



**CPA Joint Annual Conference – Gateway Hotel, 16-17 November 2011**

**Address:**

## **Sustainable Wealth Creation**

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Introductory remarks....

Papua New Guinea is sometimes described as a wealthy nation, but where the people are mostly poor. Others emphasise that wealth is not about income and modern assets, but the quality of life, and that Papua New Guineans aren't poor as (unlike many others around the planet) they mostly have access to productive land and enjoy relative rural plenty.

Over the past 10 years PNG has enjoyed a positive and latterly high GDP growth rate (this year estimated at 9.3%), resulting from strong commodity prices, some valuable earlier reforms and major investment, notably geared to major new commercial projects. These high prices and new investments have generated increased employment in most sectors, albeit in PNG's still relatively small formal sector. Hundreds of new small business enterprises have also been registered in recent years, although many are only aspiring to access contracts or other opportunities associated with LNG or other major resource projects. Many landowner companies and other small businesses will invariably fail to survive long, as their principal source of business contracts dry up, but some (like Anitua from Lihir) have developed a firmer footing, diversified and grown, providing sound longer term prospects and some role model for other such businesses.

Astronomic real estate price rises have made some wealthy overnight, whilst high accommodation and other living costs have kept others economically marginalised and off the ladder of increased living standards. An eventual adjustment in urban land values would trigger a slippage in some household and business's balance sheets, but there would also be winners from reopening opportunities, so long as more land became accessible for urban occupancy. Stronger recent agricultural commodity and food prices have offered improved incomes into accessible rural areas, whilst new financial institutions and improved ICT, notably since 2007, have enabled a modest expansion of financial inclusion, albeit from a dismally low level, of less than an estimated 10%, 5 years ago.

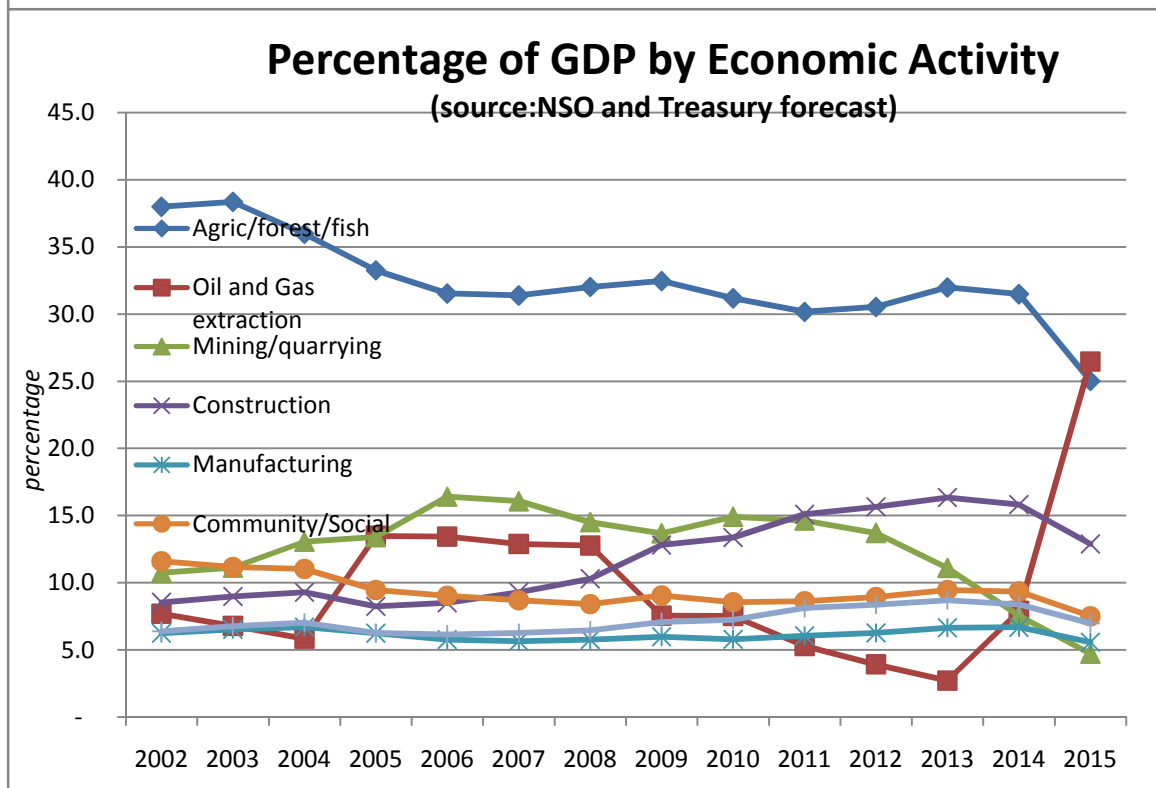
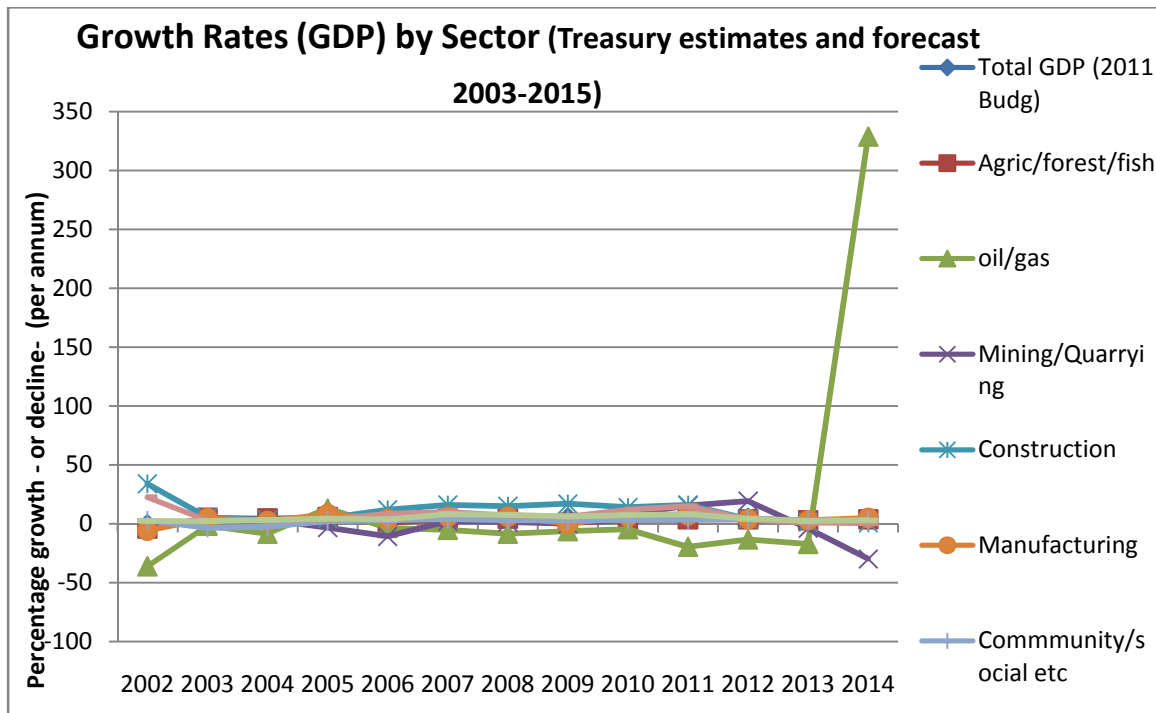
The standard growth model worldwide envisages largely agricultural economies shifting progressively into manufacturing and services, whilst the cities progressively absorb the rural population, whilst agricultural productivity rises parallel with the declining workforce. This model probably does not apply readily to PNG (or much of the Pacific)

with its still relatively small domestic market, poor infrastructure and deficient services undermining competitiveness and prospects for manufacturing and many services, at least for the time being, except downstream processing of locally produced raw materials. PNG's broad-based rural land ownership (at least until the advent of SABLs), relative accessibility for households to reasonably productive agricultural land, limited prevailing skilled workforce for alternative industries, and continued sound opportunities for agricultural exports with buoyant, or at least revived market demand all favour agriculture continuing to provide the core livelihood and economic lifeblood for most households well into the future.

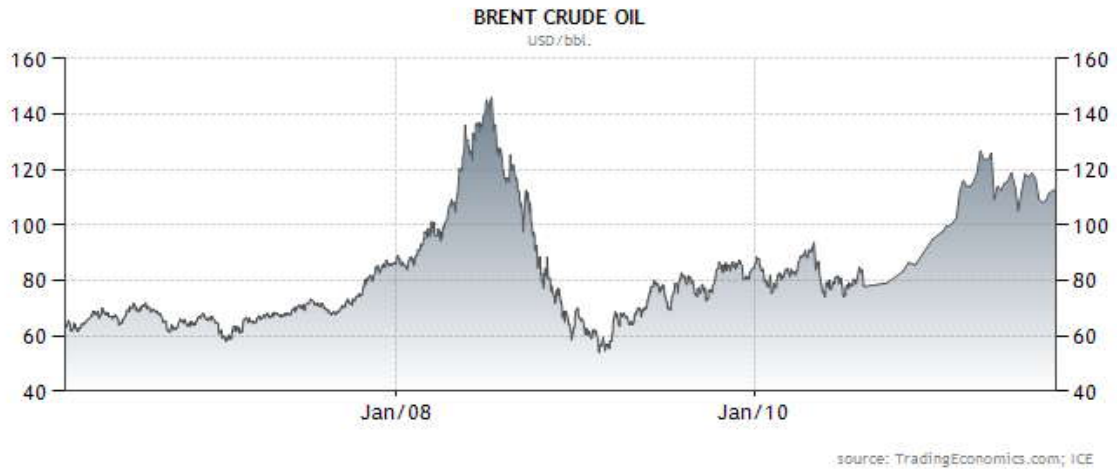
Young people may prefer to hang out in the towns and avoid the perceived grind of agricultural work, but for the time being agriculture and other natural resources and their progressive value-adding, will continue to provide the bulk of opportunities, both with existing products and exploring new niches, in what is an evolving market, with changing demand, for example for fair-trade and organic products, bio-fuels and environmental services.

The agriculture and natural resources sector is likely to provide this critical role, both as a dynamic contributor to economic development, but also as a valued absorber of household labour, well into the future, albeit for a declining portion of the population and overall GDP over time; that is, so long as the sector and rural areas receive adequate fiscal support, and are not ignored as they have been over recent years, effectively driving people to towns for access to markets and basic services, and so long as the impact of the boom sectors, notably with the 'Dutch Disease' effect of extractive industries, are mitigated with appropriate policies and practical measures to minimise negative impacts and maximise broad-based opportunities. If this prospective 'resource curse' impact is not addressed effectively then there will be limited and inadequate economic opportunities, except from resource rental, in either the urban or rural areas.

As we've said over and over again, whilst LNG may provide a major employment boost for local and some overseas skilled workers, this is short-lived, with numbers dropping back to less than 1000 permanent staff with PNG LNG once production commences around late 2014. Mining's employment impact is more sustained but PNG is still facing a severe dual or two speed economy, as it has for many years, but to a lesser extent than now. The challenge is to ensure that PNG avoids, or at least minimises the Nigerian or Nauruan style impact of the economy being narrowed to one or two core industries, with all else withering, and subsequently dead, long before the boom resource is exhausted, or frustration from the excluded bubbles over, and boom turns to bust.



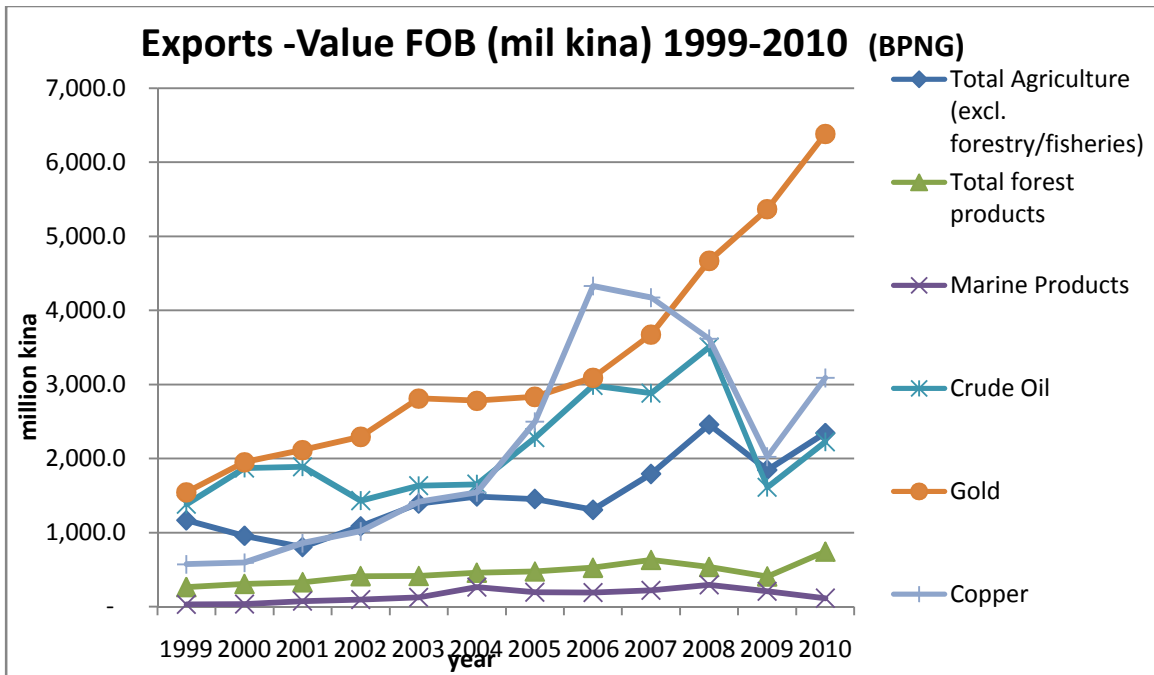
Just to put it in perspective, until 1984 agriculture was the main export earner for Papua New Guinea. It was subsequently overtaken by minerals, initially copper and gold but then joined by oil in 1992, which together also increasingly provided the main source of revenue; more from one products in one year and from another the next, although, until the advent of LNG, gold was dominant in most years.



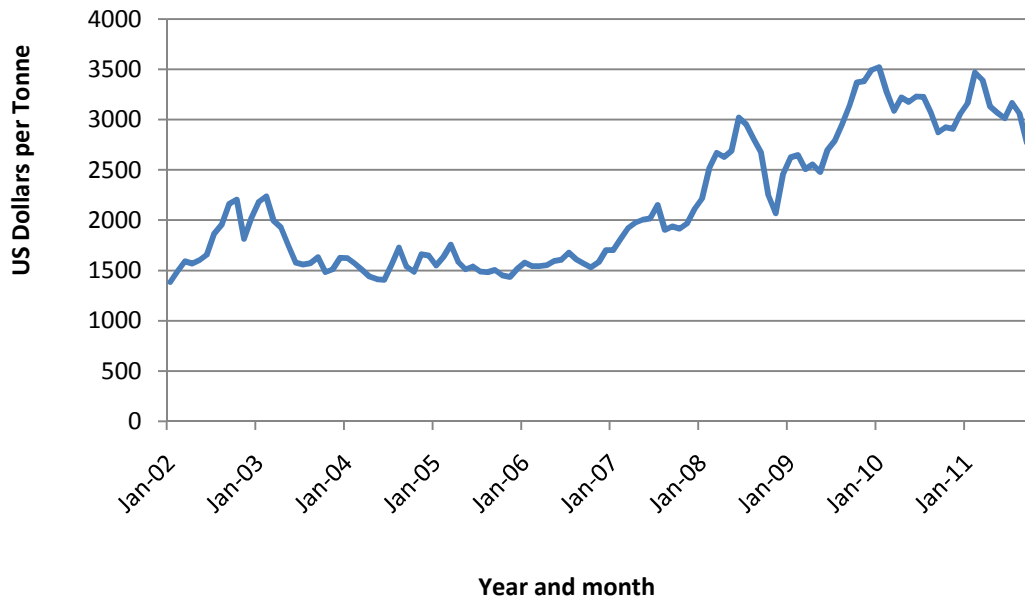
5 Year Copper Spot



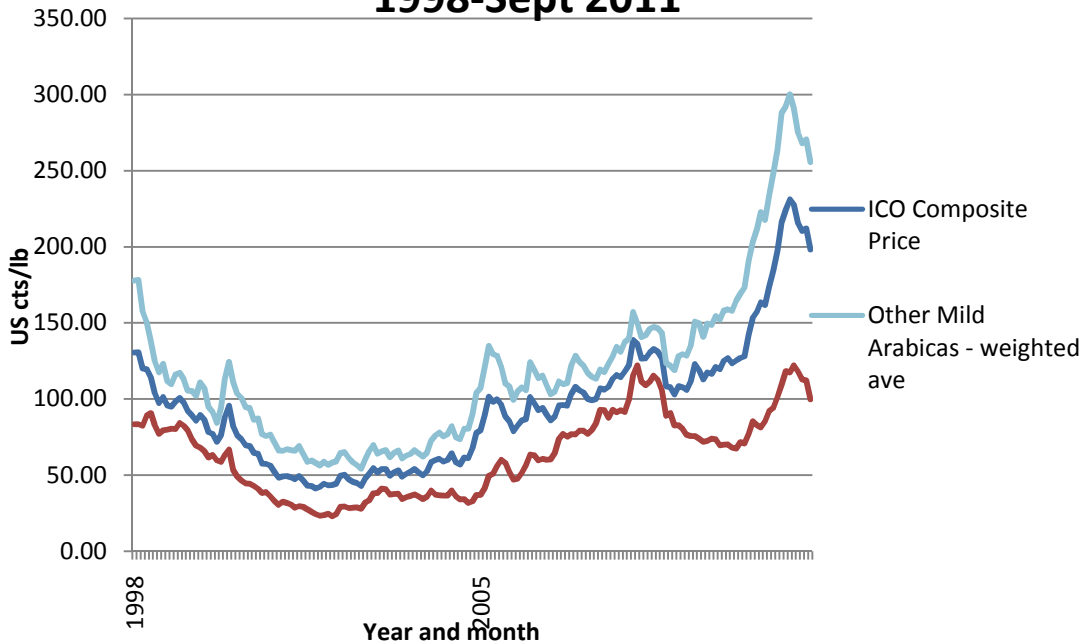
Exports -Value FOB (mil kina) 1999-2010 (BPNG)

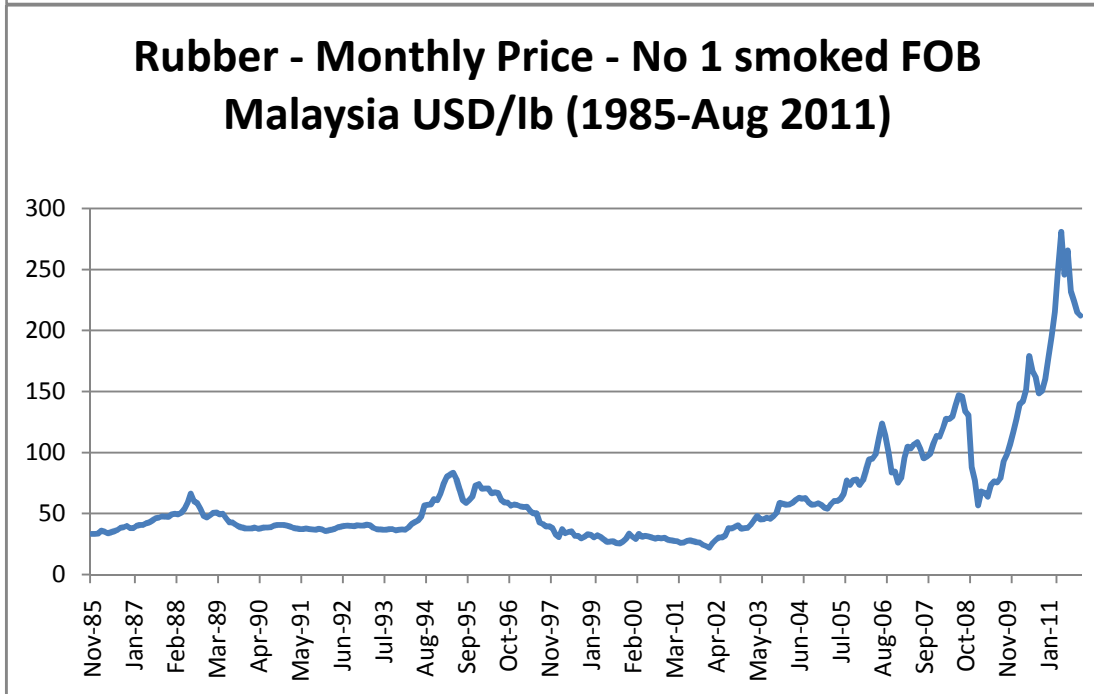
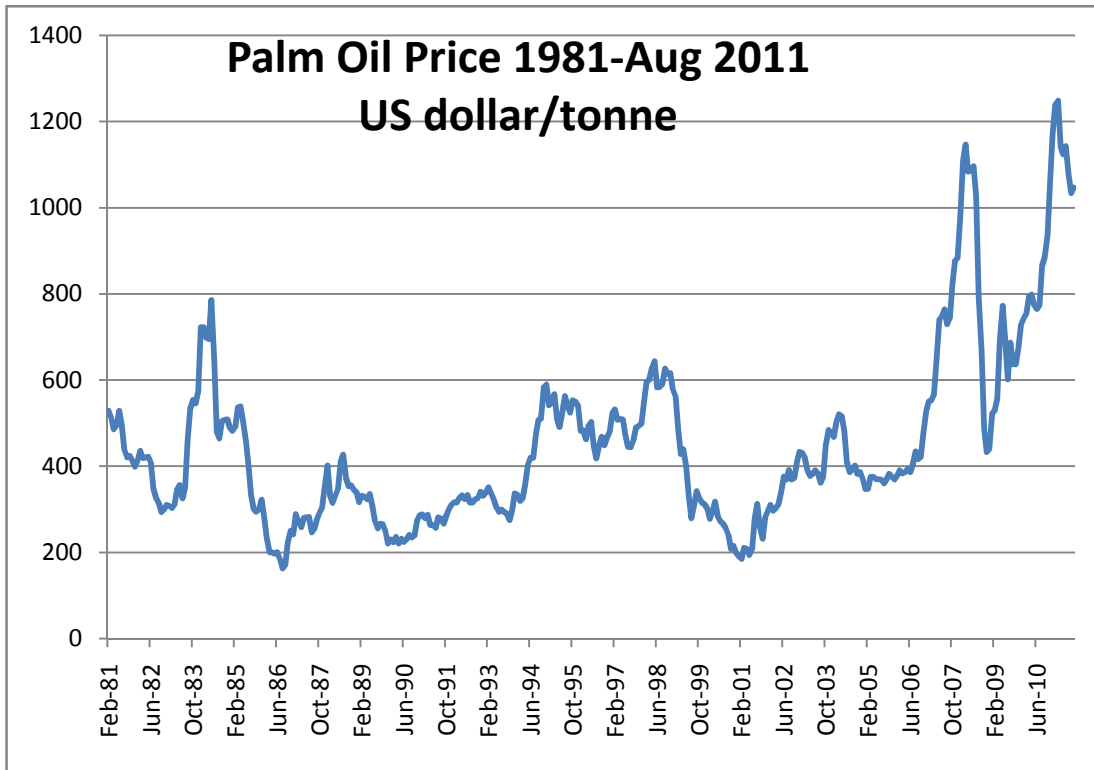


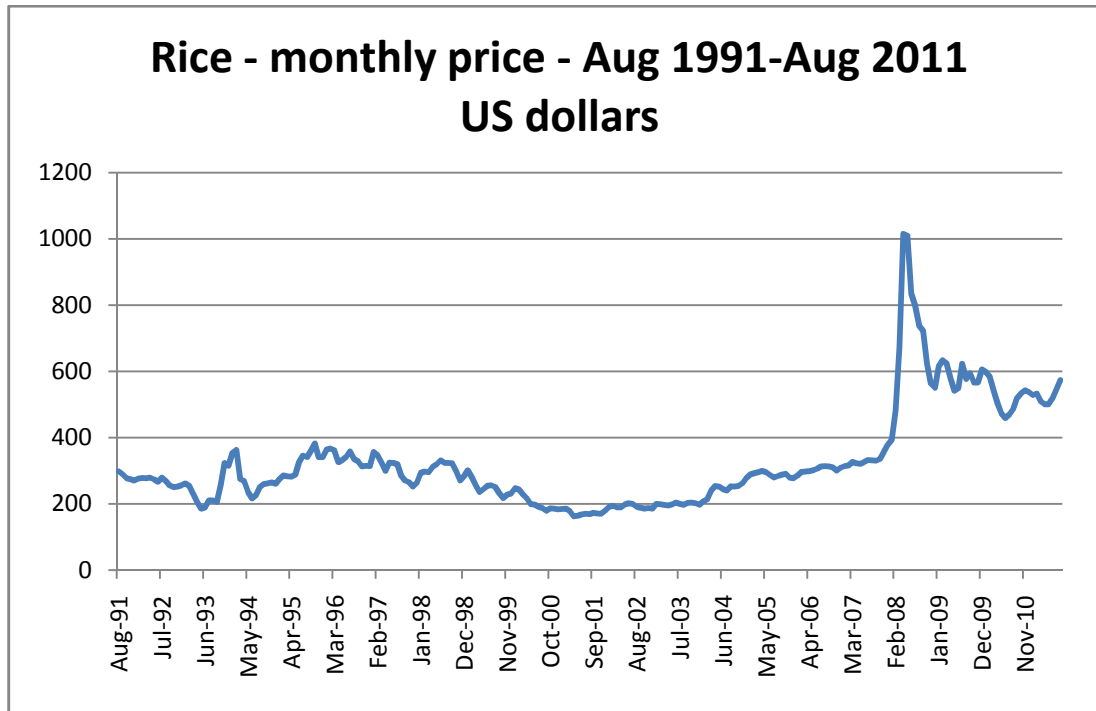
### International Cocoa Price - daily price (ICCO) Jan 2002-Sept 2011



### International Coffee Prices (US Cts/lb) 1998-Sept 2011





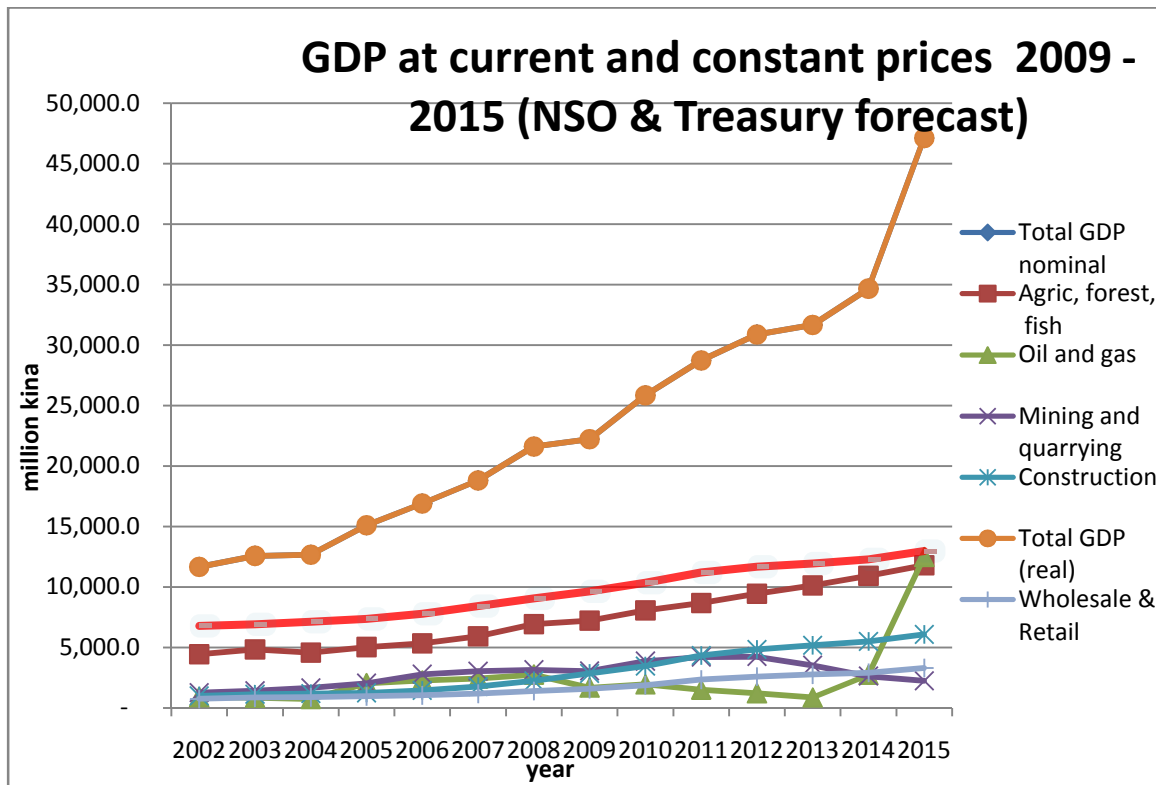


For most citizens, however, agriculture remained the main source of livelihood both from export and food crops and other produce, and remains so to this day, despite the large growth in the urban population, particularly over the past decade or so..Agriculture, with forestry and fisheries remain the dominant contributor to GDP, still at around 30%, although oil and mining are forecast to catch up by the middle of this decade as LNG production kicks off, but in terms of GNP, i.e. economic benefits that are retained in country, agriculture will continue to contribute significantly more, as by its nature it is less dependent upon outside capital or income outflow (excepting some of the logging and distant water fisheries industries, that is). I've shown you the graph before, indicating the relatively modest GNI growth rate from LNG, after remittances and other transfers are shipped back out of the country, and how revenue the will also be substantially deferred until repayments are made, including the State's costly 19.4% equity stake.

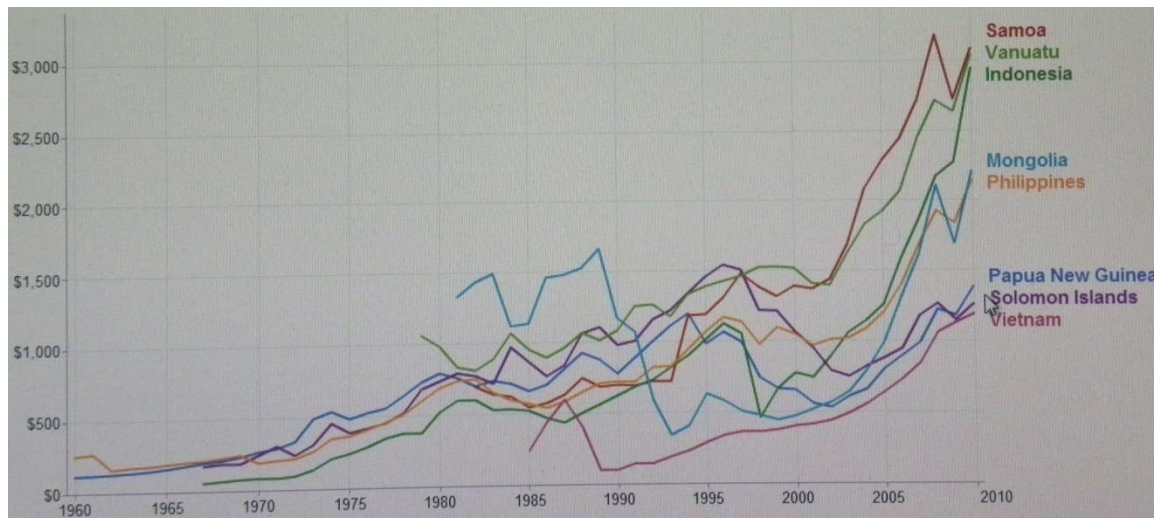
What is wealth and therefore its creation? Normally a nation, company or individual's wealth is defined in terms of their assets, minus their liabilities, and that if the balance is large and positive they're wealthy and small or negative, they're poor and perhaps indebted. Clearly that wealth will be determined in how far those assets are valued by society, but also one's wealth is also determined by how far those assets are being used to generate income, food or other benefits. The old aristocrats of Europe were deemed wealthy by dint of their vast estates, but were often cash poor, as many had limited cash income. Many Papua New Guinean households and communities, likewise, have extensive land, forests and other natural resources, but little access to markets or financial capital or management or marketing experience to utilise these resources, hence bringing in outside investors, who sometimes cream off much of the value, leaving the landowners with some realisable if temporary cash income, but stripped of their capital base.



National accounts determine real gross domestic product on the level of economic activity. Real GDP is effectively a measure of that country's gross standard of living, whether calculated using the production, income or expenditure method, based upon transaction costs or receipts, less inflation. It's based upon market values, which, as we know can be tenuous, whether shares, property, or latterly even government bonds, and for example includes the transaction costs of demolishing an object as well constructing it. It includes an imputed, if crude, valuation of non-monetised transactions, which in an economy like PNG's, with its large or subsistence sector, remains substantial.



**GDP per Capita** (1960-2010 – PNG 2010 USD1,382, Samoa USD3087, Vanuatu USD 3042, Solomon Is. USD1,261 – source World Bank)



This graph shows PNG's steady growth in GDP per capita over recent years, but also how various other countries in the region have performed markedly better, including Samoa, Vanuatu and Indonesia than PNG, some far less wealthy in natural resources.

Papua New Guinea is deemed to be a lower-middle income country under the World Bank's definition (using GNI per capita) having a GNI per capita calculated at USD1,300 per head in 2010. (lower middle income covers \$1,006 - \$3,975 per head. GNI is considered a fairer assessment of a country's wealth, denotes GDP minus outgoings, for example in dividends back to shareholders in companies overseas, but in the future when the Sovereign Wealth Fund is operational it would include income from that fund invested overseas. Clearly with major overseas-financed investments being developed in PNG currently, GNI would better reflect the economic benefit to PNG, notably once funds have been remitted to investors.

Of course, statistical data is fairly crude, especially in the S Pacific countries and PNG's demographic and income statistics are some of the crudest. We have a deferred 2010 National Census which looks like it will provide population data of a very mixed, but large poor quality. We are awaiting the 2009 HIES outcome, to be released we hope imminently, which will hopefully provide valuable detail on household income and its variation across the country. There is no doubt that per capita income is highly skewed in PNG and has become, and threatens to become increasingly so, as some resource projects have been developed, generating major local income disparities between influential landowners better able to tap into resource rents and others, and disparities with remoter and non-resource areas, particularly some provinces and districts which have been largely overlooked for many years in government expenditure distribution and service provision, (as highlighted in successive NEFC reports).

So assessments of wealth and wealth creation need to be undertaken with careful consideration of how skewed that wealth is, but also using other social indicators, including those covered by the Millennium Development Goals, none of which PNG is likely to achieve in 2015. These indicators, however, tend to highlight that we still have

extensive poverty prevailing in PNG. The World Bank estimates poverty at 37.5% of the population, but in more practical terms other non-financial indicators highlight continued unacceptable poverty rates, notably the very high maternal and child mortality rates (purportedly the 2<sup>nd</sup> highest in the Asian-Pacific region), short average life expectancy, poor access to potable water, low access to education and health services, and high illiteracy rates. Inaccessibility by road or other transport to markets and services may leave households with extensive natural resources but few opportunities to reduce health risks, earn an income or improve their welfare. Take away their natural resources, like forests, land or marine life, and they're being forced into rural poverty or forced into the towns, with few useful skills and opportunities. Our towns themselves are poorly run, with inadequate recognition that urban growth is inevitable, and quite be successful and relatively harmonious and healthy, given some planning, accessible public services and utilities, and control on corruption, such as over contracts.

Another factor in assessing national and household wealth, includes the notion of waste and resource depletion and degradation, to achieve a more sustainable development index. The concept of the 'green GDP' was introduced particularly since the Rio -Earth Summit, nearly 20 years ago, and has even been applied by the Chinese government. Conventional GDP figures will show the economic gain, for example from felling a forest or harvesting marine life, but not reflecting the altered net asset value or prospective income following that depletion and lack of remaining natural capital (especially if harvested unsustainably), nor the cost of waste, which tend to provide a very different economic scenario, and sometimes one suggesting a net loss of wealth from resource extraction or development, especially if the proceeds are ill-used, or poorly reinvested by government and private companies and households.

Green accrual accounting has been resisted in some quarters as it severely undermines growth statistics, but is increasingly being incorporated, notably on the basis of the costs and need to mitigate green house gas emissions, using carbon accounting and the growing voluntary and mandatory carbon markets, and the prospect for a range of other payments for environmental services, designed to value and safeguard land and marine ecosystems, including mangroves for coastal protection, potable water which is recognised as an increasingly valuable commodity, along with traditional commodities.

In cost benefit analysis, notably on the potential gains or losses from a major new project, there must be attempts to place a value on non-traded assets or services, such as the utility to the community of a fine view or pure uncontaminated water. In national green accrual accounting the economic income from resource extraction is balanced by the net loss of that asset, whether it be a forest and its carbon stock or the mineral resource which has now been utilised and no longer an asset for future use. Wealth can also be very transitory; who is wealthier? The villager living by a pristine lagoon with plenty of fish, good garden land and his own forest, or someone whose converted those assets into cash and if he's lucky a car. It clearly depends upon how he, and the wider society, value those different assets and how they're utilised. Clearly, if he's bought antimalarials, an education for his kids, enjoyed some good beers from the cash, he may feel wealthier, at least for the time being, but one he's blown or badly invested the cash, and the car's rusty

and the old logging road's now impassable he might feel he's a major net loss, and has ended impoverished by the experience, if perhaps wiser!

What I'm emphasising is that wealth can be valued in different ways, and can be ephemeral. What maybe valued highly one day may have little utility the next, so owning Greek treasury bills or Lehman Brother shares maybe valuable assets one day, but have only a fraction of their worth the next. Owning miles of canals, copper cables or cart horses maybe immensely valuable one day, but superseded by new technology the next. Likewise property prices may appreciate rapidly when a place suddenly becomes accessible, with a new airport or railway, or a major commercial project, like LNG construction is underway, or when credit is readily available and cheap, as in the US until 2008, but suddenly slide or even collapse when conditions change and where the driving force for that value disappears, as when one product loses its fashion, becomes obsolete or substituted, or perhaps is deemed unhealthy or contaminated.

Wealth creation is generally seen as what the private sector does best, combining land (or what's beneath the surface or in the oceans) with labour and capital to bring about some value adding, whether through a large enterprise employing thousands and generating profits for its shareholders, or through small or micro-enterprises, including PNG's smallholder farmers or market traders, who are self employed or just employing a few, probably family members. Private individuals and businesses, especially small business, tend to be the most innovative (like Steve Jobs and Wozniak when they kicked off a great idea at home), whilst larger businesses have the capital to develop that innovation, if they so choose, and less exposed to the risk of developing a single innovation or product.

Government is sometimes viewed by private sector players as unproductive, and even a parasite upon businesses and households, which generate the wealth. Certainly many of the PNG Government institutions have under-performed, and latterly been under-resourced with suitable management, skills and operating funds. Some have even been a negative force, handicapping genuine opportunities and commercial initiatives, particularly where corruption has severely permeated their ranks, as apparently with parts of the Lands Department and some other Institutions, for example involved with issuing SABLs without due process and landowner consultation.

Nevertheless, whilst government is generally not seen to be particularly effective at generating wealth for large numbers of people, it does perform a critical role in enabling businesses and households to create wealth, notably by performing its core functions of providing reliable roads and other transport infrastructure, education and training services, law and order, and a sound and level playing field for business to invest and operate competitively, application of standards and oversight, e.g. through quarantine, which are crucial for economic activity to function and for the society to maximise the benefits from that activity.

Government in PNG can perform these functions far better than it has with application of good governance practice and recruiting and retaining good managers. Laws, regulations institutions and processes can be improved, but largely PNG is well provided with these,

what it requires is their efficient and honest application. In some cases certainly some traditional public sector functions can be better performed by the private sector, contracted out, opened to competition or private investment, such as power and ports.

Government can also foster conditions for innovation, such as using developing the planned Agricultural Innovation Grant Scheme, but as with the management of the planned SWF, transparency, wide public awareness and ownership, independent fund management and strong oversight are critical, to ensure that PNG's atrocious mismanagement of grant schemes and development funds, such as NADP and DSIP, are not repeated. The massive misuse and unaccountability of public funds, especially trust funds and so-called windfall revenue, has been a major missed opportunity to invest in, and restore core public goods and services, which the country cannot afford to repeat, although it is recognised a few innovative and useful schemes have been funded even out of these funds.

With LNG emerging government's primary focus should be on ensuring that, apart from ensuring that these major projects proceed in a timely manner, and that they genuinely contribute their fair share to public revenue, that these projects contribute and do not undermine the rest of the economy, notably through effective use of the SWF to mitigate Dutch Disease implications (including undue currency appreciation), but also that revenue, including from these projects, is effectively invested in empowering Papua New Guineans to participate in the economy, notably through reliable access and infrastructure, but especially in education and skills development. More effective human resource planning and support is valuable, but the State, even working closely with the private sector and community, cannot entirely foresee future investment opportunities and employment demand. Empowering PNG's young people with literacy and the skills to learn and be adaptable are critical, rather than just specific skills, such as welding which may be in great demand during pipeline construction but surplus later.

PNG does not have the resources, and low production costs of Saudi Arabia and the Gulf. It's population cannot live off resource rents. A diversified economy providing extensive employment, in industries which can compete locally and internationally is required, with the extractive industries facilitating that scenario, rather than undermining it. There is no point in PNG being a relatively wealthy country, extracting its resources, but few people having meaningful employment! That first requires firmly negotiates with proposed developers (preferably using standard conditions) ensuring fair and transparent project agreements which are then properly enforced with resource developers, whether in mining or forestry, which do not grant internationally uncompetitive tax exemptions or extensive jobs to overseas workers, and ensure good opportunities for local product value-adding. It then requires facilitating beneficial multiplier effects into viable (not protected) related industries, where practical, and that the proceeds from the projects to the State are monitored closely (including adherence to requirements of the Extractive Industries Transparency Initiative) and invested effectively, rather than consumed up front, (as was the case, by and large in Nauru with its proceeds from their phosphate mining, as opposed to Kiribati which managed its trust fund for longer term needs).

- Critical – governance & control corruption
- Focus – of government on effective/good governance over core functions and addressing main impediments, especially for small to medium enterprise (from roads/ports, education/training, law and justice, red tape, lands, power utilities, competitive markets, reducing production/transport costs)
- Address needs also of informal economy and major focus on extending financial inclusion, opening up banking/credit market but extending supervision, and use of mobile phone (and other cashless) banking to extend financial services, and lower security risks and transaction costs, including into rural areas (e.g. trading copra and other commodities)
- SWF – ownership/governance/transparency – balancing long term investment/sanitisation/stability with shorter term investments in skills training and immediate needs to extend economic opportunities
- Advisory support for local businesses, including lancos
- Free trade to encourage competitive access to markets, but balanced with some restraints and investment to reduce local cost factors, to ensure fair opportunities for local businesses, including freight subsidies (shipping/air) for remoter communities
- Awareness of risk, public debt and avoid financial crises (property market bubbles, heavy borrowing for state equity etc) which severely wealth destructive; possible separation of financial functions to limit risk on high street banking role
- Address major exploitation of PNG resources and resource owners (eg SABLs), which undermine PNG and landowner participation in development, and jeopardise genuine investments; ensure transparency in dealings
- Anti-corruption and social auditing programme – including use of web to post information, budgets, land, resource and financial arrangements, etc.

#### Development Focuses and opportunities:

- LNG – medium term resource, good revenue in longer term, but few jobs
- Oil – running out (only lasted 20 years)
- Mining – major potential, but need better sequencing, safeguards, standards etc
- Agriculture – years of declining prices recently reversed and sound future prospects with growing global demand, including for renewable energy, the core employer/income earner; sustainable prospects, invest in research/pest control, greater productivity, information sharing, new market niches and standards and changing opportunities/demand, including for Fair trade and organic etc.
- Payments for environmental services – major opportunities for PNG (e.g. Aust entered carbon market at AUD 27m3), and accountants will need to be able to account and audit these new commodities and markets, together with other professionals, including scientists; the credibility of these markets will depend upon their reliable verification
- Fisheries, ensure resource managed and protected for sustainable harvest in face of growing demand, opportunity for greater local servicing, processing etc, but ensure standards and local benefits as well as cost competitiveness

- Forestry, sound prospects but meet global sustainability standards notably FSC, and more local processing and many areas may gain greater returns from PES; again, as with fisheries, accountants will play a key part also in verifying compliance with market standards
- Sustainable Energy –large and mini-hydro, geo-thermal etc for longer term local needs (and possible export)
- Manufacturing – mostly for downstream processing of local land and marine resources
- Tourism – esp. niche markets..adventure/eco etc, but can grow as exotic place if law and order problems and transport/accommodation costs more competitive
- Commerce – as with other activities encourage restraint on population growth and outside migrants, unless they have skills they can and will share...high population growth and bringing in outsiders to perform functions readily suitable for PNGans, shares PNG's wealth wider, without bringing local opportunities. Overseas investors/managers/professionals can create more local jobs, but not those directly competing for/undermining the local employment (preferential arrangements for Pacific neighbours)
- Open up regional/international skills/labour opportunities overseas, with remittances back to PNG, also learning market demand for staff (positive Samoan/Sols experience with agricultural labour scheme to NZ)
- Dual citizenship should be allowed. PNG is the loser by denying this and requiring young people to take a choice at 18; they are part of PNG's talented youth, who feel Papua New Guinean and whilst they may also have opportunities overseas, (together with many older 'PNGans') most are eager to contribute at least part of their future to PNG; most countries accept dual citizenship and global skills are more marketable and mobile these days, with increasing numbers of particularly of skilled PNGans now securing overseas work opportunities (and remitting funds back to PNG), and it is foolish and unnecessarily spiteful to deny them the opportunity to hold or retain PNG citizenship
- ICT – positive lessons from Digicel/competition for other sectors and opening up opportunities in other sectors (e.g. vegetable market price information provided on mobile phones with FPDA etc)
- Standards – PNG must reject sweat shops, but needs social and environmental standards and work standards to be competitive, and to establish business culture for long term investment and maintaining business, not selling out to the first bidder or consuming proceeds!
- Youth –they should not be considered a problem, but the country's future and need to be invested in and supported to play their full part.
- Non-government organisations- in PNG many of the countries many essential and other services, right out to remote locations, are provided, sometime with voluntary contributions, by churches and other non-government organisations. As with the range of other business activities and opportunities which PNG faces, these NGOs, often supported by government, private or donor funding,

are dependent upon competent accountants and bookkeepers to be able to function and be sustained.

In many ways accountants are the glue which sticks the many parts of the economy together, or perhaps, more politely, the oil that lubricates it, and it's the quality and reliability of your work upon which sustainable wealth creation depends. Whilst the global financial and economic crises, and some previous business crashes, as with Enron, came about substantially through 'creative banking and accounting', forgetting basic principles of risk management, including maintaining prudent liquidity levels, and collateralising or essentially losing track of debt and risk levels. We must adhere to reliable accounting standards and build up knowledge and capacity to respond to new market demands and products and be ready to oversee or restrain those, as in Wall street prior to 2008, who'd stretch a yard to a mile or grant AAA status to junk assets on the basis packaging.

PNG is seeing new horizons, but also still has extensive poverty; it must open up opportunities for the long term, which requires treading on solid foundations, not transitory or shaky grounds, or illusions, and accountants have a critical contribution to ensuring that solidity, notably through provision of reliable information (including over use of public funds, from the district level to the Sovereign Wealth Fund) or, rather than sustainable and broad-based wealth creation, we'll see opportunities and natural and human resources squandered or diverted, resulting in sustained and widespread poverty. The future should be bright, but that depends upon the energy, commitment and integrity of many, including that vital part played by your profession.

Thank you....