Papua New Guinea

Efforts by the Government to remedy the macroeconomic imbalances generated by previous policies were a prominent feature of the economic scene in Papua New Guinea during 1995. Public finances were brought back into balance; the balance-of-payments deficit was eliminated and the rate of inflation brought under control. However, GDP declined sharply.

Expectations are for a return to modest but positive economic growth on average over the next two years. The overall balance of payments will continue in surplus, and prudent fiscal and monetary policies will help to provide an economic climate conducive to the pursuit of wide-ranging structural reform.

Recent Trends and Prospects

A decline in mining and petroleum production and restrictive monetary and fiscal policies combined to produce a fall in GDP of 4.8 percent in 1995 compared with growth of over 3 percent in 1994 and 16.6 percent in 1993. Output declined in most of the non-mining sectors, except in the agriculture sector where output growth, though lower than in 1994, reached 2.6 percent with the aid of favorable export prices, especially for coffee and palm oil. Manufacturing production fell by 3.6 percent; however, increases were recorded in energy production and construction as new mineral ventures began to be developed. The service industries, however, which account for over 30 percent of GDP (Figure 2.29), recorded negative growth.

Though employment in the formal sector has only recently recovered to the level of 1989, there was strong growth in such employment in most sectors of the economy in 1994. Employment growth continued in 1995. While this was mostly in the agriculture sector during the first half of the year, because of seasonal factors during the second half of 1995, the mining and construction sectors played a more prominent role in job provision.

The 1995 budget was delayed until March 1995 to allow time for its formulation in the framework of a structural adjustment program agreed with IMF and the World Bank. Total expenditure was reduced to 26.3 percent of GDP from the 1994 level of 29.7 percent and involved a significant reduction of current expenditure and an increase in capital expenditure. Revenues in 1995 benefited from new measures introduced in late 1994 so that an overall budget surplus of 0.1 percent of GDP was achieved, compared with deficits of 5.9 percent and 2.8 percent of GDP in 1993 and 1994, respectively.

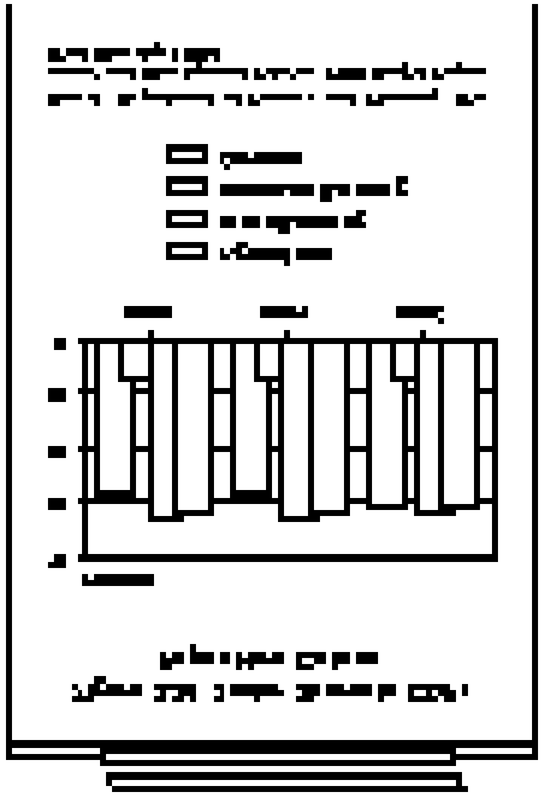
With the floating of the kina toward the end of 1994, the focus of monetary policy shifted from the maintenance of adequate external reserves to that of containing inflationary pressures generated by higher import prices. Monetary policy was tightened in late 1994 and through 1995 with successive increases in the Minimum Liquid Asset Ratio (MLAR) of the commercial banks, which led to significant increases in nominal interest rates. Inflation gathered momentum from late 1994; further upward pressure on prices came from the easing of price controls in mid-1995 on a wide range of goods. The inflation rate, though declining in the second half of 1995, averaged about 15 percent for the year as a whole compared with 2.9 percent in 1994.

The balance of payments on current account was less favorable than in 1994. Export earnings declined by about 1 percent; increased earnings from some mineral and agricultural products were insufficient to offset the effects of sharply lowered returns from petroleum and log exports. Import payments were nearly 15 percent higher than in 1994, reflecting new mining and petroleum developments. The trade surplus thus declined and, with the deficit on the services and investment accounts remaining much the same as in the previous year, the current account surplus slipped to 7 percent of GDP from 10.6 percent in 1994. With net capital movements more favorable than in 1994, the overall balance turned to a surplus equivalent to 3 percent of GDP. External reserves increased to over two months of import cover at the end of 1995, from one month a year earlier.

The medium-term outlook for the economy of Papua New Guinea is for a return to positive economic growth of about 1 percent over the 1996–1997 period. Growth is likely to be stronger in the non-mining sectors of the economy; agricultural output is expected to increase by 3–4 percent per annum over the next two years and a high level of construction activity will be sustained. However, mineral output will fall over the period and not recover until new developments come into production in 1998.

The budget for 1996 provides for an overall deficit of 1 percent of GDP. Revenue, including grants, is projected to contract to 25.4 percent of GDP while expenditure will rise slightly to 26.5 percent. Recurrent expenditure is to be reduced by over 4 percent while development expenditure is to more than double to over 6 percent of GDP. Money supply growth in 1996 is projected to be lower than in 1995 and the rate of inflation is expected to be appreciably lower at around 6 percent.

The external accounts are forecast to show a major shift to a current account deficit in 1996 of over 7 percent of GDP. Exports are not expected to be much greater than in 1995 as mining revenues continue to decline and import payments rise by some 30 percent as a result of new mining investment activity. Substantial capital inflows to finance such investment will, however, be sufficient to generate an overall surplus of about 2 percent of GDP with a consequent further increase in external reserves.



Policy and Development Issues

The policy measures taken in late 1994 and in 1995, especially to lower the fiscal deficit, have been successful not only in bringing about a much-needed degree of macroeconomic stability but also in enabling a start to be made on structural reforms necessary for the achievement of sustainable economic growth. Reducing the size of the government sector and restructuring public finances to give more emphasis to basic services such as health, education, and physical infrastructure and to reduce manifest inefficiencies and geographical inequities in their provision are core elements of the structural adjustment program. Deregulation and privatization are pressing requirements so that the private sector can play a more pervasive role in shifting the economy away from its present excessive dependence on the exploitation of natural resources. Continuing adherence to the structural adjustment program will contribute significantly to strengthening the economy in 1996.