

Consultative and Planning Workshop:
**“Impact of LNG on the PNG Economy –
Particular reference to the Agriculture
Sector”**



**The Proposed Sovereign Wealth
Fund(s)**

Presentation by Anthony Yauieb, Deputy Secretary

Department of Treasury

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Outline of presentation

- The PNG LNG Sector
- Economic Issues and Challenges
- Sectoral Impacts of the LNG
- Analysis – ACIL Tasman
- Policy Options – to mitigate LNG economic implications
- PNG Sovereign Wealth Fund(s)



The PNG LNG Sector

- Major economic and development implications:
 - Substantial long term revenues from PNG LNG project
 - Potential to transform economy
 - Opportunity to underpin national development



Economic Issues and Challenges

- Macroeconomic Stability
 - Exchange rate appreciation/Dutch Disease
 - Monetary Policy Issues
 - Absorptive Capacity
- PNG's development needs



The Exchange Rate/Dutch Disease

- Caused by a large inflow of foreign currency
- The significant revenues from LNG project are likely to contribute to a stronger exchange rate
- The effects of Dutch Disease – decrease competitiveness of non-mineral sectors of the economy



Monetary Policy Issues

- Increase in domestic liquidity has adverse implications – increase inflationary pressures
- BPNG mopping up excess liquidity increased cost of monetary policy operations
- Appreciation of Kina reduces the value of foreign reserves
- High Inflation would hurt the poorest in the community the most



Absorptive Capacity of the Economy

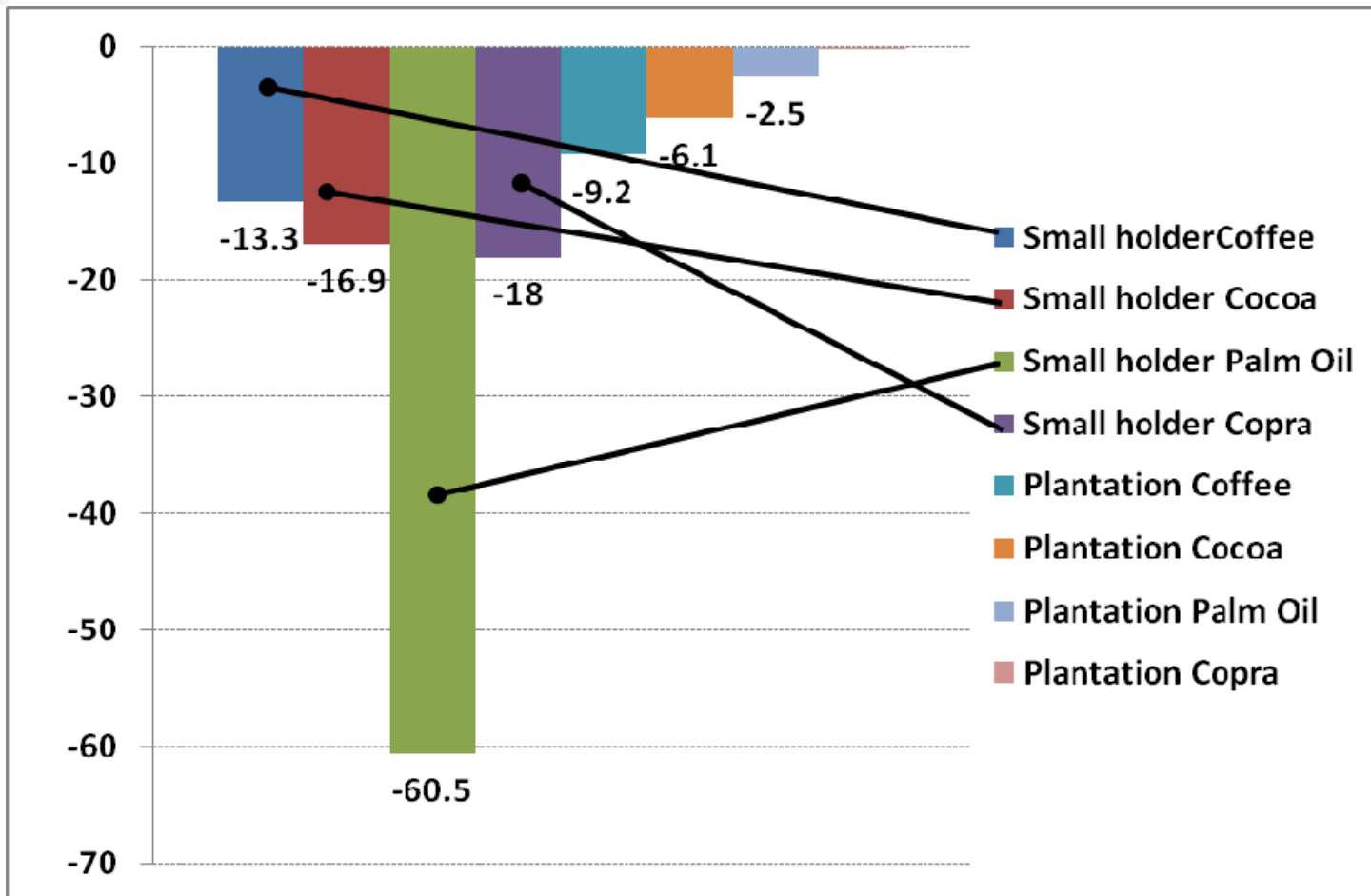
- PNG Economy has limited capacity to absorb additional Government spending from LNG revenues
- Too much Government spending can cause the economy to overheat and inflation to get out of control
- Excess demand pressures increase imports and inflation
- Absorptive capacity can be categorized under 3 distinct measurement constraints:
 - 1) Macro-economic constraints
 - 2) Quantitative constraints
 - 3) Institutional constraints
- Economic modeling on absorptive capacity is very complex
 - Economic modeling work currently undertaken by AusAID and IMF



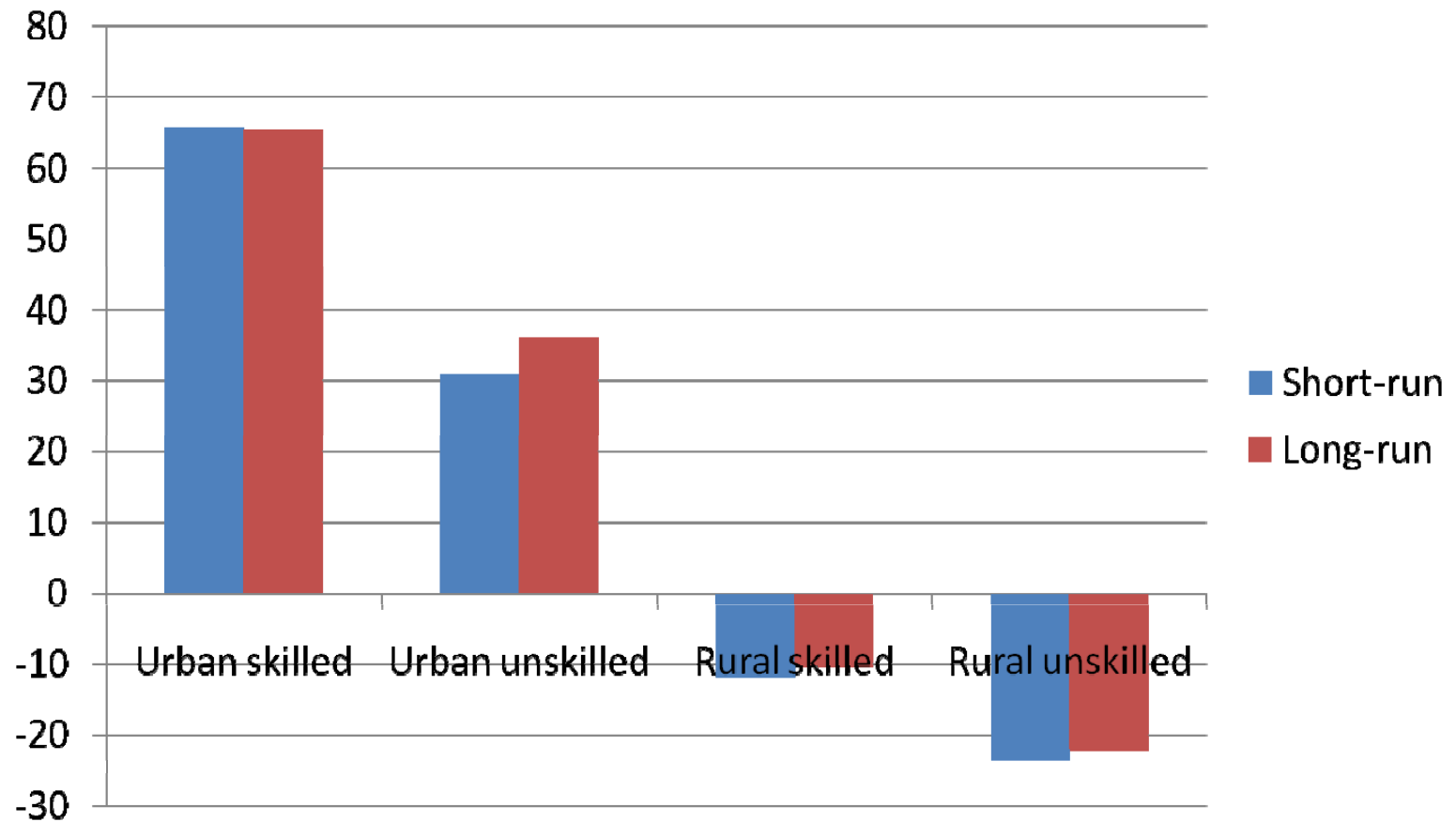
Sectoral Impacts of the LNG

- A range of non-traded exposed sectors will likely expand
 - Construction, Transport, Communication, Services
- LNG may disadvantage export and import competing sectors of the economy
 - Agriculture, manufacturing and tourism could be badly affected if not managed properly
 - Negative impacts of a higher exchange rate may reduce the economic activity and employment across many provinces in PNG
- Analysis and modeling by ACIL Tasman indicates:
 - Real Exchange Rate may appreciate by 11 per cent in the long run
 - Reduce the external competitiveness of domestic non-mineral export sectors eg. Agriculture and forestry
 - Potential large adverse impact on value added in the agricultural sector

ACIL Tasman – Modelled impact of PNG LNG in the Agricultural Sector (%)



ACIL Tasman – Modelled impact of PNG LNG on Employment (%)





Policy option – Sovereign Wealth Fund (SWF)

- Can Dutch Disease be avoided?
 - Cause of Dutch Disease is an inflow of foreign currency into PNG
 - It can be reduced by not bringing all of the foreign currency into PNG
- Policy option to minimise the effects of Dutch Disease is through creation of an offshore SWF



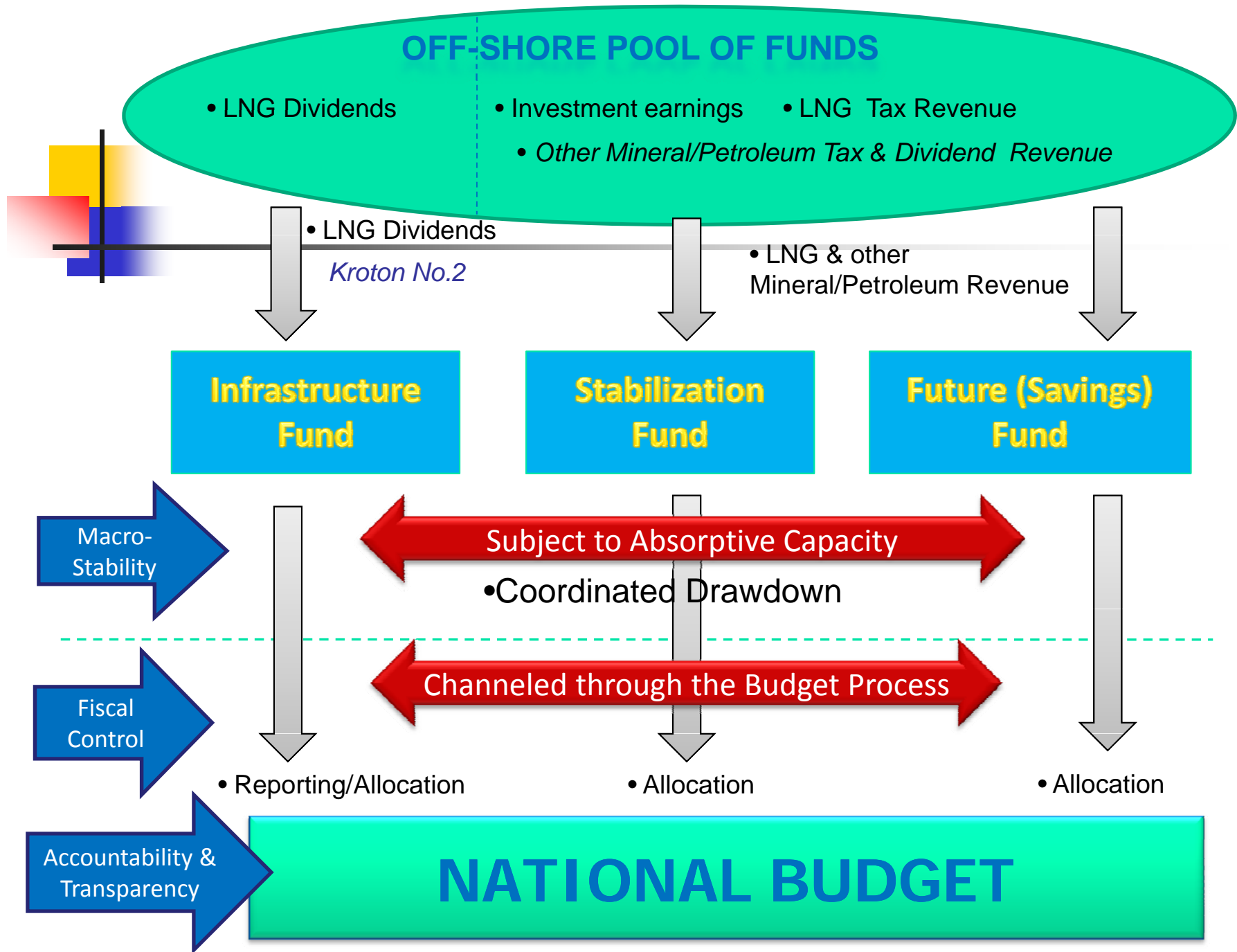
Offshore SWF(s)

- Size of LNG revenues have substantial macroeconomic implications that need to be carefully managed
 - Exchange rate appreciation / Dutch disease
 - Cost and operation of Monetary Policy
 - Risk of overheating the domestic economy
 - Adverse effects in non-mineral sectors of the economy
- Offshore arrangements:
 - State will retain full ownership and control
 - Promote macroeconomic stability;
 - Underpin long term development and socio-economic objectives
 - Help protect non-mineral sector industries
 - Are robust, transparent and effective



PNG SWF Model

- Establish a consolidated pool of offshore funds with three coordinated and integrated Funds
 - 1) Infrastructure Fund
 - 2) Stabilization Fund
 - 3) Future (Savings) Fund
- Fully integrating SWF with the budget and fiscal framework
- Governance, transparency, disclosure, accountability and asset management rules be based on international best practice
- Drawdown rules be developed to ensure prudent macroeconomic management while supporting development objectives
- SWF to be overseen by an independent board
- Investment be undertaken by offshore investment manager





The End

Thank you for listening