

Papua New Guinea Economic & Budget Briefing

The challenge of turning the last days of the boom into lasting improvements in living standards

Tim Bulman

Country Economist

The World Bank in Papua New Guinea

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Economics Society of PNG, Port Moresby

www.worldbank.org/png



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in Papua New Guinea

- 1. PNG has enjoyed a transformational decade**
 - ▶ But the driving forces are approaching exhaustion...
 - ▶ and PNG's human development needs—and business opportunities—remain enormous
- 2. The government is looking to broaden and extend this boom**
 - ▶ But these efforts bring **risks**, as PNG's own history shows
 - ▶ ...and the resource-intensive type of growth PNG is experiencing brings **special challenges**
- 3. So the focus needs to be on doing things smarter:**
 - ▶ Improving the **effectiveness of spending**
 - ▶ Making the **business climate more supportive** of Papua New Guinean businesses



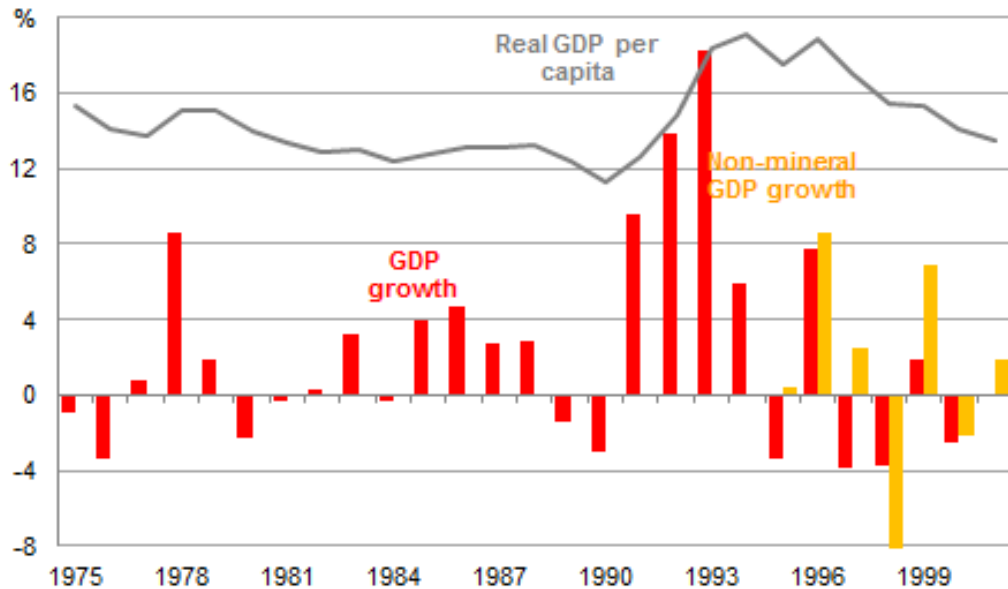
PNG's transformational decade

PNG's transformational decade

Where we were 10 years ago...

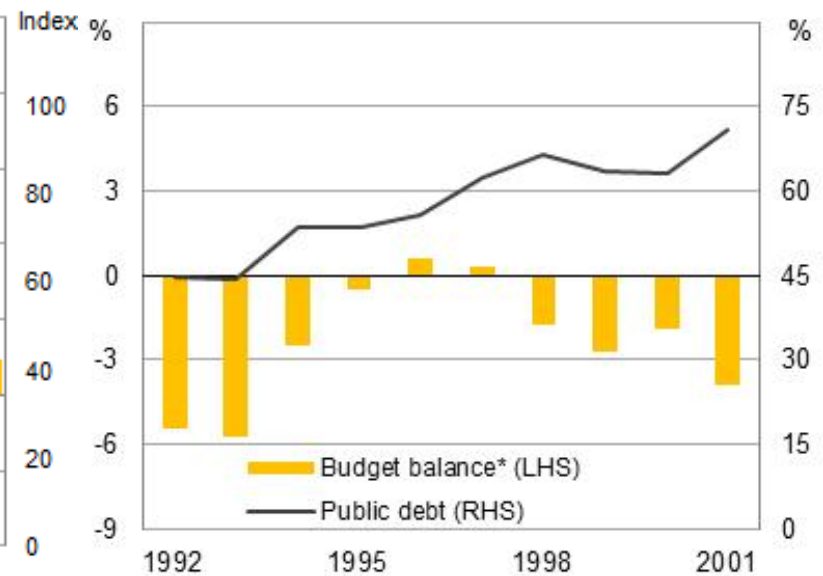
Sliding incomes, low & volatile growth

(annual growth and GDP per capita, 100 in 1975)



A deteriorating fiscal position

(percent of GDP)

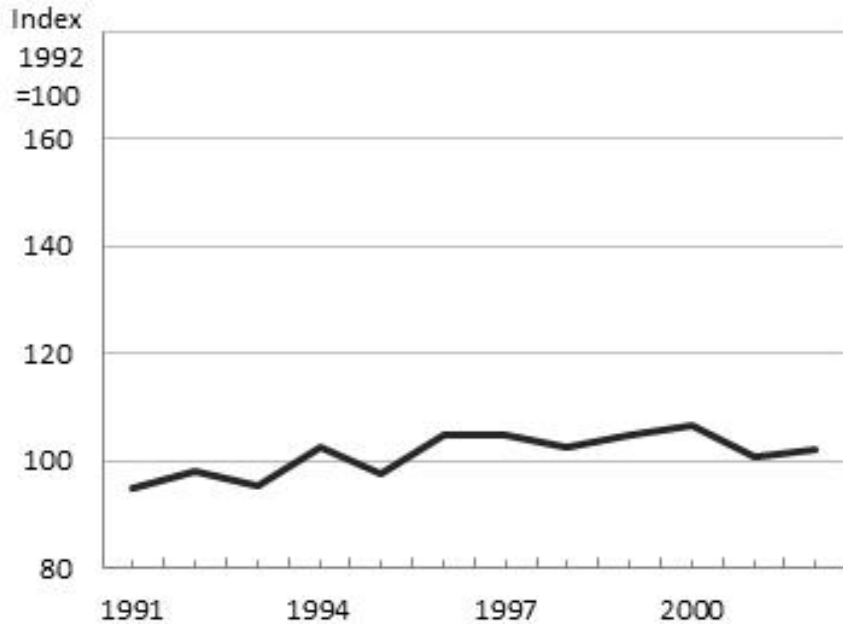


PNG's transformational decade

Where we were 10 years ago...

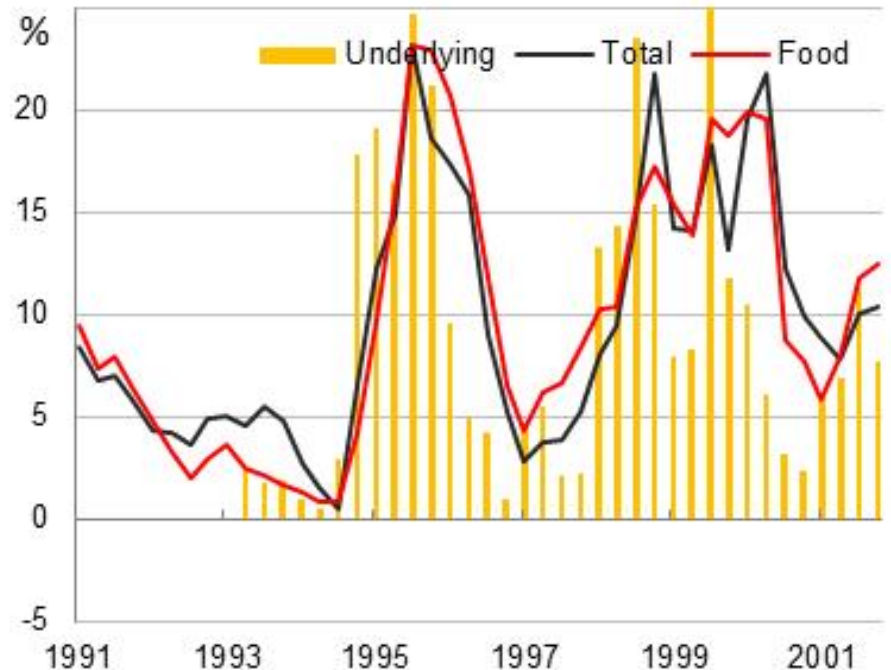
Stagnant employment

(formal employment, indexed 100 in to 1992)



....and fast-rising prices

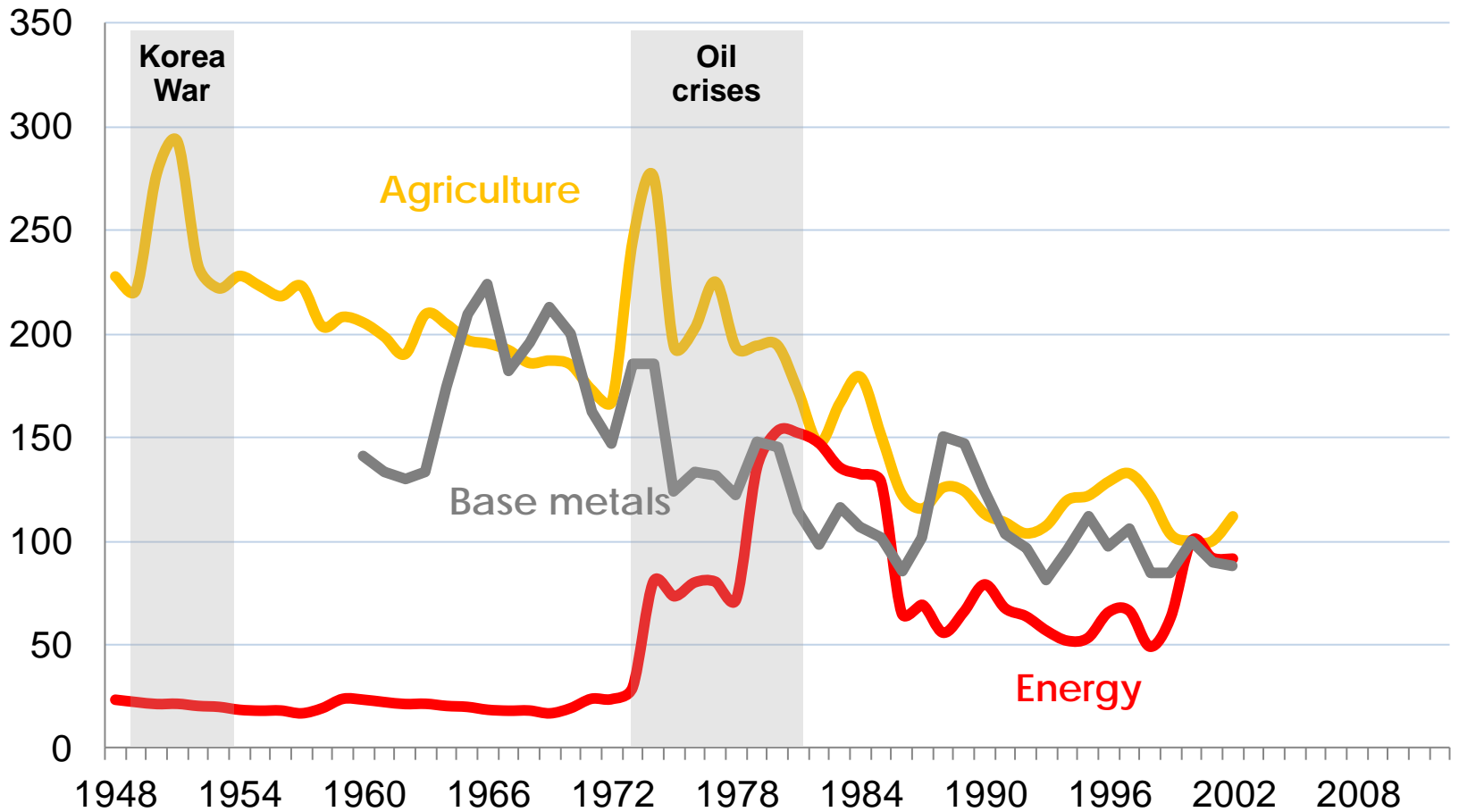
(year-on-year growth)



PNG's transformational decade

Where we were 10 years ago...

...after all, in 2002, commodity-reliant economies were doomed to incomes falling forever

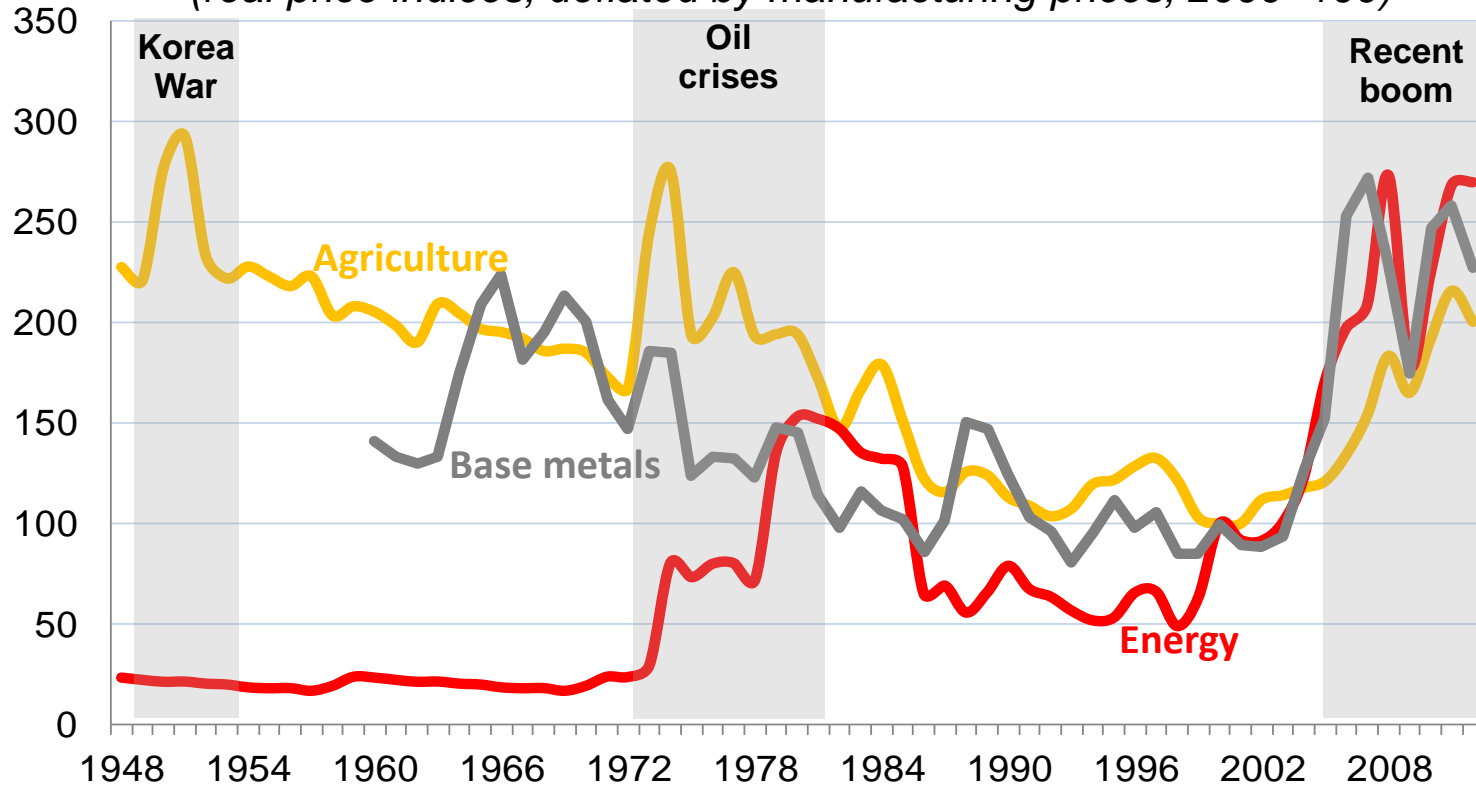


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Sources: World Bank DEC



(real price indices, deflated by manufacturing prices, 2000=100)



Source: World Bank DECPG



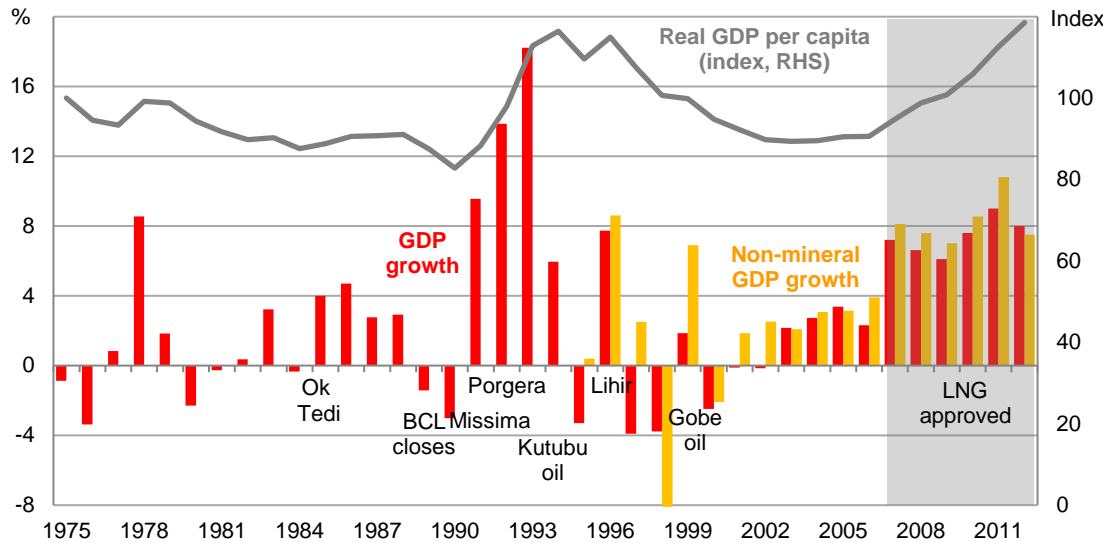
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Sources:, World Bank DEC

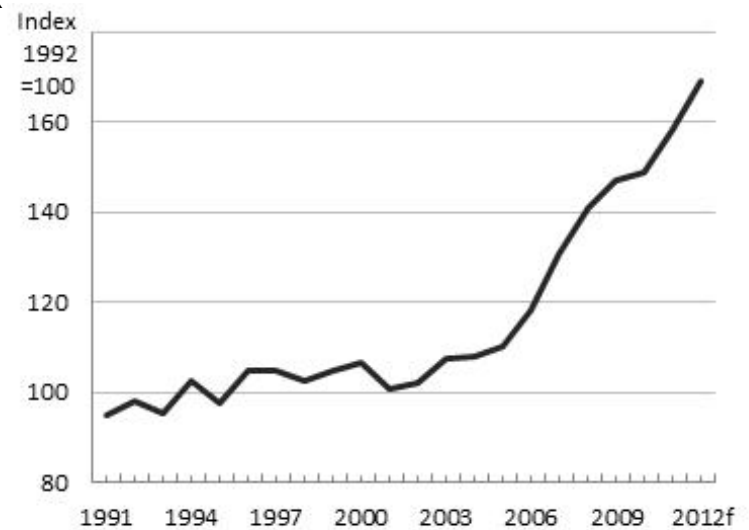
PNG's transformational decade

...and the rest is history...stronger and 'better quality' growth

Stronger and less volatile output growth ...driven by the non-resource sectors



...driving a surge in formal employment opportunities

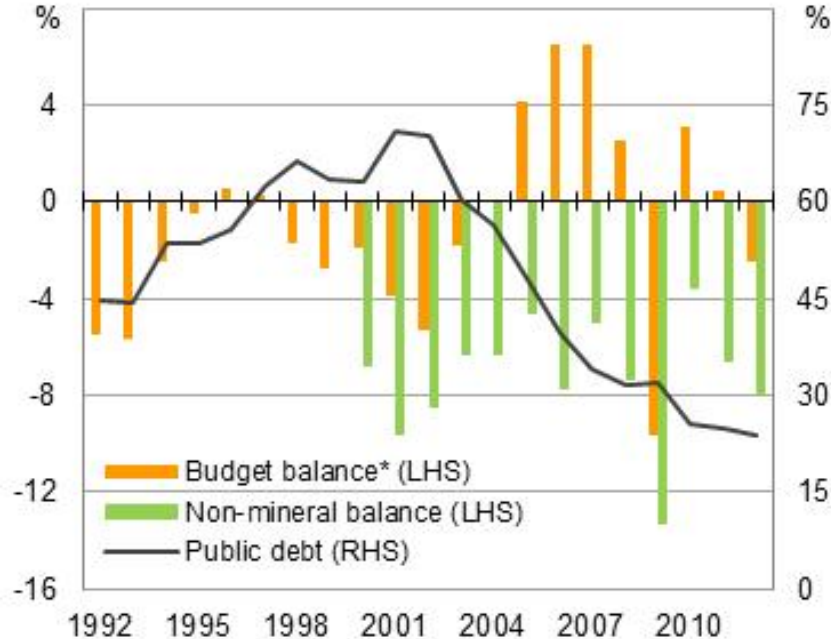


PNG's transformational decade

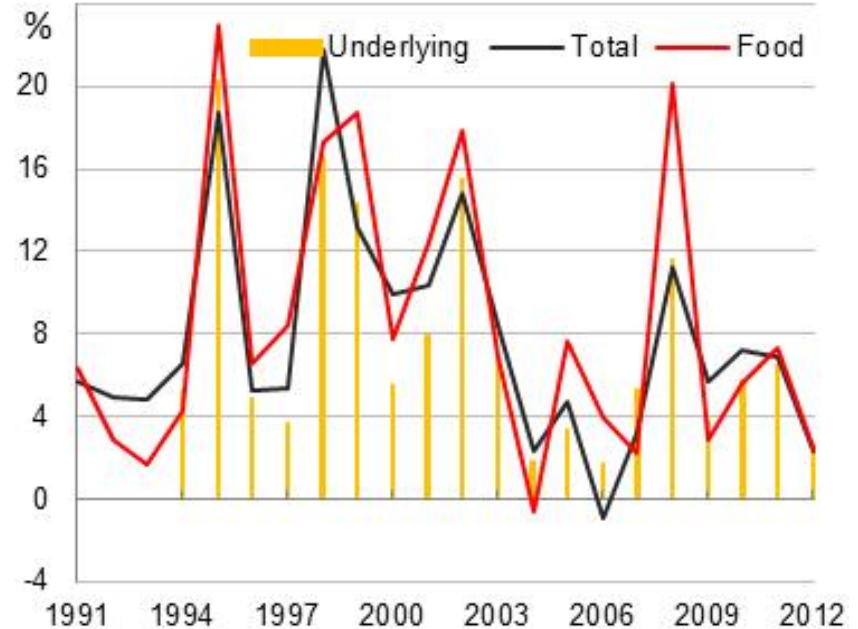
...and far healthier government finances

Improved public finances

(budget balance and public debt, percent of GDP *not including* contingent and off-balance-sheet liabilities, currently near 20% of GDP)



...and slower price growth (year-on-year inflation)

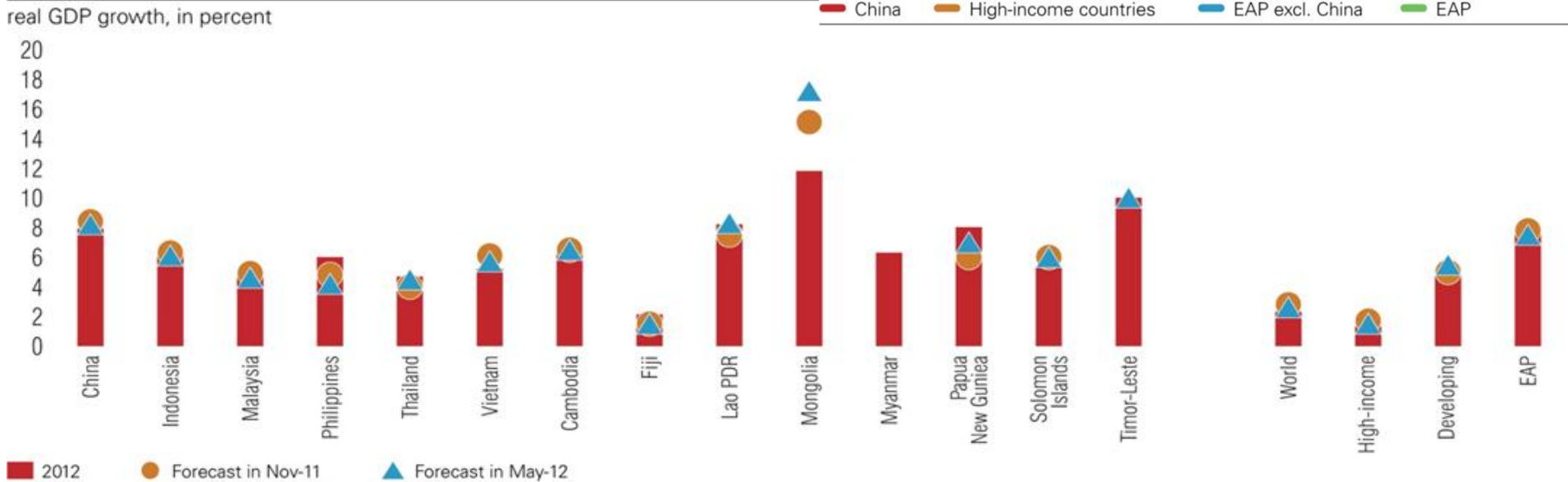
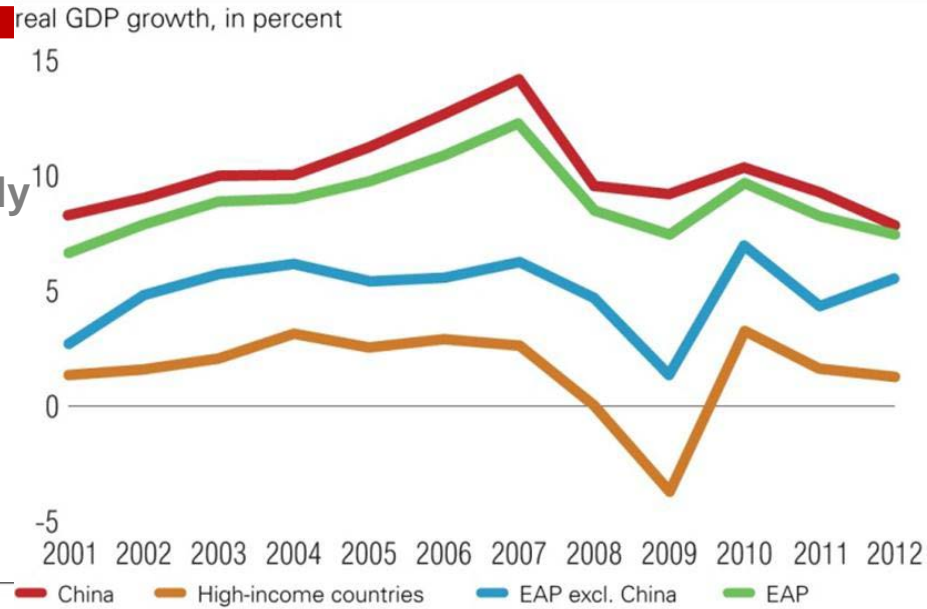




The last days of this boom

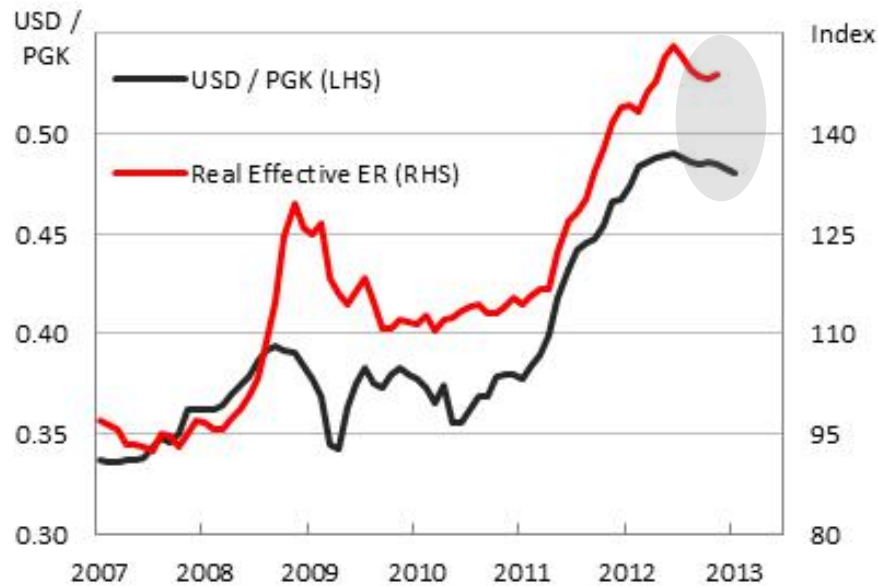
Growth in the region slowed in 2012 – although by less than expected

- ▶ **Growth has slowed globally**
 - ▶ But our region remains relatively resilient
 - ▶ And the slowdown was less-than expected

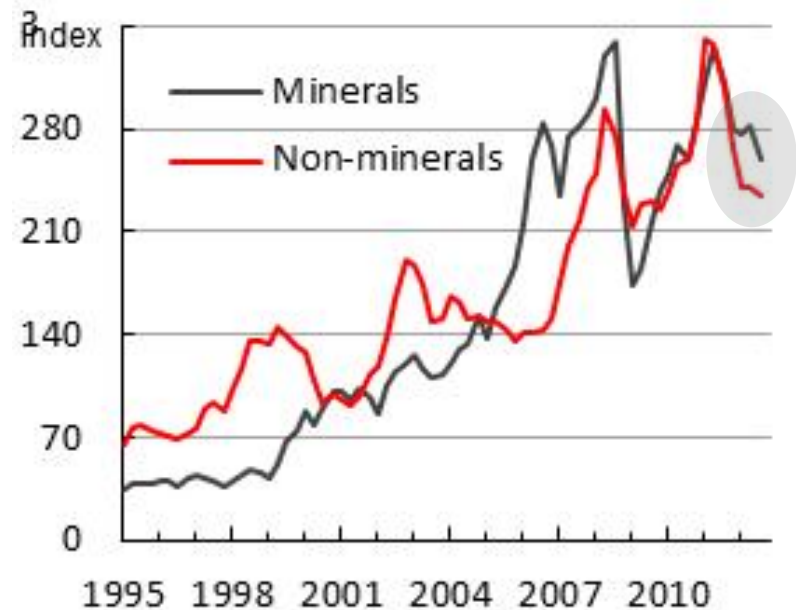


Source: World Bank.

The strength of the Kina (PGK per USD and real effective exchange rate)



...and weaker international commodity prices (PNG's export prices, in PGK terms)



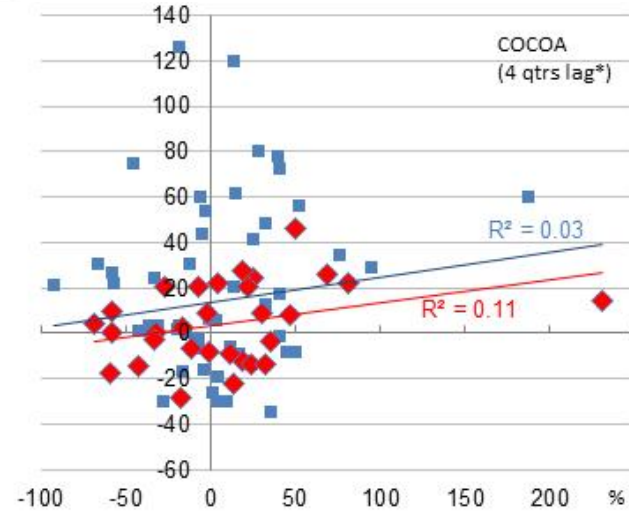
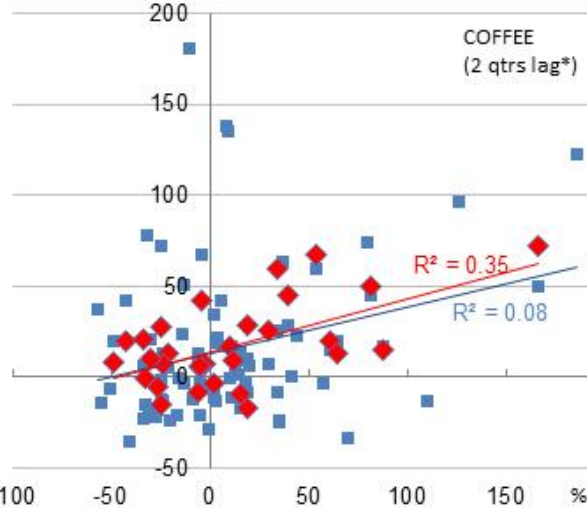
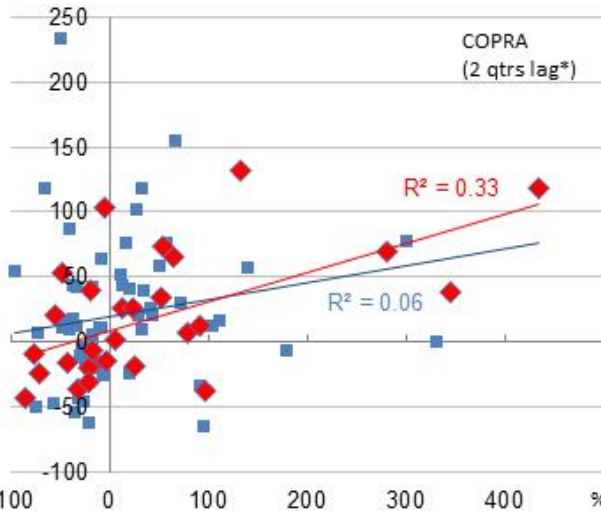
► ...are **dragging incomes** and spending power...



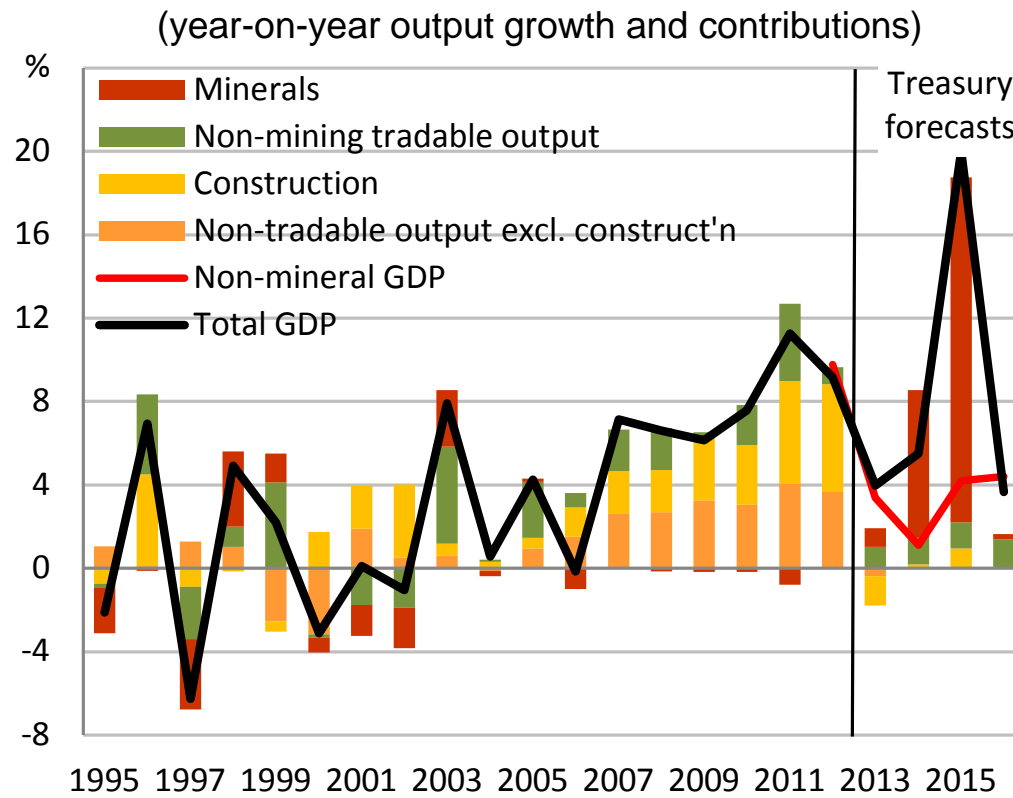
- ▶ The incomes of cash crop farmers are particularly sensitive to movements in prices, as farmers cut production when prices fall

- ▶ Especially copra and coffee farmers, and especially more recently

(year-on-year change in prices and sales)



- ▶ Together, these factors suggest markedly slower growth over the coming years
 - ▶ especially excluding the impact of PNG-LNG on the headline GDP statistics



percent change form a year earlier

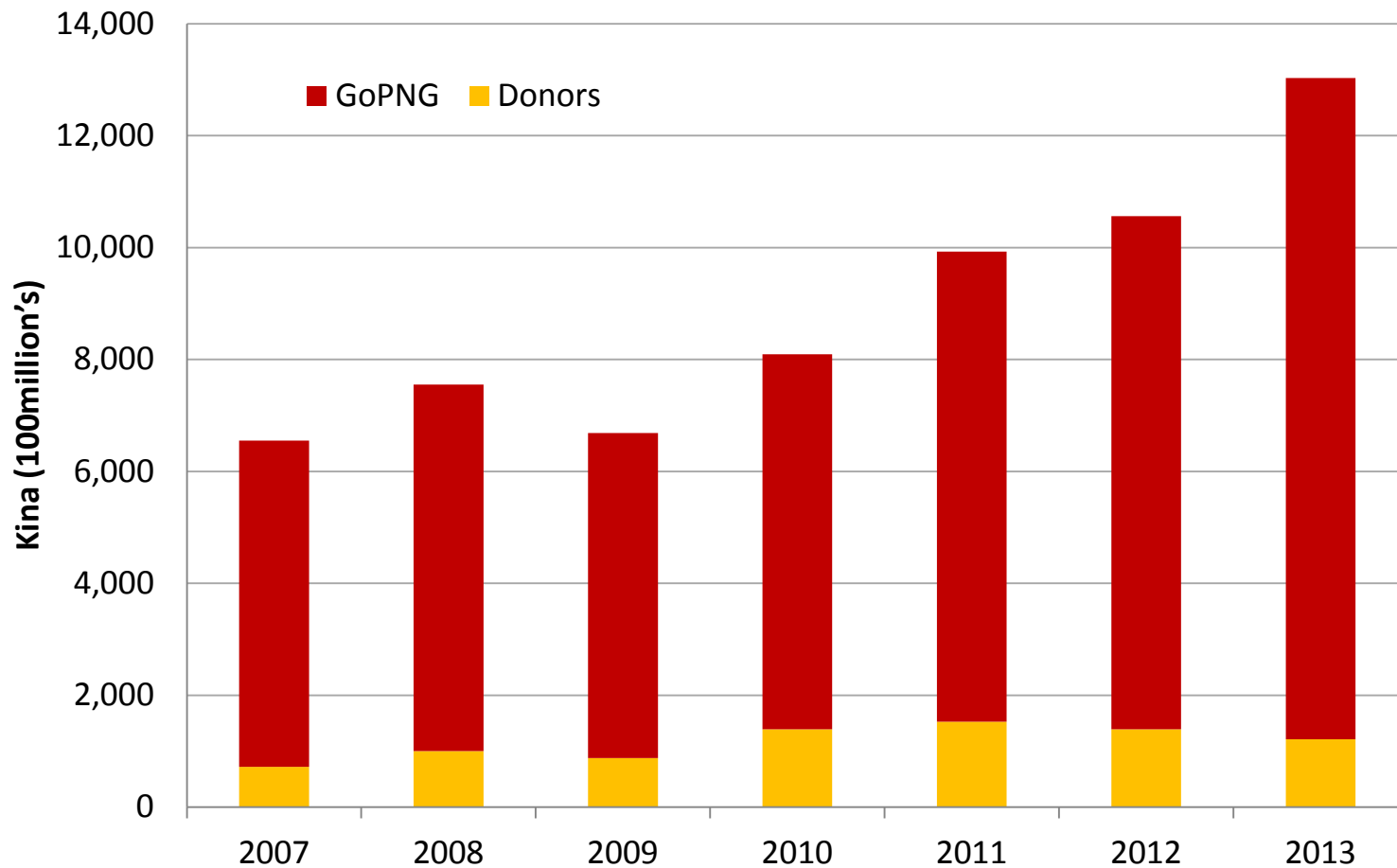
	2010	2011	Forecast			Changes from May-12 (in percentage points)	
			2012	2013	2014	2012	2013
East Asia	9.3	7.1	5.8	6.6	6.6	-0.5	-0.4
Developing East Asia	9.7	8.3	7.5	7.9	7.6	-0.1	-0.1
China	10.4	9.3	7.9	8.4	8.0	-0.3	-0.2
Indonesia	6.2	6.5	6.1	6.3	6.6	0.0	-0.1
Malaysia	7.2	5.1	5.1	5.0	5.1	0.5	-0.1
Philippines	7.6	3.9	6.0	6.2	6.4	1.8	1.2
Thailand	7.8	0.1	4.7	5.0	4.5	0.2	0.0
Vietnam	6.8	5.9	5.2	5.5	5.7	-0.5	-0.8
Cambodia	6.0	7.1	6.6	6.7	7.0	0.0	0.0
Fiji	0.1	1.9	2.1	2.2	2.3	0.6	0.5
Lao PDR	8.5	8.0	8.2	7.5	7.5	-0.1	0.0
Mongolia	6.4	17.5	11.8	16.2	12.2	-5.4	4.4
Myanmar	5.3	5.5	6.3	6.5	6.6
Papua New Guinea	7.6	9.0	8.0	4.0	7.5	1.0	-1.0
Solomon Islands	7.8	10.5	5.3	4.0	3.3	-0.7	0.0
Timor-Leste	9.5	10.6	10.0	10.0	10.0	0.0	0.0
Developing East Asia excl. China	7.0	4.4	5.6	5.7	5.8	0.4	0.1
<i>Assumptions about the external environment:</i>							
World	4.3	2.7	2.3	2.4	3.1	-0.3	-0.6
High-income countries	3.3	1.6	1.3	1.3	2.0	-0.2	-0.6
Developing countries	7.5	5.9	5.1	5.5	5.8	-0.4	-0.2

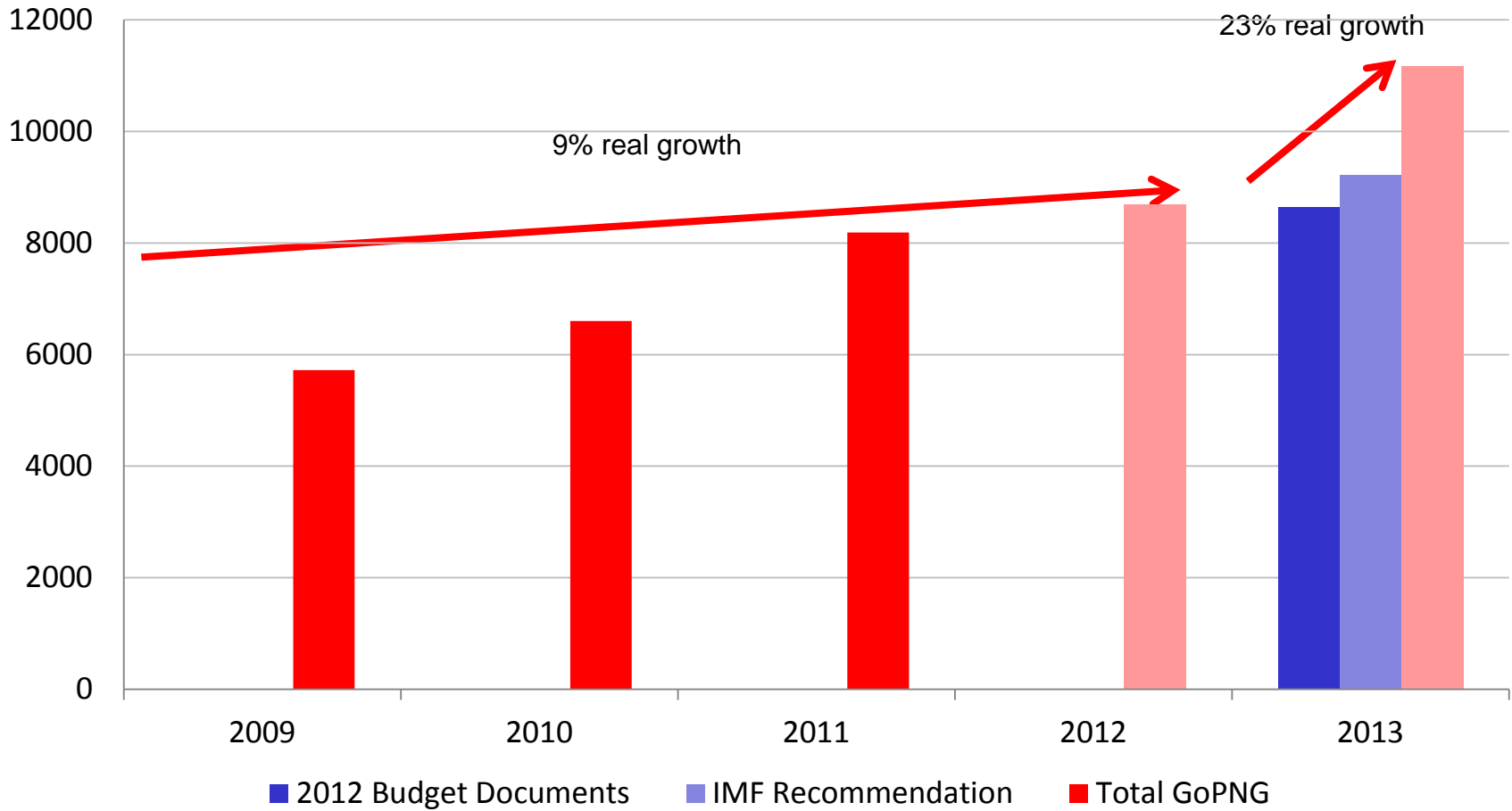
Source: World Bank data and staff estimates.



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Broadening and extending the boom





► Domestic Financing Requirement

Needs: Deficit 7.2% of GDP (K2,548.9) – net external borrowings (K475.9) + Investing Financing for LNG (K305) = 6.7% of GDP (K2,378)

Availability: Financial Depository Corporations Liquid Assets* + Currency and Deposits with the Central Banks = K8,203

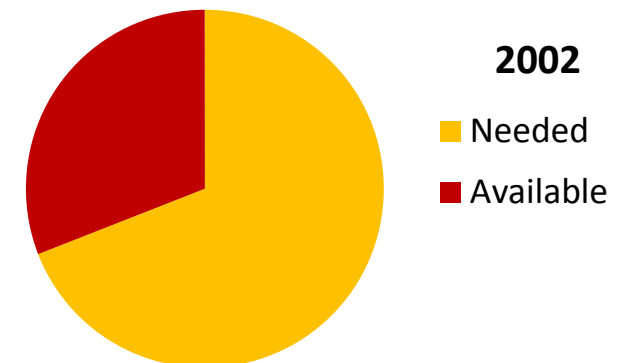
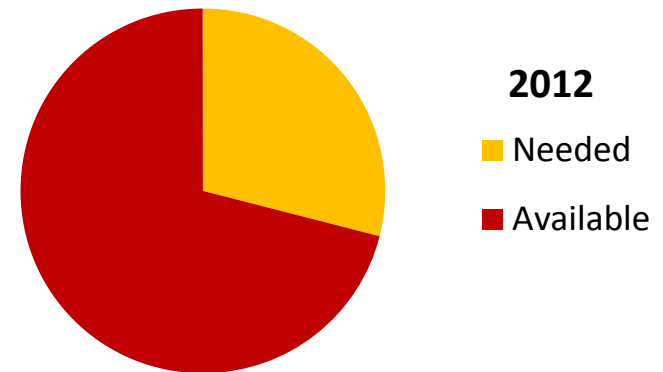
Note: Bank Loans to the Private Sector K7,896
External Reserves = 15.6 months on non-mining import cover

Public sector debt (2012) 26% of GDP

By comparison, in 2002:

Needs: Deficit 3.7% of GDP,
domestic market borrowing K265.1
Available: Liquid Assets of K384 million

Note: Bank Loans to the private sector K1380
External reserves = 6.2 months non-mining import cover
Public sector debt = 69% of GDP



Government spending to broaden and extend the boom

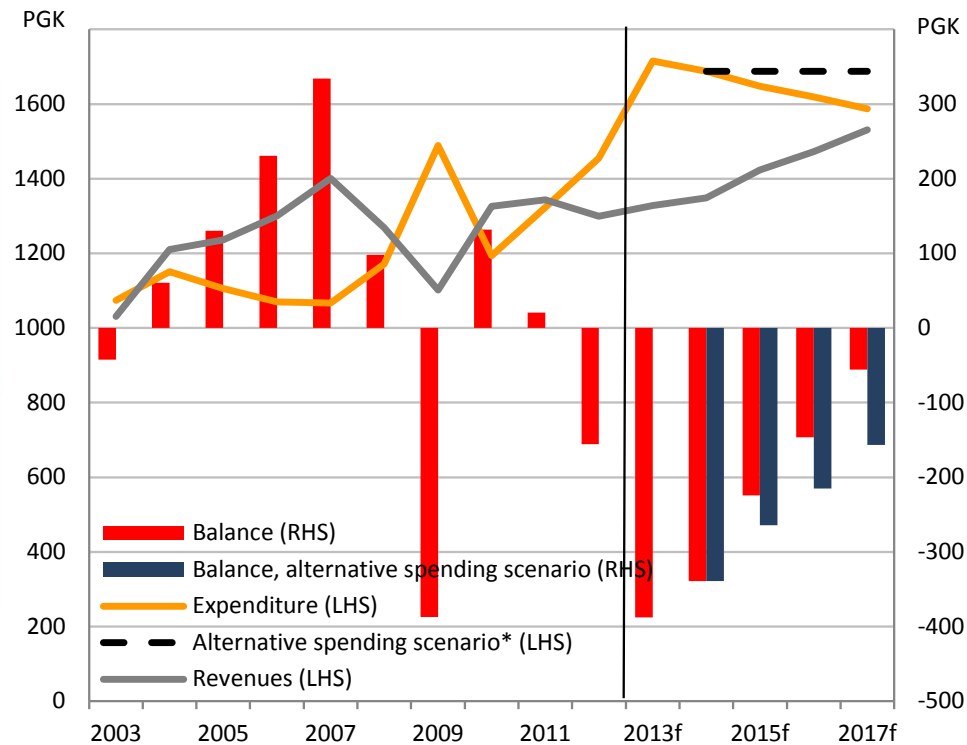
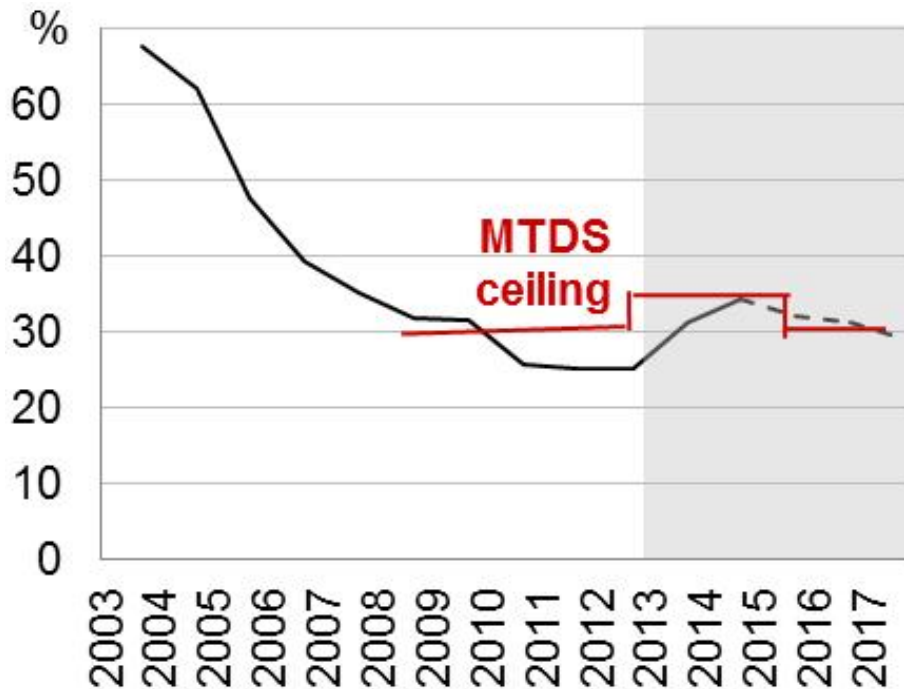
...and can generate macroeconomic pressures if no return to sustainable budgets

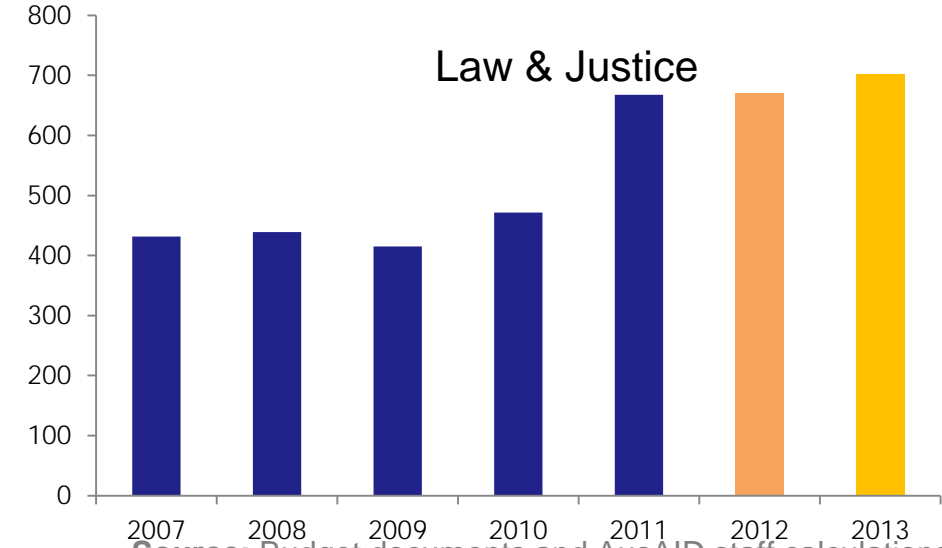
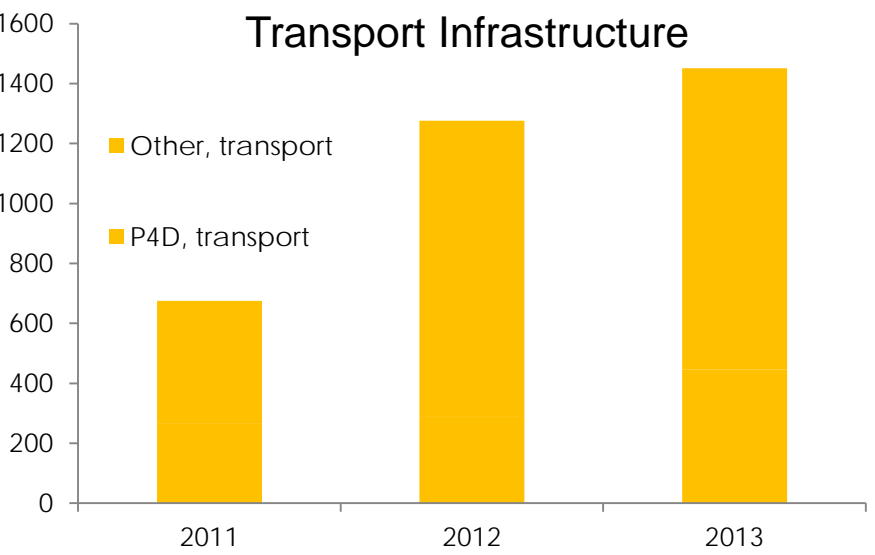
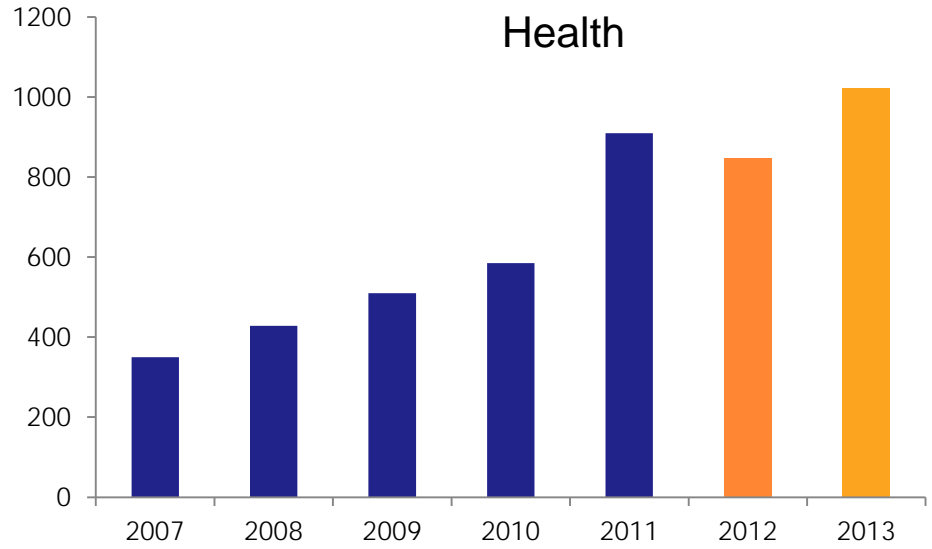
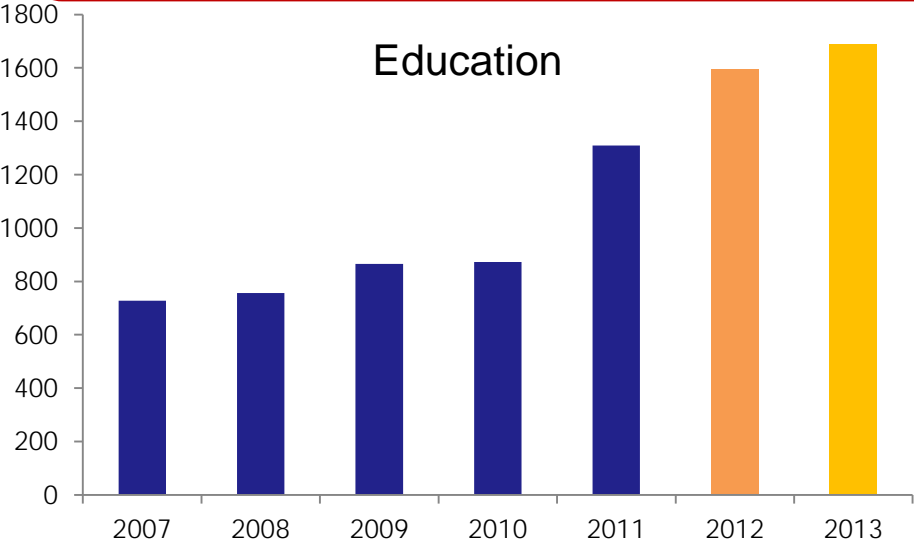
Focus in PNG generally been on quality of spending. But 2013 Budget starts to reverse improvements in public finances

...and balanced budget by 2017 requires unwinding new spending in real per capita terms, which may be difficult,

...so macroeconomic risks returning to the horizon

(public debt and its drivers, percent of GDP not including contingent and off-balance-sheet liabilities, currently approx 15-20% of GDP)





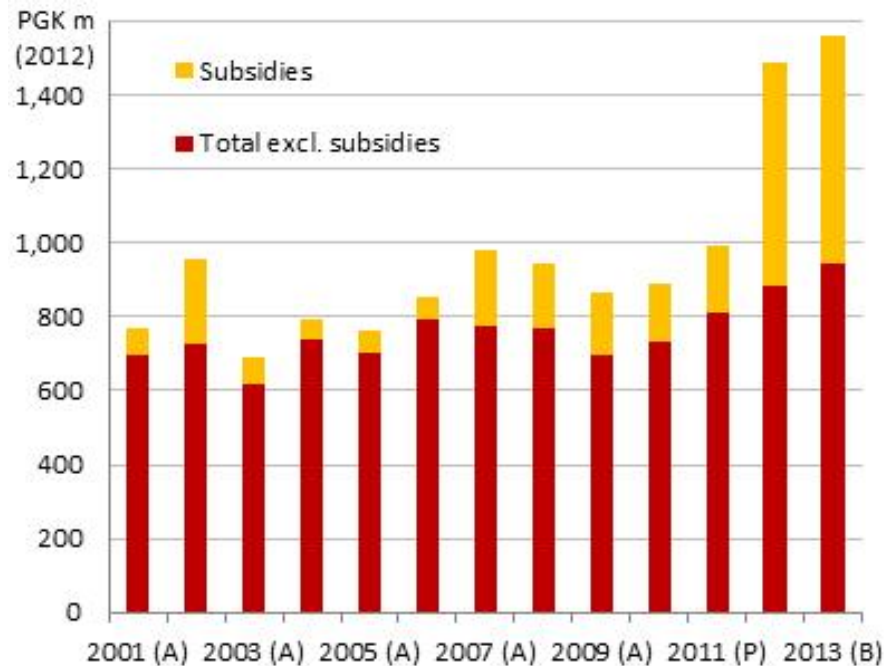
Source: Budget documents and AusAID staff calculations

Features of the 2013 budget

1. Most of the additional funding for education is a transfer to households

- ▶ **The tuition fee subsidy appears to be an effective means to support households**
 - ▶ Particularly valuable for the poorest and with least access to cash
 - ▶ ~20% of HIES respondents cited lack of funds for fees as the reason for dropping out of school
 - ▶ But funding for education is not keeping up with rising enrollments

(actual and budgeted allocation to the Education Department and Provincial governments, and Treasury 207, 2012 Kina m)



Features of the 2013 budget

...but this places even more pressure on the quality of education

- ▶ As the tuition fee subsidy induces higher enrollment, and student numbers grow, pressure will grow on the quality of education
- ▶ Some action in the 2013 budget – eg, funds 3100 new teachers and restores funding to examinations

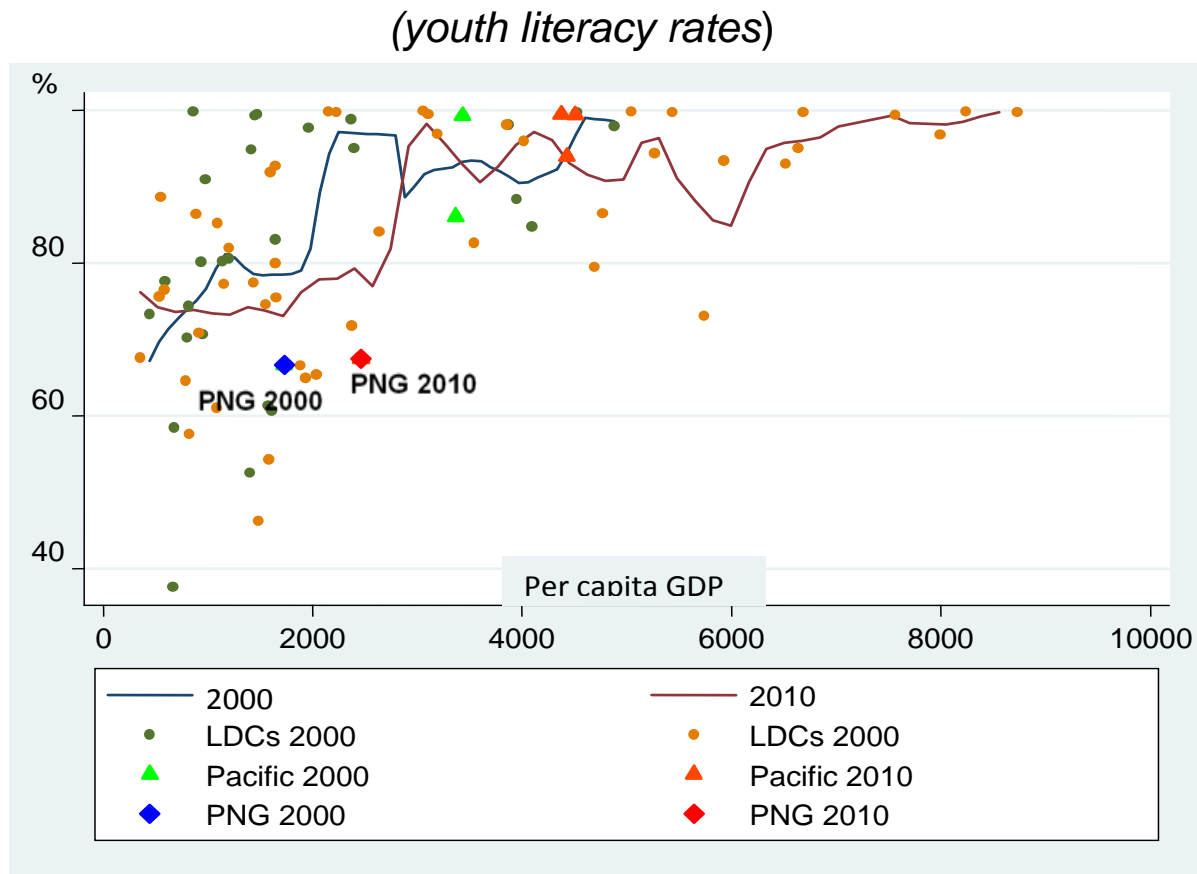
	National	Rural	Urban	Metro	Southern	Highlands	Momase	Islands
Completed studies	17.8	14.7	31.4	37.0	15.4	13.9	11.7	25.6
Too old	0.4	0.5	0.4	0.3	0.6	0.6	0.2	0.4
No school fees	20.0	21.3	14.3	13.2	19.6	22.4	25.0	12.2
No interest	11.6	12.4	7.9	7.7	9.0	13.3	11.0	14.4
Family did not allow	3.3	3.4	2.8	2.7	4.2	3.4	3.2	2.7
Did not pass exam	23.3	23.8	21.0	19.3	30.4	23.0	20.8	22.0
School too far	2.1	2.4	0.7	0.6	2.0	2.1	2.9	1.8
School not functional	1.3	1.5	0.4	0.5	1.8	2.1	1.0	0.5
Work	6.6	5.5	11.5	10.8	5.1	3.9	6.3	11.3
Disability	0.2	0.1	0.2	0.3	0.0	0.2	0.0	0.4
Displaced	0.4	0.4	0.6	0.6	0.6	0.4	0.3	0.3
Safety, harassment	1.6	1.8	0.8	0.4	0.3	4.1	0.6	0.9
Others	11.4	12.2	7.9	6.7	11.0	10.7	16.9	7.5



Features of the 2013 budget

...but this places even more pressure on the quality of education

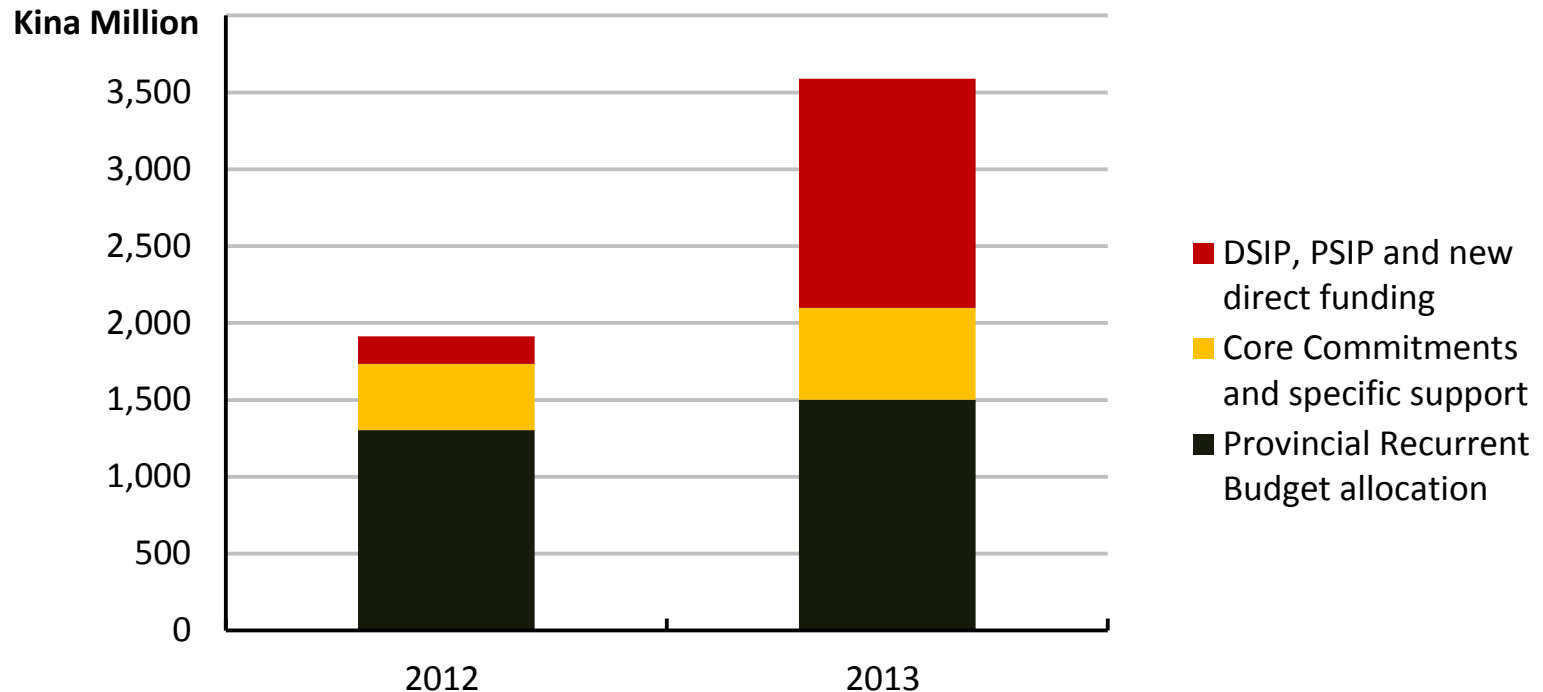
- ▶ And PNG's educational outcomes are well short of comparator countries



Features of the 2013 budget

2. Surge of cash to the most devolved levels of government

- ▶ **87% increase in transfers to local and district governments, to K 1.5 billion**
 - ▶ Transferring capital project spending from national authorities to local agencies
 - ▶ Equal allocation to each district

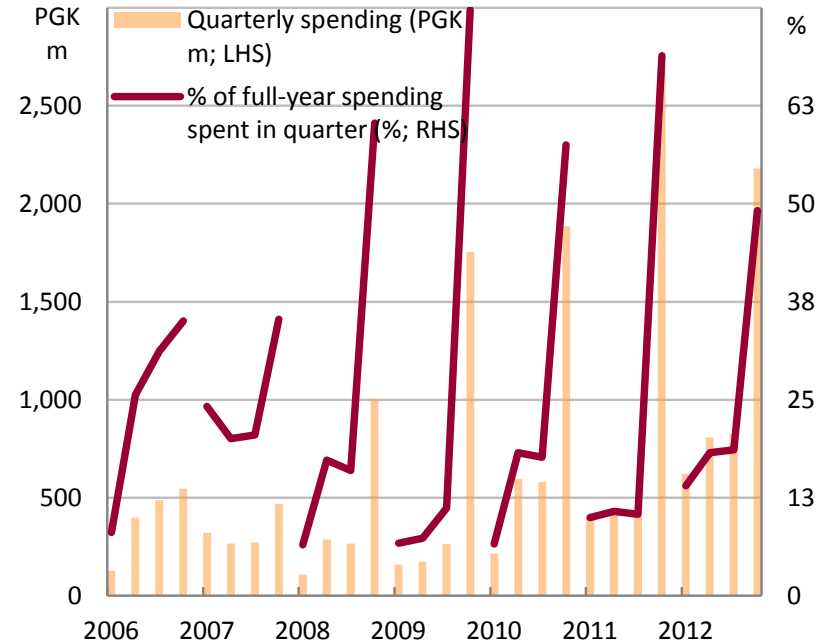
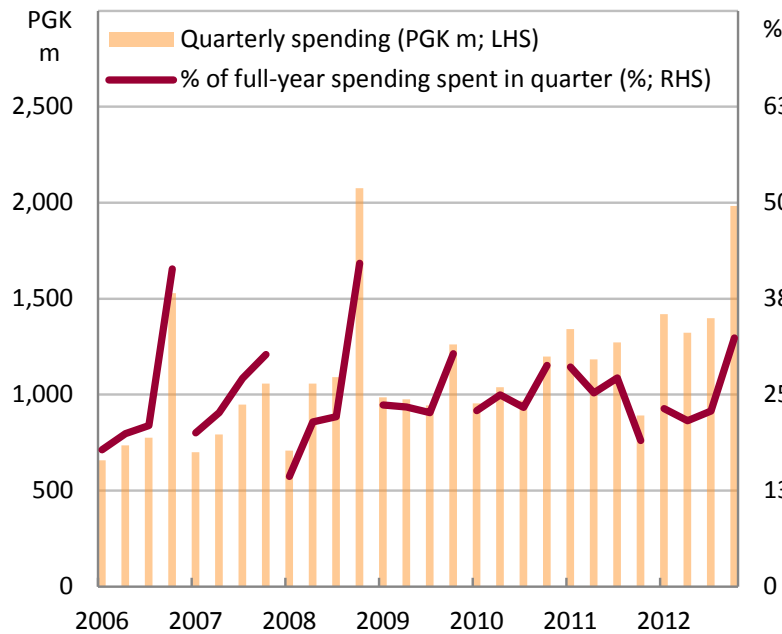


Features of the 2013 budget

...addressing weaknesses in the current system?

► Current spending mechanisms clearly have weaknesses

Spending the budget over the course of the year:
Recurrent Development



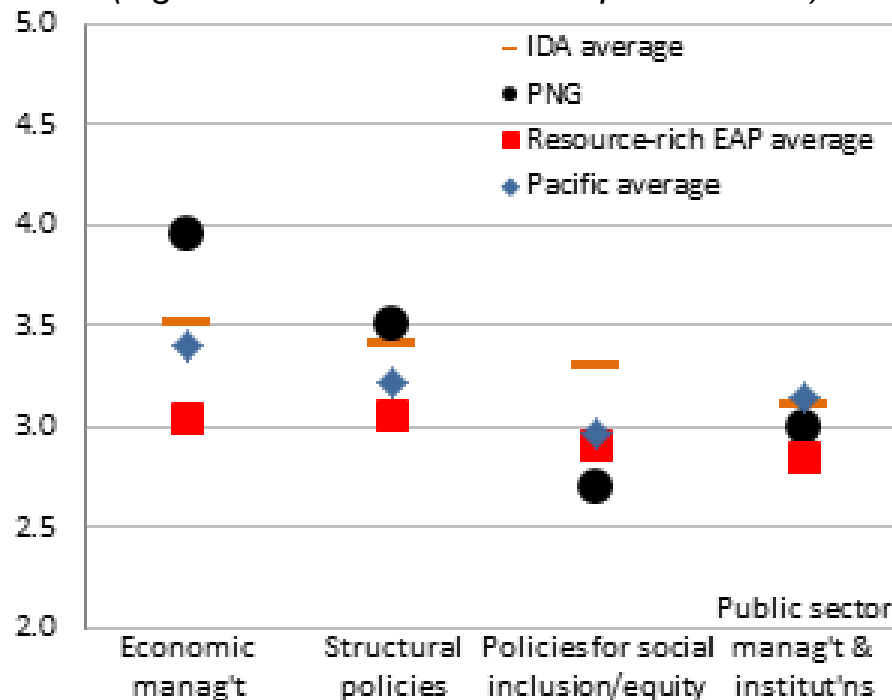
Features of the 2013 budget

...addressing weaknesses in the current system?

- ▶ But little evidence that more devolved implementation works better, on average

Assessment of how well a country's policies and institutions transform resources into sustainable economic development, across four dimensions

(higher scores indicate better performance)



- ▶ ...and monitoring spending is generally poorer (AG reports on Provincial Gov't)



- ▶ **Various initiatives in the 2013 Budget to start addressing these issues:**
 - ▶ Better costing of projects, including publishing **5-year forward estimates** of spending and revenues
 - ▶ **Expanding the chart of accounts** (by which spending is classified) through Provincial to District authorities
 - ▶ Shift to funding well-formed national, provincial and district **plans** rather than public investment plans (PIP).
 - ▶ New **guidelines for the use of DSIP funds**
 - ▶ **Integrate the development and recurrent budgets** into a single national budget from 2014
 - ▶ Invest in **rolling out the new Integrated Financial Information System** across national departments and to subnational governments
 - ▶ **Increase transparency** around spending through decentralizing the responsibility of spending.
 - ▶ Develop subordinate legislation, policies and processes around the PNG Sovereign Wealth Fund (**PNG SWF**).



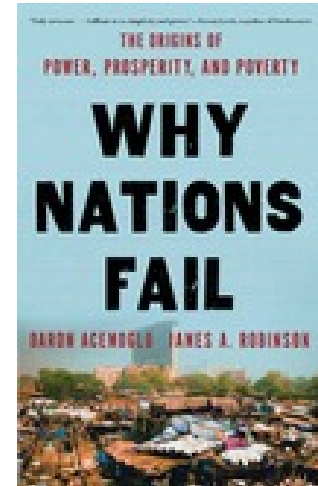
The deeper challenges of resource-heavy growth

The deeper challenges of resource-heavy growth

Why deliver quality services when incentives are weak?

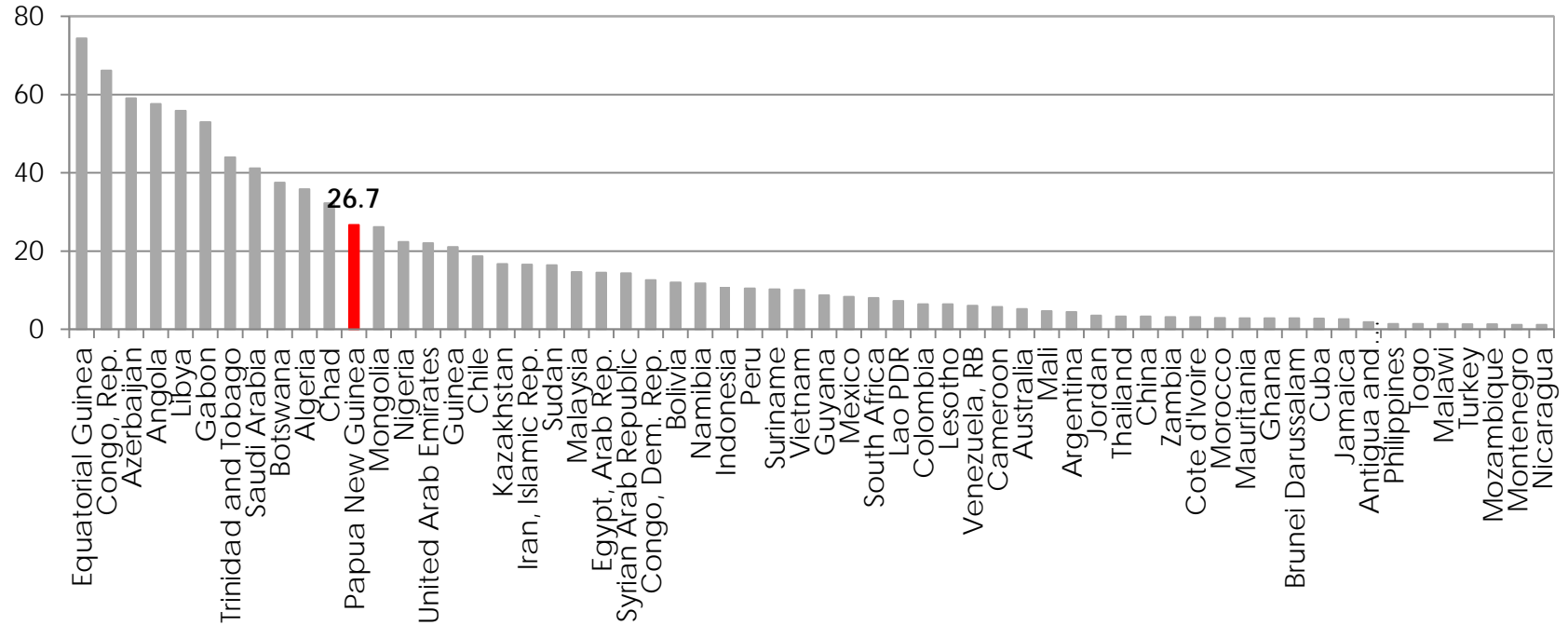
The thesis of *Why nations fail* (Acemoglu & Robinson, 2012):

- ▶ This is a primer of the **risks** with concentrated, extractive-sector driven growth (**NOT** where PNG is today...)
- ▶ Economies **dominated by a few extractive** economic sectors tend to have **more extractive political institutions**
- ▶ These rarely encourage innovation to be rewarded, and growth to become sustained and broadly-based
- ▶ **The incentives** for policy makers to provide quality public services are weak
 - ▶ Few citizens pay taxes, and so weaker incentive to demand public services
 - ▶ A small elite can do better under an extractive status quo than the more inclusive alternative
- ▶ While PNG's recent boom is notable for the breath of growth across sectors, much has been linked to a few, narrow investments, or the reforms of the early 2000s
 - ▶ Risks are likely to be greater when sectors become more capital- or low-skill-labor intensive – these are less inclusive

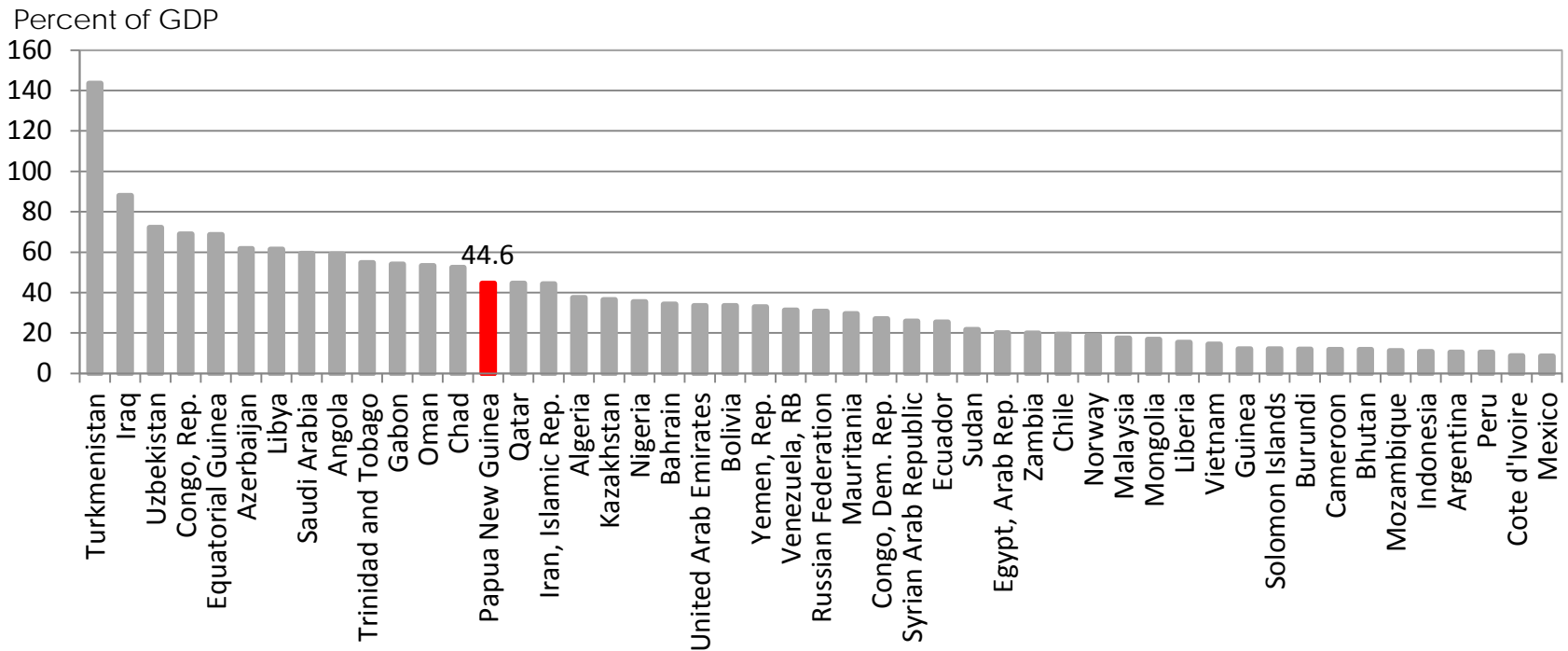


Average 2005-2009 Mining and Quarrying¹ as percentage of GDP in countries with a share higher than 1%

Percent of Total GDP

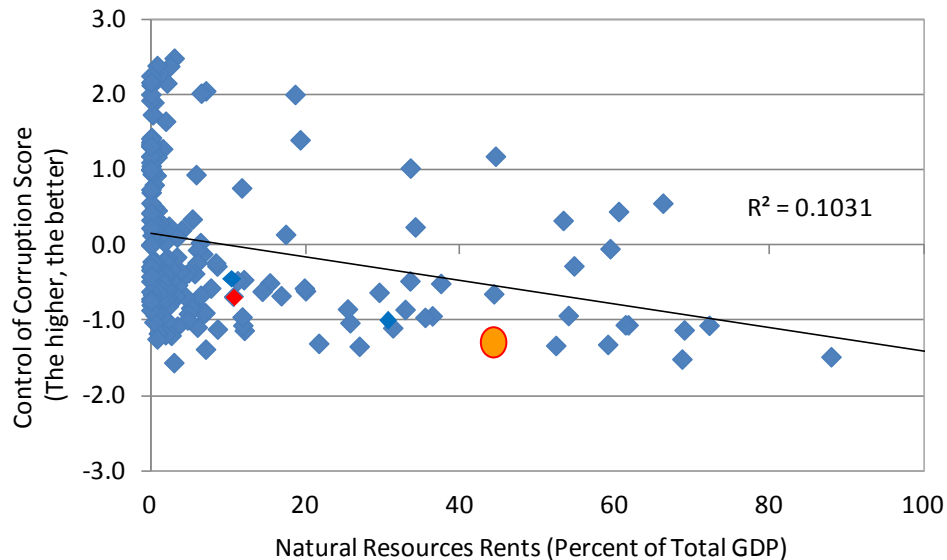


Total Natural Resources Rents Average 2005-2009

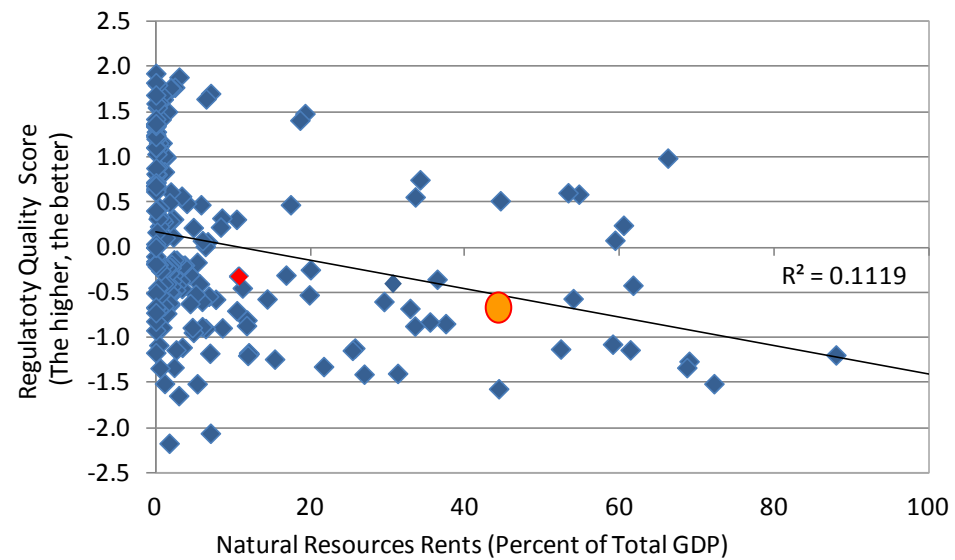


The quality of all the different dimensions of governance is negatively correlated with the importance of natural resources

Control of Corruption

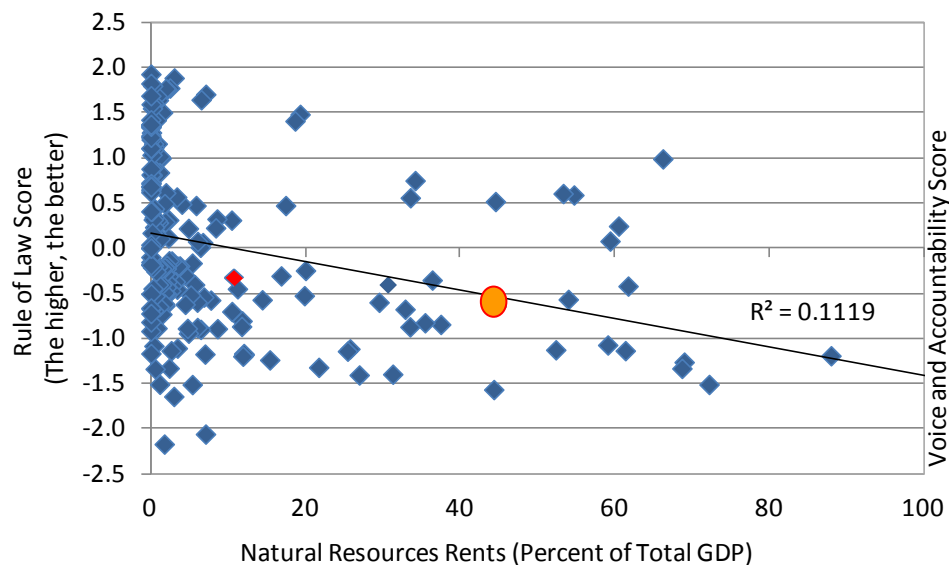


Regulatory Quality

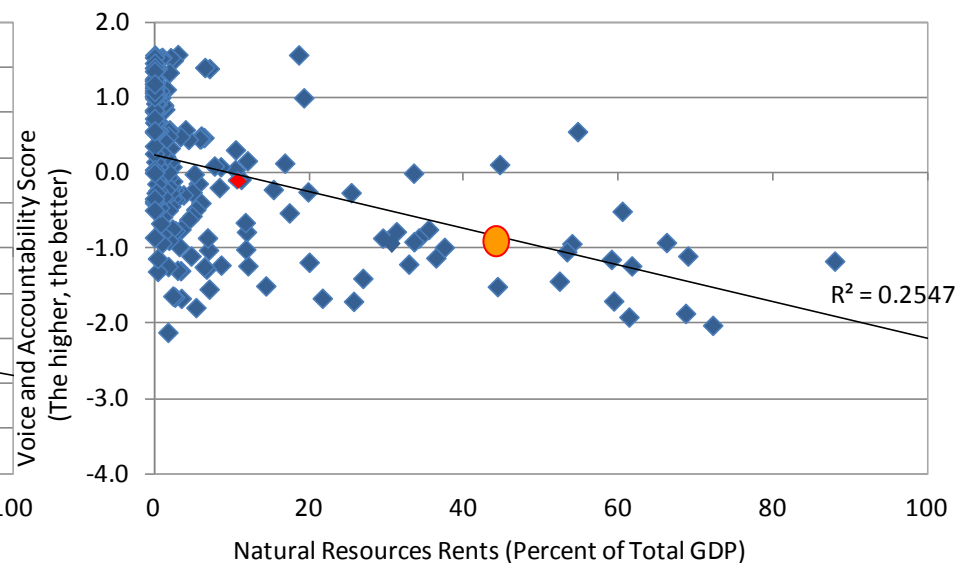


The quality of all the different dimensions of governance is negatively correlated with natural resources

Rule of Law



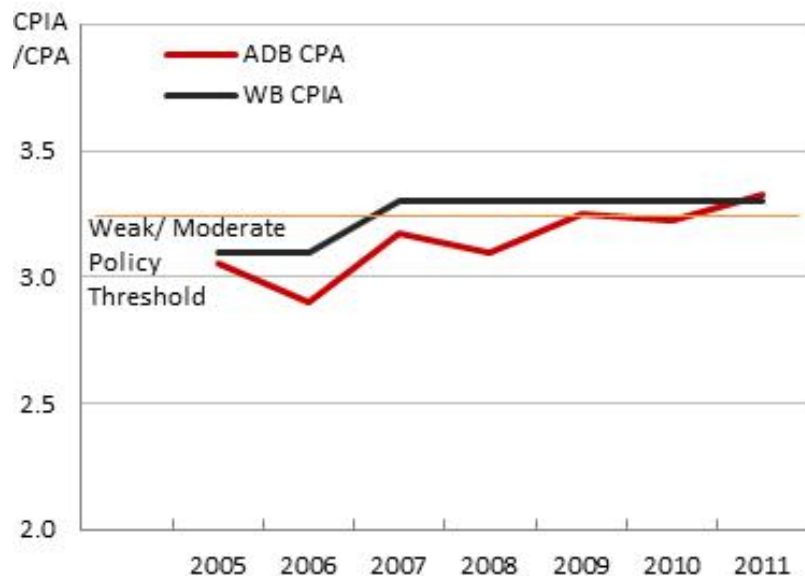
Voice and Accountability



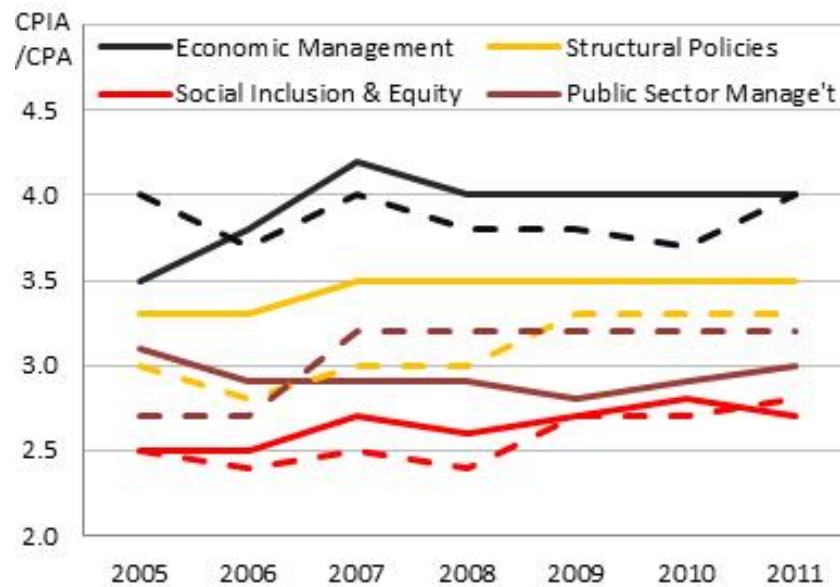
- ▶ PNG's policy and institutional strength rating improved to just above the 'weak' threshold in the mid-late 2000s, but has **since stagnated**

- ▶ Most recent gains have been in policies for 'social inclusion & equity', following earlier gains in Economic Management and in Structural Policies

(overall CPIA score)



(CPIA score across four dimensions; solid lines show WB scores; dashed lines for ADB scores)



**Turning the boom into sustained improvements in living standards
by doing things smarter**

Great scope to raise living standards by changing how things are done

Strategic regulatory reforms can be the best support for PNG businesses

While PNG ranks relatively well on a few indicators, in most areas regulation is holding PNG businesses back

(ranking of PNG, out of 185 countries)

Starting a business	Dealing with construct'n permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
91	159	23	88	83	49	106	120	166	125

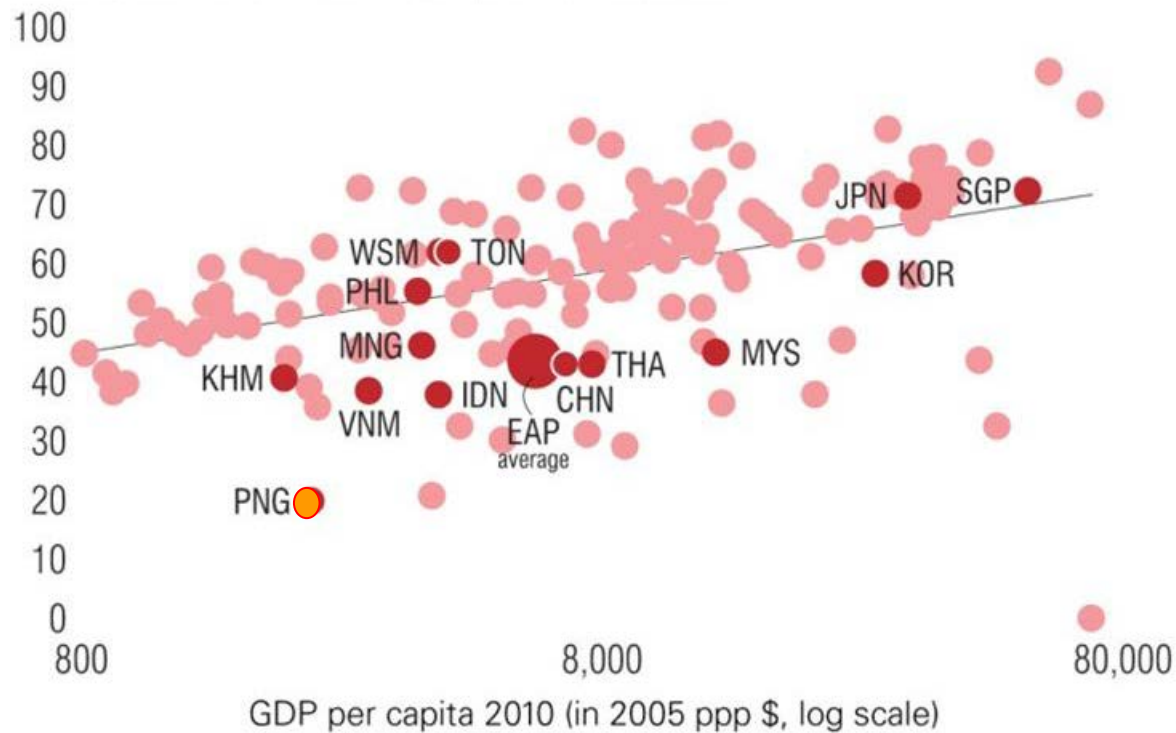
- ▶ Small and medium enterprises are the largest source of employment and incomes across the world
- ▶ Closing markets to competition and providing subsidies is not a long-term solution to encouraging locally owned businesses in PNG.
 - ▶ Rather than working to reduce competition, policy makers' efforts would more effectively bring sustained improvements in living standards by working to improve - owned businesses ability to compete.
- ▶ The kinds of reform that will reduce costs for PNG businesses and increase their competitiveness are not expensive, and they are not difficult.
 - ▶ Some key reforms are already underway
- ▶ Business-enabling reforms provide an environment that will **increase the impact of the government's wider reforms**, and help PNG-owned businesses to can make the most of the spin-off opportunities presented by large investment projects



Great scope to raise living standards by changing how things are done

Eg, services lag generally in East Asia/Pacific, but even more so in PNG

(Services as a share of GDP, and per capita income)

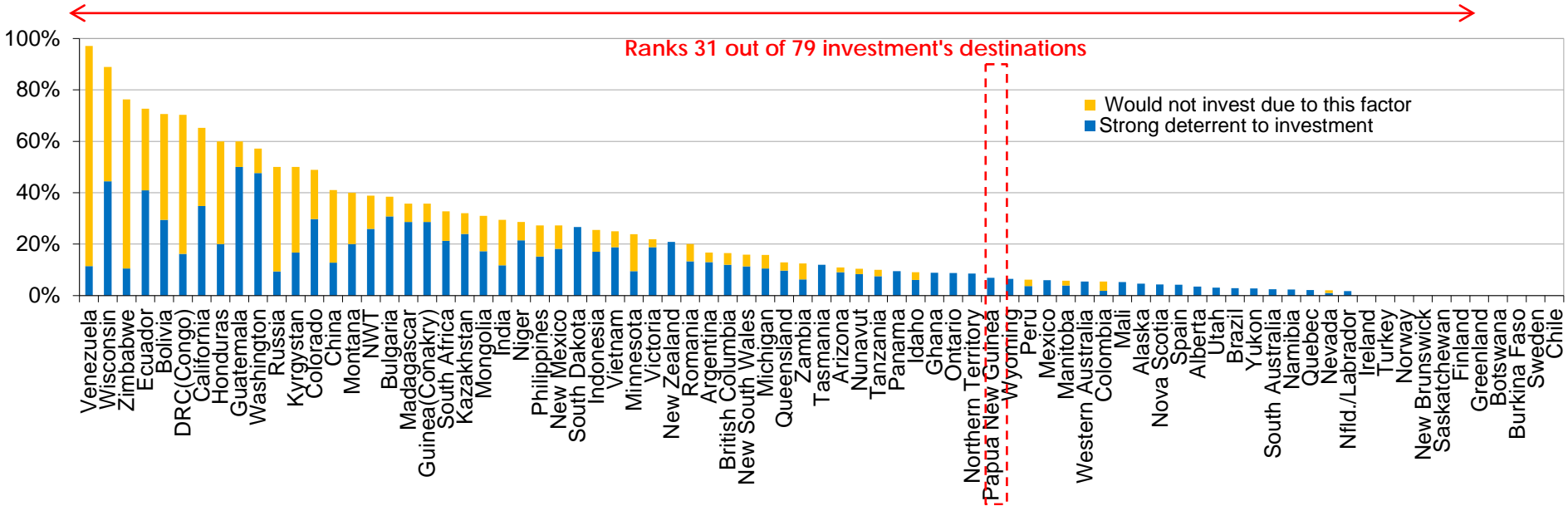


How much of a deterrent for investment is the degree of uncertainty regarding the administration, interpretation and enforcement of regulations?

(Percent of respondents)

Worst Investment Climate

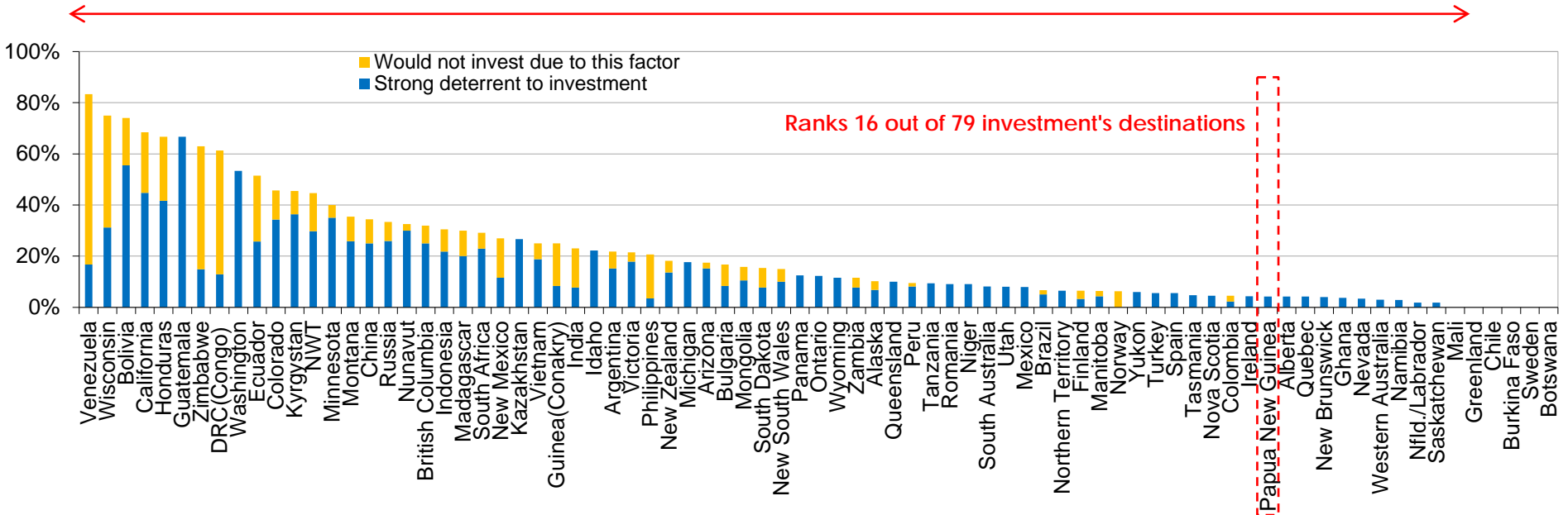
Best Investment Climate



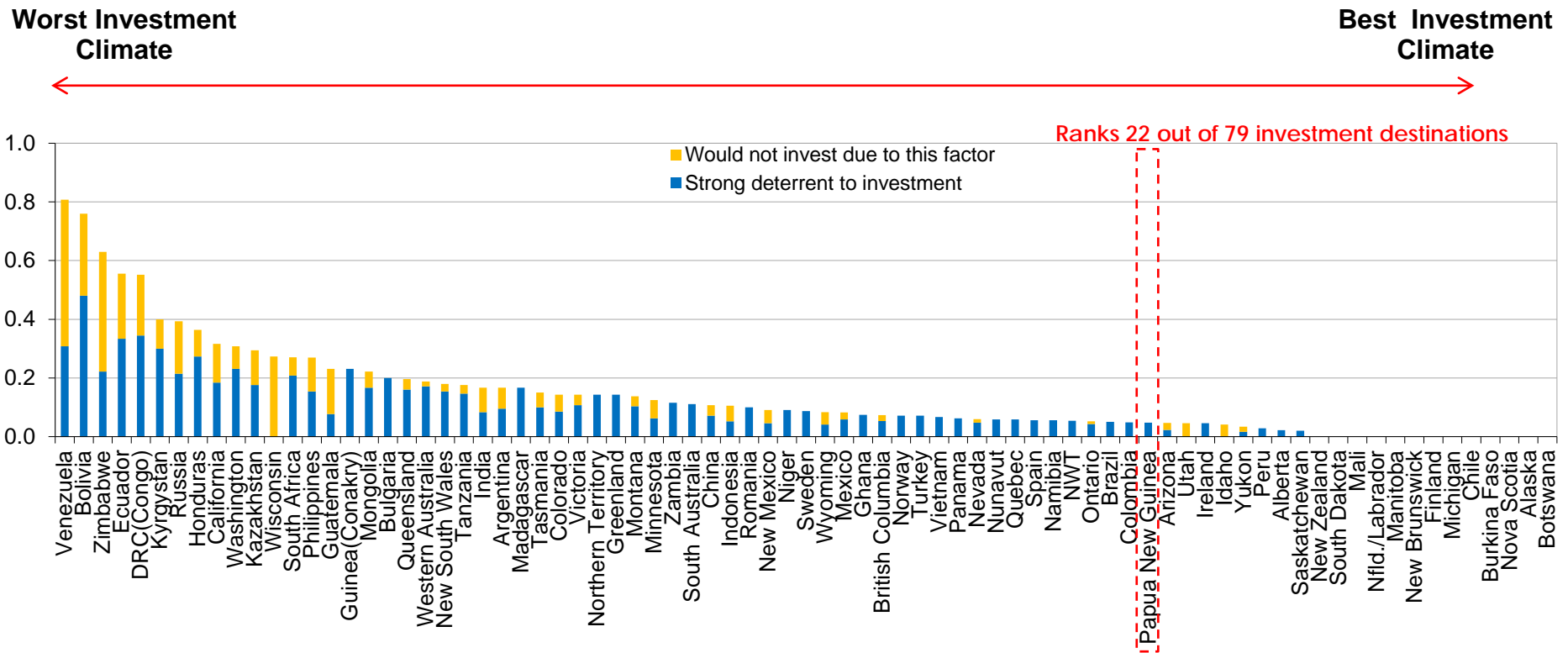
How much of a deterrent for investment is the degree of regulatory duplication and inconsistencies? (Percent of respondents)

Worst Investment Climate

Best Investment Climate



How much of a deterrent for investment is the tax regime? (Percent of respondents)



1. PNG has enjoyed a transformational decade – but the **drivers are coming to an end**
2. The government is looking to extend this boom and spread the benefits more widely
 - ▶ But the delivery mechanisms are imperfect...
 - ▶ and attention must be paid to overall **fiscal sustainability** if PNG is to avoid the experience of the 1990s
3. The resource-focused nature of PNG's growth adds to the challenges
 - ▶ Dutch disease is already evident, hurting cash crop production & rural incomes
 - ▶ ...and large resource sectors make it harder to build institutions for sustainable, inclusive growth
4. So the focus needs to be on **nurturing the drivers of the next boom:**
 - ▶ Maintaining PNG's investment climate for resource projects, while keeping balance in the fiscal regime to support long-term revenues
 - ▶ Making the **business climate more supportive** of Papua New Guinean businesses, especially those outside the resource sector
 - ▶ Can help businesses more than protecting established players & reducing competition
 - ▶ Good regulatory reforms make the government's other reforms and the economy's other opportunities more effective
 - ▶ PNG has shown it can do this in some key areas

The analytical outlook

Are we entering a sweet-spot for data analysis in PNG?

PNG has traditionally had a reputation of limited data availability → less analysis

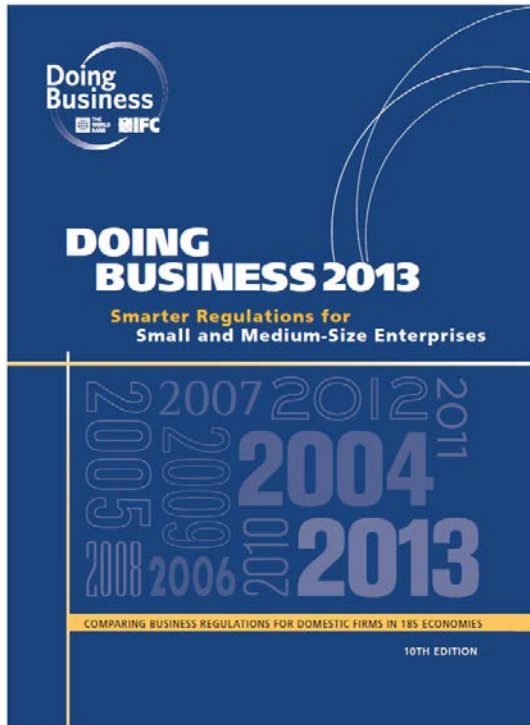
- ▶ **This may be changing, with important, rich data sets now available**
 - ▶ **2009-2010 PNG Household Income and Expenditure Survey (HIES)**
 - ▶ A rich dataset of living standards, economic activity, and social indicators of households across PNG
 - ▶ **NEFC work to better track subnational spending, costs, etc**
 - ▶ **Census data?**
 - ▶ **Various other surveys under-way or being completed**
- ▶ **Macroeconomic data remains highly problematic, although BPNG and Treasury are working to improve their surveys**
- ▶ **We should make the most of these datasets now, while the data are still (relatively) fresh, and policy makers are looking for different ways to do things**
 - ▶ **A new source of light on our priority analytical questions**
 - ▶ Informing program design
 - ▶ Providing a baseline to assess the effectiveness of our activities



Linking to the global story

Turning the last days of the boom into lasting improvements in living standards

Doing Business, 2013



www.doingbusiness.org

East Asia & Pacific Economic Update



www.worldbank.org/eapupdate

PNG Economic Briefing

Papua New Guinea Economic Briefing
From the last days of the boom, to lasting improvements in living standards



THE WORLD BANK GROUP IN PAPUA NEW GUINEA

February 2013

In 2012 PNG's economy enjoyed what is likely to be the last year of strong growth for this economic cycle. Construction of PNG-LNG and various spin-off investments, and investments in the domestic service sectors, continued to be key drivers. External conditions detracted from the economy, although they also helped to slow growth in prices. The government's 2013 budget represents a marked change from recent years, with the largest deficit on record aside from the 2009 global economic crisis, substantially more funds allocated to lower-level administrative units, and markedly slower revenue growth expected. While this budget may be affordable in the short-term, an extended series of deficits of this size risk returning PNG to the macroeconomic instability that followed its last extended economic boom, as the government has acknowledged. It expects to bring the budget back to balance by the 2017 elections through stronger revenue growth and slowing spending. By capping on the government's debt ratios, the new medium-term debt strategy anchors these targets. But there are significant risks around these projections, and around the effectiveness of spending as far more funds are allocated to less developed areas of PNG's public financial management systems. Improving this will be key to addressing PNG's significant human development needs, documented in the recently-released 2009-2010 PNG Household Income & Expenditure Survey. Over coming years, growth across the economy is likely to slow significantly, beyond the large impact on headline growth rates of first production from the PNG-LNG project. In this environment, the foundations for PNG's next boom will lie in ensuring government policies effectively and efficiently help Papua New Guinea's emerging entrepreneurs do business.

1. Economic Update: The economy continued to expand strongly through 2012, although the drivers are receding, and growth will slow through the coming years

Strong and broad economic growth continued in 2012, although the drivers of this strength started to recede

PNG's economy continued to expand strongly through the first half of 2012, albeit less quickly than in 2010 and 2011. Over 2012, the economy is likely to have grown by around 8 percent, compared with near 9 percent growth in 2011. Domestic demand remained the key driver, with pre-election spending of government funds supplementing the effects of ongoing construction of the PNG-LNG project and spin-off investments. Indeed, the strength in PNG's non-tradeable sectors (largely domestic services) has accelerated the economy ahead of its Pacific neighbors. (Figure 1, Figure 2) Since early 2012, external factors have detracted from the domestic strength. The appreciation of the Kina (PGK) in 2011 and early 2012 and weakening international commodity prices into the second half of 2012 had the effects of both reducing rural production, incomes and government receipts, while also slowing the growth in urban consumer prices.

Treasury Department estimates suggest the key drivers of growth remained construction of the PNG-LNG project and activity across other domestic services...

Construction of PNG-LNG and of the various spin-off investments remained the key drivers of PNG's economic growth into the second half of 2012. While the official national accounts published by the PNG National Statistics Office have not been updated since 2006, the Treasury Department estimates that construction activity grew by almost one-quarter in 2012, to be double the level recorded as recently as 2009. Growth in wholesale & retail trade, and transport & communications activity in 2012 was only a little less rapid than construction, following several years of very strong growth. All these sectors have seen benefits from the one-off surge in demand associated with the PNG-LNG project, which will end as construction winds down in 2013 and 2014. But there also appears to be a positive effect: from this demand that is boosting Papua New Guinea firms' physical and organizational capacity, and some of this boost in capacity will be beneficial for sustaining activity beyond the PNG-LNG project.

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Papua New Guinea Economic & Budget Briefing

The challenge of turning the last days of the boom into lasting improvements in living standards

Tim Bulman

Country Economist

The World Bank in Papua New Guinea

February 25, 2013

Economics Society of PNG, Port Moresby

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