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Statement by the Hon. **ROY YAKI**,
Governor of the Bank and the Fund for the **PAPUA NEW GUINEA**,
at the Joint Annual Discussion

ADDRESS TO THE BOARD OF GOVERNORS

ROY YAKI

MINISTER FOR FINANCE

PAPUA NEW GUINEA

FIFTY-SECOND ANNUAL MEETING

HONG KONG, CHINA

September 23, 1997

**ADDRESS BY ROY YAKI
MINISTER FOR FINANCE, PAPUA NEW GUINEA
TO
THE BOARD OF GOVERNORS OF THE FUND
AND THE BANK**

Introduction

Mr. Chairman, governors, ladies and gentlemen, it is a privilege for me to address the 52nd Annual Meeting of the Board of Governors of the World Bank and IMF. On the behalf of the Government of Papua New Guinea, I would like to extend our appreciation for the gracious and warm hospitality displayed by our hosts, the Special Administrative Region Government of Hong Kong, China.

I would also like to applaud the outstanding leadership of Mr Wolfenshohn over the last year. The progress made in implementing the debt initiative for highly indebted poor countries, enhancing collaboration with the Fund on strengthening financial systems and creating the "Knowledge Bank" are testament of his skilled guidance. I also extend the same to Mr Camdessus for his leadership in steering the IMF to where it is now.

The success of any reform program is determined by the political will to implement it. Prior to outlining our economic reform program I would like to comment on the state of political affairs in Papua New Guinea.

Political Situation in Papua New Guinea

Mr Chairman, Papua New Guinea celebrated its 22nd independence anniversary last week and as a mark of our growing maturity our sixth general elections were conducted in July this year democratically and trouble-free. While the immediate period leading to the elections were marred by civil unrest relating to the Sandline affair this has served to strengthened our young nation by alerting political leaders that they are accountable and answerable to the people they represent.

The new coalition government formed after the election commands a substantial majority and recognising that political stability is imperative if consistent policies are to be maintained. I am pleased to announce that the government is confident of retaining political office into the next millennium.

The restoration of peace and normalcy on the war-torn island of Bougainville is the utmost priority of the new Government. Progress in relation to the crisis on the island of Bougainville has been slow and difficult but steady. The recent Burnham Declaration advances renewed hope that Papua New Guinea may finally be on the doorstep of peace.

The attainment of lasting peace has substantial social and economic significance. In economic terms it will allow the revival of agricultural production from what was formerly our largest agricultural export-earning province. The issue of the reopening of the huge Bougainville copper mine is not an immediate priority and it will require some time to resolve.

The sectors of health, education, and sustainable resource management are other key priorities of the new government in cognizance that these sectors are fundamental to the endowment of our citizen, not only with the means to productively contribute and participate in the development process but to also secure an improved quality of life.

Economic Situation in Papua New Guinea

Mr Chairman, Governors, after an unprecedented crisis in 1994 Papua New Guinea is in the throes of a welcome recovery. The macroeconomic fundamentals point to a restoration of stability with interest rates declining to below 10 per cent, CPI inflation currently 5 per cent and declining, our exchange rate stable against our major trading partners and in 1996 the achievement of our first ever overall budget surplus of 0.9 per cent of GDP. Our external position is healthy with our reserves at US \$554 providing 5 months of import cover.

In 1997 real growth of GDP is forecasted at 6 percent led by strong growth in the mining and construction sectors. The non-mineral sector is projected to grow by 6.6% in constant prices with real growth of 4 per cent in the agriculture, forestry and fisheries sectors which accounts for the livelihood for some 80 per cent of our people.

Our first objective of attaining macroeconomic stability has been achieved and the next challenge to is realize sustainable and robust growth through the continuation and consolidation of our reform program.

Papua New Guinea's Reform Program

Mr Chairman, Papua New Guinea has embraced a reformist agenda in the face of considerable opposition and obstacles. While the new Government has just assumed office we are determined that the reforms will continue under the auspices of our Medium Term Development Strategy 1997 - 2002 to set Papua New Guinea firmly on the path of higher incomes and employment and reduced inequalities in the areas of poverty, income distribution, and access to essential basic services.

The centerpiece of the strategy of restoring domestic stability was the progressive reduction of the overall budget deficit, as a percentage of GDP, from 5.9 per cent in 1993, 2.8 per cent in 1994, 0.5 in 1995, and for 1996 a surplus of 0.9 per cent.

Fiscal discipline will be sustained and expenditure tracking and control mechanisms have been instituted and are being continually reviewed and refined. Careful attention, by the Government, is being rendered to ensure the flow of resources towards productive projects and programs particularly those in the social, infrastructure, and private sectors.

Monetary policy, previous accommodative of expansionary fiscal policy of the early nineties, will no longer bear the burden of imprudent fiscal policies. The increased competitiveness of our economy occasioned by the devaluation and subsequent floatation of our currency, the Kina, in 1995 will be maintained through the maintenance of low inflation and a stable exchange rate.

However, ours is an unfinished agenda. I now would like to briefly outline the key reforms to be undertaken under the next phase of our program. Components of this next phase includes the introduction of a National Value Added Tax (NVAT), provincial reforms, financial sector and capital market reforms, and public sector and public service reforms.

In the face of diminishing resource available precipitated by declining levels of mineral receipts and budgetary support from the Australian government, revenue flows will be stabilized by increasing the tax base through the introduction of a consumption tax in the form of a NVAT.

The NVAT will eliminate the cascading system of provincial sales taxes and provide the revenue base that is efficient, promotes investment and exports and that is transparent. The tax reforms will be revenue neutral and of the competing claims of deficit reduction, tariff and excise cuts and personal income tax cuts for the new NVAT revenues, the second option of rationalizing the current tariff regime will be pursued.

The current tariff regime has been used for two objectives: revenue raising and industrial protection which has led to an inefficient and distortionary indirect tax system and contributed to Papua New Guinea's high cost structure. Beyond requirement of Papua New Guinea's accession into the WTO and APEC there is a need for industry and tariff policy reforms which stems from the continued decline in the performance of our private sector which is inefficient and uncompetitive on the world stage.

Expenditure restructuring is a central component of the reform program. The share of expenditure on consumption will be reduced and investment will

be increased. The quality of expenditure is also being examined and the efficiency will be improved by a greater focus on the link between the budget and the outputs and outcomes.

Public sector and public service reforms are also being pursued to enhance the quality, efficiency, and motivation of the public sector. A study was commissioned by the Government and its recommendations, which are broadly along the lines of the New Zealand model, are being closely examined by the Government. Specific measures undertaken to date to reduce the wage and salaries bill include a retrenchment exercise and the compilation of a master payroll list to eliminate ghost workers.

In 1995 the Constitution of Papua New Guinea was amended with the passage of the new Organic Law on Provincial and Local Level Governments. This represented a profound response to the lack of goods and services that were being delivered to our rural residing populace.

This new Organic Law decentralizes the process of resource allocation and emphasizes the bottom-up planning approach, allowing local government units to participate in the planning process ensures that projects and programs are undertaken that yield benefits that are consistent with our people's needs. The provincial reforms redirects substantial resources, in fact just over 30 per cent of the central government budget goes to the provinces and the rural sector.

The private sector's role in the economy is fundamental to the creation of jobs and income. For the private sector to flourish the Government will ensure

that macroeconomic, sectoral and microeconomic policies are sound, consistent and transparent.

Restrictions on foreign participation through direct investment are being eased and the costs for inputs are being lowered through the rationalization of the tariff structure. The Government has divested holdings and privatized those activities best served by the private sector. The role of Government is now being closely examined and will be focused on those programs and activities that complement the private sector-led sustainable growth.

Recognizing that international financial flows are now dominated by private sector capital flows Papua New Guinea is instituting reforms to its investment regime to attract these foreign investments. Papua New Guinea does attract significant foreign direct investment but the bulk of these represent investment in our enclave mineral sector with very little linkage to other sectors.

A National Investment Policy is currently being formulated that will clearly signal to foreign investors that Government will take all measures to facilitate and expedite investments. The broad objectives are firstly, to create a more competitive and conducive business environment for Papua New Guinea; and secondly to promote sustainable growth through improved and increased upstream and downstream production and processing.

Papua New Guinea has substantial renewable resources and the exploitation of these resources must be consistent with the maintenance of ecological sustainability. To achieve sustainable use of resources, limits have been placed on the annual harvest based on calculated sustainable levels and

environment protection standards are being enforced. Sustainable harvest yields have been set for forest and fisheries resources. Surveillance, however, remains the greatest constraint to our endeavors to halt the rapid depletion of our stock of renewable wealth.

The recent floats for the Lihir mine and the Orogen have confirmed that significant amounts of both debt and equity financing can be realized both domestically and abroad for the right type of project in Papua New Guinea. The major challenge is to harness that potential stock of investment into Papua New Guinea so that the investments are applied not only to very large resource projects, but also to medium and smaller sized projects in other sectors of the economy. This role of allocating resources to the most profitable private sector projects is the role taken on by efficient financial and capital markets.

The fundamental objective of our reform program is to develop more efficient and dynamic financial and capital markets but important sub-objectives include: (I) the introduction of new capital and entrepreneurship to the sector, particularly from national sources; (ii) development of an appropriate regulatory regime which is conducive to the growth of investment activities by providing for greater investor protection and confidence; and (iii) the broad pursuit of market oriented and liberalized strategies, though recognizing important elements of market failure in Papua New Guinea which leave the State with an important role in the provision of financial services and credit in decentralized locations.

While we appreciate the support extended to us by both the Fund and the Bank, the implementation of our reform program has been made more intricate than necessary by the desperate policy advice and stance from the two Bretton

Woods institutions. Greater coordination, harmonization and linking between the objectives of stability from the Fund and growth from the Bank is crucial to the adjustment programs.

The Government also conveys its appreciation to the Bank on selecting a reputable Papua New Guinea National Citizen to head its Liaison office in Port Moresby. We are confident that this will enable closer working relationship between the Bank and the Government.

World Bank / IMF Issues

Mr Chairman, governors, I wish to commend the Bank and the Fund on their determination to bring the Highly Indebted Poor Countries Initiative to fruition. While Papua New Guinea is classified as a moderately indebted middle-income country we nevertheless can empathize with fellow Governors here whose huge debt burden stifles their ability to pursue their development agendas.

Papua New Guinea with a per capita income of around US\$ 850 is classified as a middle-income country. This per capita level is, however, deceptive, as consideration of our social indicators would rank us well below other countries of comparable income. Consequently, Papua New Guinea does not qualify for softer facilities from the Bank and the Fund. The replenishment of the IDA-11 continues to be a concern for Papua New Guinea as the shortfall is now increasingly being met from the net income of the IBRD. This in effect means that Papua New Guinea and other similar countries are financing the IDA-borrowers. We would strongly urge that the Bank and the Fund consider

options to increase the concessionality of the harder facilities of the IBRD and the SBA.

The Bank's attempt to restructure itself, through the Strategic compact, to better serve its member countries is welcomed. The key role the Bank plays in the development programs of developing countries requires the Bank to embrace a medium term perspective and to see how world evolves and how best the Bank should adapt itself to attend to the needs of its member countries.

MIGA and the IFC are important facilitators of the flow of private capital investment into Papua New Guinea and we encourage a more prominent role for both agencies in Papua New Guinea.

Conclusion

Mr Chairman, Governors, while the outlook remains favorable for Papua New Guinea. The challenge remains to build on the positive actions undertaken to realign Papua New Guinea with a market oriented regime while maintaining stability on both the internal and external fronts. The Government will strive to continue the reforms and firmly establish the foundation for the realization of the enormous potential that is Papua New Guinea's.

The Fund and the Bank will remain key external partners in the development of Papua New Guinea and we look forward to the continuation of a mutually satisfying and fulfilling relationship.

The discussions and the contributions by fellow Ministers has been enlightening and fruitful and I hope that the sum of our contribution will provide tangible benefits for the developing nations.