Development Issues, the State of PNG's Economy and the 2015 Budget

Papua New Guinea's economy has been growing for over a decade, strongly for much of that period, even sustaining robust rates when much of the world was mired in the Global Financial and Economic Crises. Admittedly this positive trend followed years of sluggish economic performance in the 1980s and successive booms and severe busts in the 1990s, leaving a very low base from which recoverycommenced in the 2000s.

GDP(gross domestic product) is forecast fora major (once off) leap in2015, perhaps the highest rate globally for the year, boosted by the PNGLNG project, which commenced production in 2014. Surely,therefore,PNG should be the envy of the region, if not the world, with a 2015 Budget able to fund all the government's and people's aspirations; shouldn't it? Well unfortunately it's not so simple, although certainly, considering PNG'sextensive natural resources and their rate of extraction over many years,andother factors, including population, the overall social and economic development of the country, and benefits to the wider population (i.e. social indicators) should be far greater than prevails now.

Some may recall that in 1993 PNG also enjoyed a meteoric (once off) growth rate of 16.8% (partly upon the commencement of Kutubu oil production), but that preceded an extended period of economic turmoil, triggered substantially by economic (notably fiscal) mismanagement (i.e. over-spending and unsustainable debt that also undermined the prospects of the rest of the economy). Strong growth rates should certainly not be scoffed at, but nor should they be seen as some panacea or indication of subsequent economic performance, let alone social well-being.External market forceswill influence that performance, but domestic factors are generally a greater determinant, including suitability of business and investment conditions and the actions/inaction and capacity of government, notably through the annual Budget process. The sustainability of the process and broad-based benefits are dependenton a combination of attractiveness of the business environment and the level of investment in social development, notably education, and it should be no surprise that many countries that have invested well in social capital, but have limited natural resources, have outperformed in the longer run those dependent upon natural resource extraction, but which have failed to invest in broad-based social development.

GDP is neither a measure of revenue, nor even of economic benefit. It's agaugeof total economic output, but, as with all measures, can be misconstrued, and shouldn't be used exclusively. For some countries it's a more useful indicator of performance than for others. Being a measure of the total flow of goods and services, when there's a major net financial outflow or repatriation of proceeds from a country, for example occurringfollowing major foreign capital investment, say in an extractive industry, then the actual flow or 'product' retained within the country will be much lower than shown as GDP. Other measures, notably Gross National Income (GNI), which deducts what is remitted to investors overseas, (addingearnings from overseas - which for some countries may be considerable, including from mature sovereign wealth funds), betterreflect the total domesticincome,i.e.to PNG's citizens.A better measure of economic performance and changing household living standards is GNI per capita, which factors in the annual population growth rate. A high population increase, as in PNG, substantially reduces the average improvements in prosperity (goods and services) everyone gains.

[There is strong evidence-acknowledgedwithin affected industries- that PNG could and should gain greater benefits from the utilisation of its (non-renewable and renewable) natural resources, particularly by reducing unproductive business and investment risks andred tape which add costs and uncertainty for genuine investment. There is also a good case for more consistent investment conditions and more informed and professional project negotiations on the part of government. For example, with fisheries, it's not the number of onshore fish factories and associated increased access and harvesting licenses, which will determine long-term benefits to PNG, especially if some of those plants are merely fronts for exorbitant access to fish stocks, with the majority processed offshore.]

GDP measures all activity, whether digging a hole or refilling it.Other measures which asses the national balance sheet, are also relevant, although difficult to calculate,notably accounting for diminution of natural resources, or environmental costs.With many developing countries(including PNG), national statistics are also notoriously unreliableand various economic proxies have been developed, for example one showing annual changes in lighting levels, as appearing in satellite images; with dismal performance in (reliable) power generation and reticulation that wouldbe an unfavourable measure for PNG! Other measures which assess the level of income disparity, and public well-being, notably social indicators (mortality, morbidity and access to education and other services and freedoms) provide more fundamental measures of economic, political and social performance.

The so-called 'minerals boom' of the 1990s undoubtedly encouraged unrealistic expectations amongst leaders, and, when combined with the flexing of greater political muscle over the public sector and public purse, contributed to that decade's economic crises, and, by undermining provisions for core public goods, such as infrastructure maintenance, police, education and health services, ongoing recruitment, succession and standards, undermined the prospects for the next decade and more. This inadequate investment in core human and physical capital, and the decline of respect for systems and public institutions and weakening of governance and accountability across much of the public sector, left a legacy, which even the valuable structural reforms of the Morauta Government, relative fiscal restraint of the subsequent years and valuable initiatives, like belated competition in mobile technology, have not overcome to this day, particularly in the face of strong population growth. Yes, economic growth picked up on the back of these measures, and particularly with the commodity price boom and the subsequent PNGLNG construction, but it remained relatively concentrated in some sectors, urban centres and segments of the community, and the public sector (including most utilities) continued to deteriorate.

Have the lessons of the 1990s and the need to avoid (another round of) resource curse been learnt? The Government has certainly identified valid key priorities over recent years, notably the need to restore infrastructure and potentially upgrade, education and health services, particularly in the rural areas, law and order, and tackling corruption, plus recognising the critical role of the private sector, including SMEs. The Responsible Sustainable Development Strategy, correctly emphasises diversifying the economy (as the extractive industries, notably LNG, provide valued revenue in due course but limited employment and income earning opportunities), whilst safeguarding resources and addressing the population challenge.

However, actions speak louder than words. Increased expenditure has indeed been allocated to some of these priority areas, and yes, some deficit and fiscal stimulus measures (including construction/upgrading of public infrastructure) are justified during the current post-LNG construction economic and employment lull, but core lessons don't really seem to have been taken on board, or the government simply doesn't know how to address persistent constraints, with corruption joining poor infrastructure and (other) law and order problems, as the lead perceived impediments to business and, along with lack of investment in skills and education, undermining national development.

The Government has sought, constructively, to start breaking down the artificial division between the recurrent and development budgets. Clearly, where a new school is built (as a development activity) trained teachers must also be provided and paid, and school materials issued, on a recurrent basis. However, the recurrent services, including maintenance, training and replacement staff, materials, standards and oversight (including audit) continue to be inadequately funded, whether roads or other infrastructure, education, health, police, social welfare or other basic services, especially away from, but even in, main centres. By contrast, major new projects (some of which might be deemed white elephants or low priority) continue to attract a disproportionately large slice of the Budget, adding heavily to subsequent maintenance (and debt) costs, or to be left simply to deteriorate, alongside so much other infrastructure.

Rather than seriously tackling the weak planning and implementation capacity in the public sector (at national or local levels), the tendency has been to appoint (often unskilled) wantoks and contract tasks out (sometimes to overseas State contractors and too often to crony companies). This may generate activity, but is unsustainable, unless properly managed. Whether tendered or skipping tendering (as with a Lands Dept data management project, where the contracted cost has escalated tenfold from K3 million, with the output still awaited) this has seemingly entailed awarding many contracts well above reasonable prices, and above the lowest (reasonable) bid, sometimes entailing with an overseas workforce, and thereby foregoing the employment and wider economic benefit, which is a major purpose for fiscal stimulus

One of the achievements of the last decade was to reduce public debt to manageable levels, but debt levels have risen steeply again in 2013 and 2014 (around 40% of GDP, but much more including contingent liabilities etc), and 2015 is once again expected to entail a significant deficit Budget, and not expected to balance again until around 2017/8 as more significant revenue commences from PNGLNG. With world economies again shaky and most commodity prices, including PNG's longstanding main export earners, gold, copper and oil, and associated revenue already below forecast in 2014, and the cost of finance rising (and potentially squeezing out private borrowing), this is a risky strategy, with a rethink overdue for the 2015 Budget. 2014 was certainly not the time also for Government to make further heavy commercial borrowings for non-priority (and speculative) expenditure, especially with the backlog of outstanding priorities to address. Some continued deficit is inevitable for 2015, barring any extraordinary turnaround, so public funds need to be targeted specifically on need and essential services (including health awareness and disease and crime prevention), quality output, skills development, effective management, maintenance, sustainability and accessibility, capacity and accountability, and establishing more suitable conditions for diverse private sector business and investment (embracing smallholder farmer to large enterprises, especially those complementing small businesses).

Clearly some additional funds will be required to complete facilities for PNG's hosting of at least the 'mandatory' sports in the Pacific Games, but expenditure for facilities are already excessive in relation to the country's crying development priorities, so great restraint is required now; (caution must be taken with respect to hosting major events, which worldwide tend to entail great financial and economic loss, and diversion of expenditure from priorities). Likewise priority on infrastructure should be given to restoring or upgrading all weather access and sound trunk and alternative routes, based upon usage and genuine needs assessments, plus affordable public transport schemes, rather than excessive, superfluous or over-priced urban and peri-urban schemes. The current K10 million per district grants, controlled substantially by the local MP (and seemingly withheld from Opposition MPs) is an unsatisfactory and wasteful system in most cases (as highlighted in the Auditor-General's recent report). District populations range from 35,000 to 200,000 people and by area. This amount is excessive to be wasted, but inadequate for many genuine development projects. Some allocation to districts and LLGs is required for operations, but project funds must be linked to planning and implementation capacity and accountability, and greater input given to management and capacity building, notably through restored regional IPA colleges, and strengthening the watchdogs and support to civil society to oversee implementation.

Lands need to be tackled head-on. Corruption related to lands headed the list of malfeasance which substantially undermined investment, in an INA business survey, followed by the chronic supply and tenders process. The Government has committed itself to revoking SABLs, which jeopardise food security and genuine agriculture (and other) investment, as well as entailing land-grabbing, abuse of the rights of customary landowners and triggering extensive deforestation. But government has taken no action to revoke the SABLs or support the efforts of customary owners. New land laws and processes have been developed to empower customary owners and should be applied, but will require both budget funding (not diverted by Lands), but also penalties for continued abuse, including by respective authorities and officials.

Despite commitments to economic diversification and SME development, 2014 proved an unhelpful year for investor confidence, especially in agriculture. PNG is a costly place to undertake business (as well as for households to live), and a proactive effort is required to address these handicaps, rather than let further costs accumulate. Despite good prices in some crops, like coffee and cocoa, the actions and messages by government in 2014 largely seemed to undermine the prospects for this key sector for employment and household income generation (as well as in other export and import replacement industries, including tourism, and some manufacturing); these ranged from the illegality and constant manipulation of many of the commodity boards, investment threats to experienced exporters and investors, major overnight revaluation of the kina, loss of support for the rubber growers in Western Province, and wage rate adjustments (although clearly justified for NCD's high cost employees, although widely ignored by many unscrupulous businesses), as well as constant power failures, threatened ownership rules, uneven application of protection (e.g. special deals for a proposed rice trading monopolist etc), rules and contracts. There is a need for much more listening and understanding of the needs of the genuine domestic and overseas investors who actually generate the jobs in PNG, rather than just a few players with special access, including providing greater Budget support to address deficient public goods, which actually handicap and raise the costs of doing business in PNG, including to generate a skilled technical and professional workforce.

Clearly the uncertainty over the long-heralded Sovereign Wealth Fund needs resolution. A valuable tool for exchange rate and economic stability, investment and possibly future social protection. Delays and behind-door changes to arrangements have created uncertainty over whether the initiative been hijacked or even the ghost of the 1990s (misused) MRSF returning to haunt. In any case with recent heavy borrowings against future earnings, the opportunity for early savings into the fund has largely slipped. To be of value, the SWF must meet the highest prudential and accountability standards, including wide public awareness and reporting.

So, for the 2015 Budget, think: fiscal responsibility and better debt management; public (not political) expenditure priorities, which includes mechanisms both to stimulate sustainable economic development and address priority social needs (including those of the largely ignored disadvantaged); modest continued interim fiscal stimulus on priority infrastructure restoration/upgrades (from access roads/transport, to public markets etc) and employment generation (not white elephants); focus on maintenance, educational standards, starting with upgrading teacher training entry and support (including some overseas staffing, including volunteers), restoring institutional capacity and standards, rather than just numbers, in police, health and other public services, with accountability mechanisms, public awareness and penalties, with greater use of automated systems and checks and balances, including transparent and publicly attended supply and tender processes; greater coordination in planning and implementation at national and local levels (so roads/schools/health facilities/police capacity etc are located together, rather than planned in isolation); more timely and routine fund release for real priorities, like vaccine and pharmaceutical or school materials; ensuring that the SOEs operate in a more competitive environment (where possible), secure private partners/competitors for major capital investments, and that profits are transparent and returned to the State not accumulated 'offline'; with revenue extending the tax base, providing more even-handed business investment conditions, and concentrating on reducing the costs and uncertainty to business, which has been further undermined of late by threats and special deals, and a lack of appreciation of the existing high costs and risks of doing business in PNG for genuine investors.

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18 October 2014