some of the private outflows arose from speculation that the currency would continue to depreciate. Official reserves declined to $187 million, equivalent to 2.0 months of nonmineral import cover (Table 3 and Appendix 4, Table A.4).

51. A balance-of-payments surplus of 1.1 percent of GDP was achieved in 1999. The current account registered a surplus of 1.4 percent of GDP as mineral exports increased 8 percent on the back of higher prices, outweighing another drop (9 percent) in nonmineral exports and a fall in unrequited transfers (Appendix 4, Table A.4). The capital account recorded a smaller deficit of $104 million: private capital outflows increased almost threefold, but foreign direct investment rose, and exceptional funding of $109 million was available (primarily from the Australian government). Gross official reserves increased to $204 million, and nonmineral imports cover to 2.1 months (Appendix 4, Table A.4).

52. During 1996–1999, the stock of external debt fell from $2,354 million to $1,721 million as amortizations exceeded gross disbursements in each year. Debt service obligations increased from $376 million to $615 million, and the debt service ratio rose from 17.7 percent to 27.3 percent (Appendix 4, Table A.4). In order to reverse this trend, the Government has committed to an external debt policy that precludes contracting or guaranteeing any new nonconcessional borrowing by the public sector with a maturity in excess of one year, and that restricts public sector contracting or guaranteeing of debt with a maturity of less than one year to standard import-related credits.

53. The Government also has committed under the SRP to trade liberalization that will see the average nominal tariff rate reduced from 22 percent to just over 6 percent by 2005. Combined with the real depreciation of the kina, this will facilitate a restructuring toward

efficient traded goods production. The nominal trade-weighted exchange rate depreciated by 44 percent between the end of 1996 and the end of 1999 as a result of the combined impacts of exogenous shocks, fiscal mismanagement, and declining confidence. Although there was some erosion of the gain in international competitiveness because of the effect on the inflation rate, the real trade-weighted exchange rate depreciated by 20 percent (Table 3). Over time, this relative price change will elicit a significant supply response from agriculture in particular, provided transport and marketing constraints can be eased.

II. SHORT- AND MEDIUM-TERM ECONOMIC PROSPECTS AND POLICY ISSUES

A. Economic Prospects

54. The official budget forecast is that real GDP will grow by 4.7 percent in 2000. The anticipated growth would be led by the nonmining sectors, which collectively are projected to increase their output by 5.8 percent (Appendix 1, Table A.1). Agriculture, forestry, and fishing is expected to produce 8.2 percent more than the 1999 level of output; and construction is projected to increase output by 68.5 percent as work resulting from the Ramu nickel and gas pipeline projects begins. Modest growth is forecast in all other sectors except mining and community, social, and personal services. The 2000 growth rate is expected to be sustained in the medium term, primarily because of strong growth in construction in 2001 and rapid growth in minerals in 2002 and 2003, with higher growth rates in manufacturing throughout.

55. Following an externally-funded deficit in 2000, the budget is projected to move into surplus in 2001, and to remain in surplus for the next two years. This assumes growth in real tax revenue, K250 million in asset sales in each of the three surplus years, and a real decline in total expenditure involving a reallocation toward development spending. The trade surplus is projected to increase in 2000, decline in 2001 as imports related to the mineral subsector rise, and then to increase again in 2002 and 2003. It is assumed that agricultural and log exports will grow through increased volumes and steady or improved prices; and that mineral exports will dip in 2001 as the oil price drops, and then grow strongly as gas and nickel exports begin in 2002. These fiscal and trade outcomes would be consistent with a rebuilding of foreign reserves, a slight appreciation of the kina, a lower inflation rate, and an easing of monetary policy (Table 6).

56. The budget forecasts (paras. 39 and 40) were revised during the early 2000 negotiations for an SBA with the IMF: the real GDP growth rate downwards to 4.5 percent; the inflation rate upwards to a more realistic 5 percent; the official gross international reserves level upwards to $379 million or 3.6 months of nonmineral imports (despite the projection of a small expected current account deficit rather than a surplus); and the budget deficit downwards to 1.5 percent of GDP. On 29 March 2000, a 14 month, $115 million SBA was approved by the IMF Executive Board, $13.4 million of which was for immediate disbursement. Approval of SBA will lead to conversion of the $80 million provided by the Reserve Bank of Australia under a swap agreement into a longer-term loan, and will be followed by a new World Bank structural adjustment loan that will cover more than double the K101 million in SRP-related expenditure budgeted for 2000. The PNG request for the SBA and the accompanying memorandum on economic and financial policies details the main SRP initiatives—to strengthen public expenditure control and monitoring, to complete the tax policy review and improve tax collection and debt management, to pass legislation strengthening BPNG, and to

implement civil service reform and a privatization program (beginning with Finance Pacific, the holding company that owns the PNG Banking Corporation).

Table 6: Budget Forecasts

Item	2000	2001	2002	2003
Growth (percent)				
Real GDP	4.7	5.9	4.9	4.9
Mineral	1.0	1.5	13.6	16.4
Nonmineral	5.8	7.2	2.4	1.2
Inflation Rate (average annual, percent)	12.9	4.1	5.0	5.0
Inflation Rate (end period, percent)	2.3	6.1	5.0	5.0
Money and Credit (percent)				
Interest Rate (Treasury bills, average)	15.0	10.0	10.0	10.0
Government Finances (percent of GDP)				
Revenue and Grants	25.0	23.8	23.0	21.8
Expenditure and Net Lending	26.9	23.4	21.6	20.3
Budget Balance	-1.9	0.4	1.2	1.3
Domestic Financing	-1.1	1.0	0.2	0.0
Foreign Financing	3.0	-1.4	-1.4	-1.3
Balance of Payments				
Current Account Balance (percent of GDP)	6.6	-6.5	1.5	9.8
Overall Balance (percent of GDP)	2.9	1.4	1.5	1.4
End-Year Gross Official Reserves ($ million)	363	410	490	571
Exchange Rate				
Kina per $ (end-period)	0.38	0.40	0.40	0.40
Memorandum Item:				
Nominal GDP (kina million)	11,468.4	12,146.2	13,197.8	14,267.3

Source: Budget Papers. 2000. *Volume 1 Economic & Development Policies*. Port Moresby: Government Printer.

57. The package of external concessional finance, once available in full, will be the linchpin of efforts to restore macroeconomic stability. It could also help restore international and domestic investor confidence, which remained fragile in the first quarter of 2000. Macroeconomic stabilization and a revival of investor confidence, combined with successful implementation of the SRP and a general improvement in the commodity price outlook, would make the macroeconomic projections realizable outcomes. The major risks are that the Ramu nickel and PNG–Queensland gas pipeline projects will not proceed and come on stream as quickly as assumed, and that political instability will derail the reform effort. Assigning expected probabilities to these risks is difficult. The Government and the IMF are optimistic that the project will move forward as expected, but this view is not shared by some other observers. Regarding the risk of political instability, the Morauta Government's commitment appears firm and it has made a promising start to the SRP. However, effective implementation of reforms involves overcoming a legacy of corruption and bad governance within a political system that

unfortunately maximizes the chance of instability (para. 9). The year 2000 is thus a watershed in PNG's development.

B. Policy Issues

58. The Medium-Term Development Strategy 1997–2002 (MTDS) adopted by parliament in 1996 remains the main policy document defining development objectives and elaborating the means for achieving them. The 2000 budget and SRP restate a commitment to the elements of MTDS summarized in Box 2, but with greater emphasis on the need for improved governance in general and better fiscal governance in particular as fundamental to improving living standards for most of the population. The issue now is whether the rhetoric can be translated into sustainable broad-based economic growth and social development facilitated by honest, competent government.

Box 2: Medium–Term Development Strategy, 1997–2002

The MTDS includes seven elements:

- adhering to and strengthening policies begun under the 1995 structural adjustment program;
- focusing program and budget expenditures on priority areas (health, education, infrastructure, private sector development, and governance and law and order);
- strict application of productivity and priority criteria to projects to be funded;
- enhancement of resources available to the Government;
- redefining of the roles and functions of Government;
- making the private sector the engine of growth; and
- implementing the provincial reforms begun in 1996.

59. Important steps have been taken to improve governance. The National Planning Committee was reestablished at the beginning of 2000 as a means of improving policy formulation and screening of submissions to the National Executive Council, whose decisions are made public (subject to security restrictions). The Central Supply and Tenders Board is under review, and the independence and funding of the Auditor General's and Ombudsman's Offices have been guaranteed. The Rural Development Program is to be made more transparent and accountable by (i) transferring its funds to a District Development Program; (ii) strengthening the Office of Rural Development's capacity for internal audit, project appraisal, and project monitoring; and (iii) delegating financial oversight to an independent managing agent (para. 40). Projects must be consistent with district development plans, be tendered, and focus on improving basic infrastructure services. The success of this reform will be a test for governance reform in general.

60. In the area of fiscal governance, the Government is assessing its performance against IMF transparency standards; is reviewing the budget planning process with a view to preparing new budget guidelines; and, with World Bank assistance, is reviewing public expenditure. This review is focusing on key departments including police and defense, and is to be completed by 30 June 2000, so that the results may be used for the preparation of the 2001 budget.

Simultaneously, with ADB and other assistance, the Government is designing a comprehensive medium-term public sector reform program that aims at better service delivery and stronger personnel and financial management systems for a streamlined, restructured civil service.

61. The ultimate measure of the SRP's success will be its effectiveness in contributing to the generation of productive and sustained employment for a growing population. Simple arithmetic dictates that this employment generation must be private sector led and must occur primarily in the informal rural sector. The real depreciation of the kina and the tariff reform program provide a crucial stimulus that needs to be supported by good government. Good government includes macroeconomic stability; improved service provision in primary education, health, infrastructure, agricultural extension services, and management of forestry and fisheries; and effective action to address the crime and personal insecurity problem.

62. Lawlessness and disorder increased during the 1990s and constitute the biggest single obstacle to private sector development (followed by corruption, poor infrastructure, and policy instability). According to a March 1999 survey, over 90 percent of respondents fully agreed that "theft and crime are serious problems that can substantially increase the costs of doing business," compared to 30 percent in a 1989 survey.[27] These costs include security and insurance, wage premiums required by imported labor, and restrictions on opening hours and time free for education and training (para. 24). In rural areas, crops can be destroyed by tribal fighting or hijacked en route to the market, the range and availability of consumption goods is restricted, and banking facilities have been curtailed (making it difficult to pay public servants engaged in decentralized service delivery). It has been estimated that in 1997, about 30 percent of the potential coffee crop remained unmarketed because of the crime and personal insecurity problem.[28] The problem also creates an incentive for individuals not to save or invest, since accumulated assets can so easily be stolen.

63. Addressing the crime and personal insecurity problem requires direct action, since the job creation that is often presented as a solution is in fact seriously constrained by the problem, and since available evidence suggests that in any case job creation may have little immediate impact on criminal activity.[29] The 15 percent of the Port Moresby workforce reportedly engaged in the crime earn more than the unskilled wage rate and show little inclination to seek formal employment. Thus, the effectiveness of policing, prosecution, and detention must improve.

[27] Michael Manning. 1999. *Factors Contributing to the Lack of Investment in Papua New Guinea: A Private Sector Survey*. Port Moresby: Institute of National Affairs, Discussion Paper No.74: 12, 15.
[28] Footnote 9, 22.
[29] *Ibid.*

Statistical Appendix

Table A.1: Gross Domestic Product by Economic Activity at Constant (1983) Prices (Kina million)

Activity	1994	1995	1996	1997	1998	1999 (Est)	2000 (Proj)	2001 (Proj)	2002 (Proj)	2003 (Proj)
Agriculture, Forestry, and Fishing	938.1	900.4	1030.1	1001.5	940.0	921.4	997.0	1,025.5	1,034.5	1,043.8
Mining, Quarrying, and Petroleum	978.0	918.2	809.6	639.2	761.1	868.3	877.0	890.5	1,011.7	1,177.8
Manufacturing	258.4	235.6	275.2	280.2	248.5	251.6	259.1	274.0	287.4	298.5
Electricity, Gas, and Water	40.7	41.2	43.4	43.7	46.1	48.4	51.5	57.5	60.0	60.2
Construction	109.3	50.5	43.0	69.3	79.0	69.2	116.6	223.8	228.7	209.0
Wholesale, and Retail Trade	350.7	332.7	348.4	367.5	334.7	338.9	348.8	368.4	386.4	401.6
Transport, Storage, and Communication	160.4	146.8	133.4	153.3	155.6	157.6	162.9	173.3	181.7	187.9
Finance, Insurance, Real Estate and Business Services	124.4	128.5	153.5	176.8	189.7	197.9	206.3	218.0	227.6	235.6
Community, Social,and Personal Services	515.2	632.6	647.3	668.7	691.7	725.6	727.0	735.6	744.2	752.8
TOTAL GDP										
Nominal	5529.0	6641.4	7033.1	7496.1	8,901.2	10,601.3	11,468.4	12,146.2	13,197.8	14,267.3
Implicit Price Deflator	1.591	1.961	2.019	2.205	2.583	2.962	3.062	3.062	3.171	3.267
Real	3,475.2	3,386.5	3,483.9	3,400.2	3,446.6	3,579.0	3,745.9	3,966.6	4,162.3	4,367.1
Rate of Real Growth (percent)	1.9	-2.6	2.9	-2.4	1.4	3.8	4.7	5.9	4.9	4.9
Total Nonmineral GDP										
Nominal	4,170.8	4,785.9	5,322.9	6,095.1	7,032.9	7,788.3	8,576.6	9,453.7	10,076.9	10,678.5
Deflator	1.670	1.939	1.990	2.208	2.619	2.873	2.989	3.073	3.198	3.348
Real	2,497.2	2,468.3	2,674.3	2,761.0	2,685.5	2,710.7	2,868.9	3,076.1	3,150.6	3,189.3
Rate of Real Growth (percent)	4.1	-1.2	8.3	3.2	-2.7	0.9	5.8	7.2	2.4	1.2

Est = estimated; GDP = gross domestic product; Proj = projected.
Source: Bank of Papua New Guinea; Budget Papers 2000, *Volume 1, Economic & Development Policies.* Port Moresby: Government Printer.

Table A.2. Central Government Summary of Operations, 1996-2001
(in Kina million)

	Actual				Proj.	Proj.
	1996	1997	1998	1999[a]	2000	2001
Revenue	1,837.5	2,201.5	2,299.8	2,612.6	2,884.1	2,933.9
Tax [b]	1,526.4	1,674.4	1,595.4	1,944.4	2,124.6	2,296.7
Nontax [c, d]	141.0	215.1	234.1	163.0	214.9	167.0
Grants [e]	170.1	312.0	470.3	505.2	544.7	470.1
Expenditure	1,861.0	2,192.4	2,486.5	2,739.5	3,051.0	2,942.8
Recurrent	1,608.2	1,819.8	1,927.4	1,989.8	2046.6	2,072.7
Salaries and Wages [f]	604.2	655.4	690.2	762.7	814.2	844.2
Other [d]	753.1	869.9	906.4	693.9	750.9	883.0
Retrenchment Costs	…	…	…	13.9	0.0	0.0
Goods and Services, and Other [d]	450.8	525.6	599.4	381.7	457.2	518.1
Conditional Grants to Provinces [g]	190.1	223.9	171.5	63.5	65.0	119.7
Transfers to Statutory Authorities [f]	112.2	120.4	135.5	120.4	122.5	120.0
Account 207, Finance-Misc.	…	…	…	114.4	106.2	125.2
Pre-1999 Arrears	…	…	…	148.8	109.0	0.0
Interest	257.3	297.6	335.4	389.0	380.8	350.0
Domestic	174.5	206.3	228.0	260.7	233.3	200.0
Foreign	82.8	91.3	107.4	128.3	147.4	150.0
Net Lending	-6.4	-3.1	-4.6	-4.6	-8.3	-4.5
Development Budget Plus Structural Adjustment Expenditures	252.8	372.6	559.1	749.7	1,004.4	870.1
Project Grants	…	…	…	379.4	529.1	470.1
Concessional Loans	…	…	…	74.8	93.7	100.0
Domestic Funds	…	…	…	295.5	280.6	300.0
Structural Adjustment Expenditures	…	…	…	…	101.0	0.0
Overall Balance, Public Accounts	-23.5	9.1	-186.7	-126.9	-166.8	-9.0
Residual Deficit [h]	…	…	…	-130.8	0.0	0.0
Overall Balance, Including Residual Deficit	-23.5	9.1	-186.7	-257.7	-166.8	-9.0
Financing	23.5	-9.1	186.7	257.7	166.8	9.0
Foreign (net)	10.1	-87.5	-94.1	124.4	289.8	-30.0
Concessional and Commercial	-7.2	-121.2	-94.1	-90.4	-183.9	-187.9
New Borrowing	118.5	85.6	108.1	146.3	93.7	100.0
Amortization	-125.7	-206.8	-202.2	-236.7	-277.6	-287.9
Exceptional Financing	17.3	33.7	0.0	214.8	473.7	157.9
Domestic (net)	13.4	78.4	280.8	133.3	-122.9	39.0
Asset Sales	60.3	0.0	13.9	26.4	0.0	250.0
Domestic Borrowing	-46.9	78.4	266.9	106.9	-122.9	-211.0
Banking System [i]	110.3	155.3	129.1	56.1	-122.9	-211.0
Other	-157.2	-76.9	137.8	50.8	0.0	0.0
Memorandum Items						
Education	62.4	121.5	180.6	188.9	238.4	…
Health	90.3	125.4	160.3	171.2	250.4	…
Domestic Debt	…	1,078.0	1,296.0	1,706.0	1,583.0	1,372.0
Nominal/GDP (millions of kina)	7,033.1	7,496.3	8,901.1	10,601.5	11,468.5	12,146.2

[a] Actual, but subject to further verification.
[b] In 1999, includes estimated K 20 million in VAT revenue received into accrual trust account but not yet distributed.
[c] In 1999, includes estimated K 11 million in license fees received into accrual trust account.
[d] In 2000, K 30.2 million of non tax revenue and expenditure, previously off-budget and now double counted, are consolidated.
[e] In 2000, all Australian grants are project grants.
[f] In 2000 and 2001, includes allowance for wage increase.
[g] Some conditional grants to provinces (District Support Grants, Mining Agreements, and Social Safety Grant) were shifted from recurrent to development budget in 2000; they are shown in the recurrent budget for 1996-98, and in the development budget in 1999 and 2000.
[h] The residual deficit is the difference between identified revenues and expenditures, and financing.
[i] In 1999, adjusted by estimated K 52 million in write-off of government collateral deposit for net lending activity.

Source: Bank of Papua New Guinea authorities; International Monetary Fund, press release 29 March 2000, http://www.imf.org/external/np/sec/pr/2000/PR0023.HTM.

Table A.3. Monetary Survey, 1997-1999

(In Kina million)

	1997	1998				1999			
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Net Foreign Assets [a]	767	469	522	563	463	368	366	420	666
Bank of Papua New Guinea	575	284	367	374	291	230	142	230	489
Assets	666	382	471	490	391	327	228	314	551
Liabilities	91	97	104	116	100	97	86	84	62
Commercial Banks	192	185	155	189	171	139	224	190	177
Net Domestic Assets	1,831	2,109	2,130	2,170	2,183	2,334	2,412	2,421	2,216
Domestic Credit	2,320	2,500	2,682	2,700	2,716	2,898	2,912	2,995	2,697
Net Credit to Consolidated Central Government [b]	840	883	918	832	969	1,266	1,136	1,246	1,077
Bank of Papua New Guinea	(97)	124	201	506	368	678	679	698	498
Claims on Government	881	1,030	1,029	1,410	1,285	1,423	1,403	1,414	599
Government Deposits	978	906	828	904	917	745	725	716	102
Commercial Banks	937	759	716	325	601	588	458	548	580
Credit to Other Sectors [c]	1,480	1,617	1,765	1,868	1,747	1,632	1,776	1,749	1,619
of Which: Claims on Private Sector	1,064	1,205	1,341	1,384	1,372	1,341	1,478	1,463	1,376
Other Items (net)	(489)	(391)	(552)	(530)	(533)	(564)	(500)	(574)	(481)
Broad Money	2,598	2,578	2,652	2,733	2,646	2,702	2,778	2,841	2,882
Narrow Money	919	877	902	957	1,021	988	1,149	1,178	1,238
Quasi Money	1,679	1,701	1,749	1,776	1,624	1,714	1,629	1,663	1,643
					(Percentage Change) [d]				
Net Foreign Assets [a]	-9.3	-43.5	-36.3	-31.6	-39.7	-21.5	-29.8	-25.4	-43.9
Bank of Papua New Guinea	-19.7	-59.0	-46.8	-42.0	-49.4	-19.3	-61.3	-38.5	-67.8
Commercial Banks	48.1	34.1	19.8	5.6	-10.5	-24.9	44.9	0.8	3.4
Net Domestic Assets	15.4	28.9	32.5	30.8	19.2	10.7	13.2	11.6	1.5
Domestic Credit	22.7	31.3	36.3	35.8	17.1	15.9	8.6	10.9	-0.7
Net Credit to Consolidated Central Government [b]	22.7	43.6	51.1	33.1	15.4	43.3	23.8	49.9	11.2
Net Credit to Other Sectors [c]	22.7	25.5	29.7	37.1	18.0	0.9	0.6	-6.4	-7.3
of Which: Claims on the Private Sector	36.3	40.3	44.8	45.3	29.0	11.3	10.2	5.7	0.3
Broad Money	6.8	4.5	9.3	10.1	1.8	4.8	4.8	4.0	8.9
Velocity of Broad Money	2.9	3.0	3.1	3.1	3.4	3.4	3.5	3.6	3.7

[a] Net foreign assets and other items net in 2000 projected at the program exchange rate of K 0.38/US$.
[b] Includes net credit to the central government and the commodity stabilization funds.
[c] Includes credit to the private sector, provincial governments, and nonfinancial public enterprises.
[d] Year-on-year change.
Source: Bank of Papua New Guinea authorities; International Monetary Fund, press release 29 March 2000, http://www.imf.org/external/np/sec/pr/2000/PR0023.HTM.

Table A.4. Balance of Payments, 1996-2001
(In $ million)

	1996	1997	1998	1999	Prog. 2000	Proj. 2001
Current Account Balance	289	-263	23	55	-18	-112
Mineral	736	311	564	708	639	558
Nonmineral	-447	-574	-540	-653	-657	-670
Trade Balance	813	213	424	492	549	348
Exports (f.o.b.)	2,603	2,186	1,846	1,998	2,234	2,257
Mineral	1,777	1,328	1,239	1,444	1,590	1,562
Nonmineral	827	857	610	553	644	696
Imports (c.i.f.)	-1,791	-1,972	-1,425	-1,505	-1,684	-1,909
Mineral	-496	-573	-287	-322	-420	-574
Nonmineral	-1,294	-1,399	-1,138	-1,184	-1,264	-1,335
Services Balance	-690	-673	-629	-611	-750	-637
Mineral (net)	-544	-444	-389	-415	-531	-430
Nonmineral (net)	-146	-229	-240	-196	-220	-207
Unrequited Transfers (net)	166	197	228	173	183	177
Official	219	229	215	181	170	172
Private	-53	-32	13	-8	13	5
Capital Account balance	68	53	-167	-104	-36	105
Medium-and Long-Term Loan Disbursements	-196	189	-185	-413	-179	-130
Official (net)	-5	-76	-46	-32	-70	-66
Private Capital Flows (net)	-191	266	-139	-381	-109	-64
Foreign Direct Investment (net)	226	23	121	268	142	171
Commercial Banks	-12	-10	15	-2	0	0
Other (net)	49	-149	-118	44	0	64
Exceptional Financing	15	25	0	109	180	10
Errors and Omissions	10	-19	-45	-17	0	0
Overall Balance	382	-204	-189	42	126	3
Change in Net International Reserves						
(-increase)	-382	204	189	-42	-126	-53
Gross Official Reserves	-318	206	194	-18	-175	-104
IMF (net)	3	0	-4	-23	49	50
Purchases	3	0	0	0	66	52
Repurchases	0	0	-4	-23	-16	-1
Other Foreign Liabilities	-67	-1	-1	-2	0	0
Financing Gap	0	0	0	0	0	50
Memorandum Items:						
Current Account (in percent of GDP)	5.4	-5.0	0.5	1.4	-0.4	-2.2
Mineral	13.8	5.9	13.0	18.8	14.7	11.1
Nonmineral	-8.4	-11.0	-12.5	-17.3	-15.1	-13.3
Net International Reserves						
In $ million	532	328	139	181	307	360
Gross Official Reserves (end-year)						
In $ million	586	380	187	204	379	483
In Months of Nonmineral Imports	5.4	3.3	2.0	2.1	3.6	4.3
Debt-Service Ratio	17.7	17.0	22.5	27.3	16.9	14.2
Debt-GDP ratio (in percent)	35.5	40.8	45.8	43.8	39.1	32.4

Source: Bank of Papua New Guinea authorities; International Monetary Fund, press release 29 March 2000, http://www.imf.org/external/np/sec/pr/2000/PR0023.HTM.