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July 18, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Papua New Guinea - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Papua New Guinea, which is proposed to be brought to the agenda for discussion on Friday, August 9, 1985.

Mr. Bruce Smith (ext. 7301) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

PAPUA NEW GUINEA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Consultation with Papua New Guinea

Approved by Richard C. Williams and Manuel Guitian

July 16, 1985

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I. Introduction

The 1985 Article IV consultation discussions were held in Port Moresby during May 6-17. Discussions were held with Acting Finance Minister Rabbie Namaliu, Bank of Papua New Guinea Governor Sir Henry To Robert, and other officials. The staff mission was Messrs. Smith and Ishihara (both ASD), Ms. Horne (RES), Mr. Haque (ASD), and Ms. Watson (ETR); Mr. Romualdez was also present.

Papua New Guinea has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

II. Background to the Discussions

1. Adjustment to the international recession

The international recession of the early 1980s had a major impact on Papua New Guinea. Beginning in 1980, there was a deterioration in the terms of trade, amounting to 30 percent by 1982 which, together with stagnant output, resulted in a large reduction in incomes. The external current account, which had been in surplus in 1979, swung into heavy deficit reaching some 20 percent of GDP in 1981 (Chart 1). The Government borrowed heavily in foreign commercial markets to finance widening fiscal and external imbalances. The international reserve position was sustained at a satisfactory level, but external debt rose abruptly. Demand management policies were slow to adjust to the worsening environment, and while monetary policies were tightened in 1981, it was not until 1982 that a restrictive fiscal policy was instituted.

Incomes and the external situation stabilized in 1982 as the terms of trade bottomed out and adjustment policies became effective, and they improved significantly in the second half of 1983 as export demand recovered. The external current account deficit declined to 16 percent of GDP in 1983, and excluding imports financed by foreign direct investment for the development of the huge enclave mining project at Ok Tedi, 1/ the deficit would be as low as 6 percent of GDP. Supported by continued external borrowing, international reserves increased sharply beginning in mid-1983. Budgetary restraint continued to be severe, but with the turnaround in the external position, liquidity growth accelerated during the second half of the year. However, domestic demand and activity strengthened only slowly. Consumer price inflation, which had been in the 5-7 percent range during the recession, rose to 8.5 percent

1/ An analysis of the Ok Tedi project, and the mining sector in general, is contained in the accompanying paper on Recent Economic Developments.

in 1983, reflecting mainly a 9 percent effective exchange rate depreciation as the kina was devalued in line with the 10 percent depreciation of the Australian dollar in March 1983, and supply shortages of betel nut.

Despite balance of payments difficulties, the exchange and trade system has been maintained largely free of restrictions. The kina is pegged to a basket of currencies of major trading partners and the U.S. dollar exchange rate is adjusted daily to reflect changes in the value of the basket. Current payments and transfers may be made freely, although capital flows are subject to exchange control. The trade system is largely free from restrictions, but imports of some items are subject to quotas or bans, designed to protect domestic producers; details are provided in the accompanying paper on Recent Economic Developments.

2. The recovery in 1984

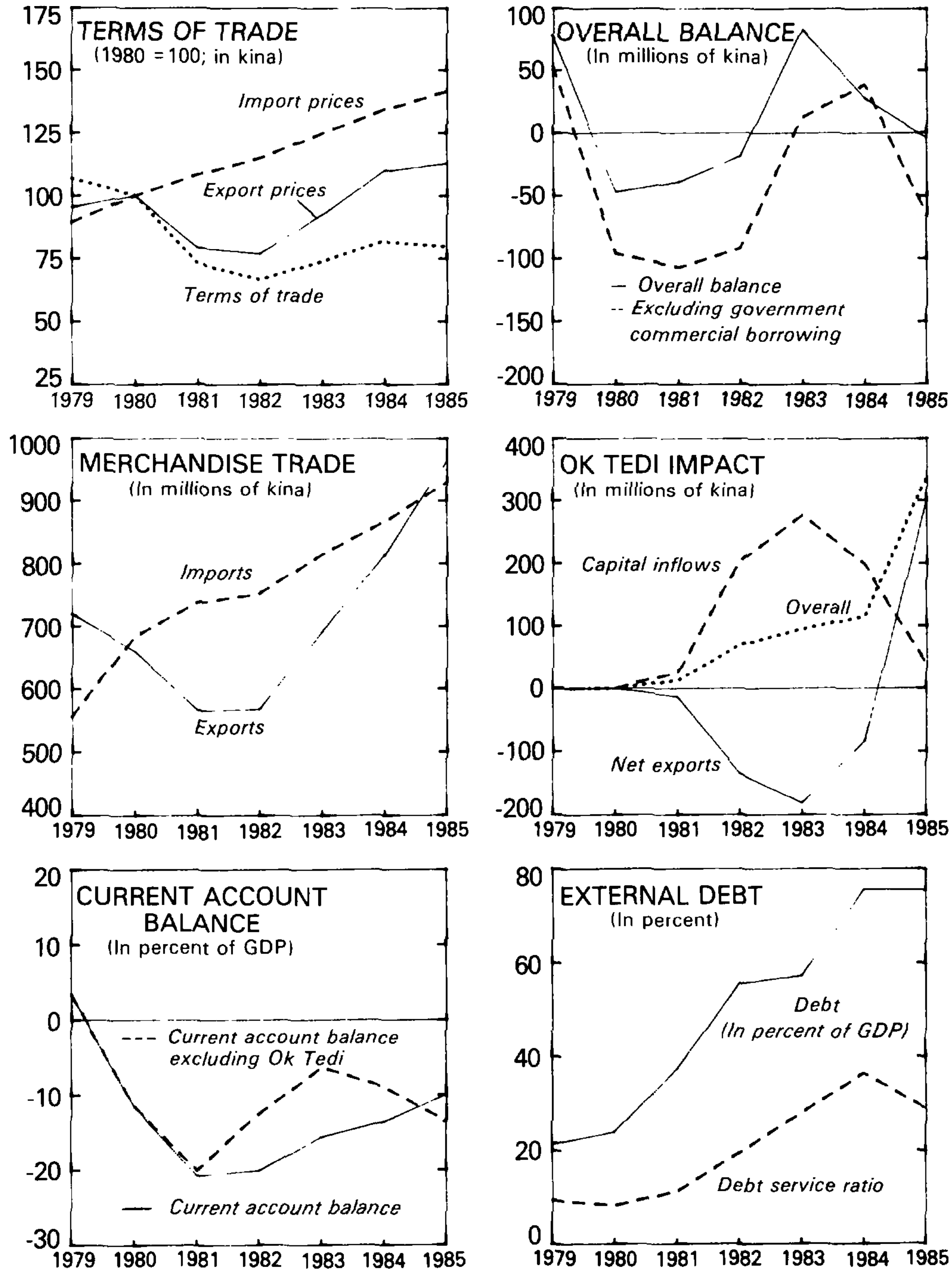
By most standards, 1984 was the best year for Papua New Guinea's economy in a long time. Real GDP rose by 2 percent, and the terms of trade improved by 10 percent (Chart 2). As a result, real incomes expanded strongly for the second year in succession--although remaining some 10 percent below the 1979 level and lower still in per capita terms. Excluding the effects of a slowdown in investment at Ok Tedi, the expansion in output was as much as 6 percent, as production of rural exports reacted to favorable prices and activity in the economy at large responded to stronger demand conditions. The notable exception was in construction where, in addition to the cutback at Ok Tedi, there was a cyclical slowdown in building. Largely as a result of this, the upturn in employment which emerged in 1983 faded in the second half of 1984; however, taking account of agricultural employment, which is mostly not covered in statistics on formal sector employment, the authorities believe overall employment increased modestly in 1984.

The main impetus to growth and demand in 1984 came from the external sector. Exports increased by 18 percent, mainly because of higher prices. Agricultural exports rose by 60 percent, with both prices and volumes increasing substantially, but mineral exports declined because of weak metal prices and reduced copper volumes due to labor disputes at the Bougainville Copper mine (BCL). Imports rose by 6 percent, but excluding imports for Ok Tedi construction which fell, general imports were 17 percent higher, reflecting the considerable strengthening of domestic demand. The current account deficit declined to 13.6 percent of GDP. Net capital inflows fell by more than a third as official borrowing on foreign commercial markets was sharply cut back and borrowing and equity investments for Ok Tedi were also reduced. There were, in addition, large positive net errors and omissions, which are believed to include unidentified capital inflows associated with the financing of oil and other imports. Overall, there was a balance of payments surplus of K 44 million, and at the end of 1984, gross international reserves were SDR 461 million, equivalent to six months' imports.

CHART 1

PAPUA NEW GUINEA

MAIN INDICATORS OF EXTERNAL ACCOUNTS, 1979-85

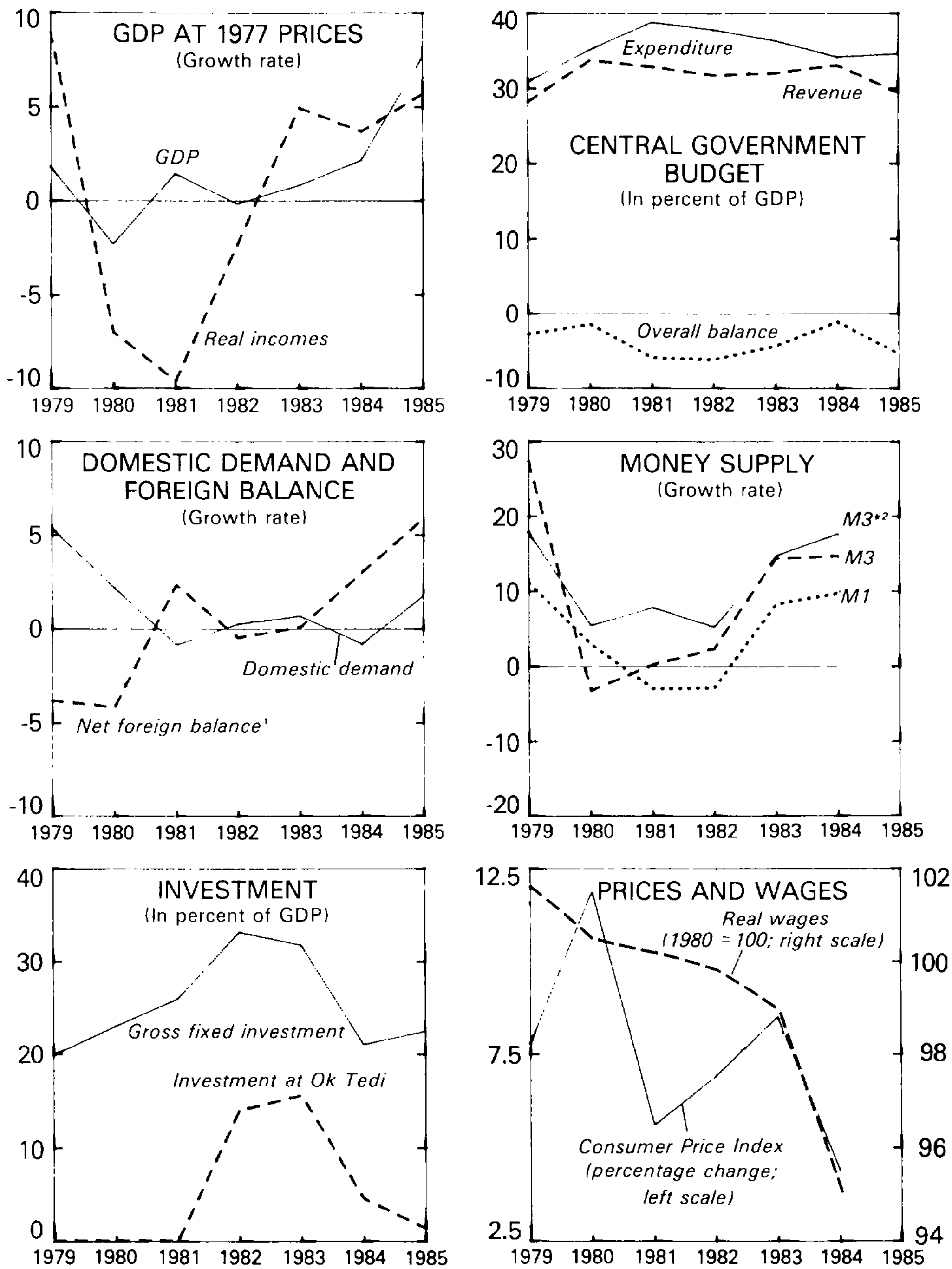


Sources: Data provided by the Papua New Guinea authorities; and staff estimates.

CHART 2

PAPUA NEW GUINEA

SELECTED MAIN ECONOMIC INDICATORS, 1979-85



Source: Data provided by the Papua New Guinea authorities.
[1] Changes in the net foreign balance in percent of GDP in the previous year.
[2] M3 less deposits of BCL and stabilization funds for coffee, copra, and cocoa.

The tight budgetary policy followed since the depths of the recession in 1982 was maintained in 1984. While revenue and grants rose by 14 percent, somewhat faster than expected, expenditures rose by no more than 4 percent, considerably less than budgeted mainly because of shortfalls in public investment. The overall budget deficit was reduced to 1.1 percent of GDP, well below that budgeted (3.2 percent), and in 1983 (4.3 percent). Despite net repayments of foreign commercial debt the Government's net asset position with the banking system increased moderately. Monetary policy continued to be liberal. Private sector credit expanded rapidly, and broad money (excluding stabilization deposits) increased by 18 percent, well in excess of the authorities' projection of 10-15 percent made at the beginning of the year. Despite this, consumer price inflation fell sharply during the second half of 1984 to 4.4 percent by the December quarter as earlier domestic supply shortages were alleviated.

Economic conditions have continued to be buoyant in the early months of 1985. Although prices for most agricultural exports have peaked, metal prices have improved somewhat and export incomes, which fueled the recovery, have remained relatively strong. At the same time, private credit has expanded rapidly, and demand conditions remain buoyant. Nevertheless, consumer price inflation fell further to 2.5 percent in the 12 months to the March quarter because of the continued unwinding of domestic supply shortages. Also, advance indicators of imports do not indicate an unusual increase and foreign exchange reserves have remained broadly unchanged over the first four months of the year.

III. Economic Prospects and the Medium Term

1. The outlook for 1985

The peak in the current terms of trade cycle occurred in mid-1984. Tentative projections suggest that after improving by some 20 percent over the past two years, the terms of trade may weaken by about 2 percent in 1985 because of lower prices for agricultural exports. However, aggregate growth and the balance of payments will gain a major boost from the first full year's production from Ok Tedi.

Real GDP is projected to expand by as much as 7 $1/2$ percent, with Ok Tedi contributing as much as 5 percentage points of the increase. With smaller increases in rural incomes as agricultural production expands more slowly and prices recede, real private consumption spending may increase by 2.5 percent. However, possible spillover effects from high rural incomes last year and the significant buildup in liquidity makes the projected slowdown subject to significant uncertainty. In contrast, government consumption, which fell persistently over recent years, is budgeted to rise sharply. Aggregate investment will remain depressed because of a decision to scale back and delay future construction at Ok Tedi, but other investment spending is expected to surge--perhaps by as much as one third. Private investment fell precipitously between 1980 and 1983 as the recession forced the cancellation of investment plans and, in some cases, the consolidation of business operations on a smaller scale, while public investment was squeezed after 1981 by fiscal restraint. Business investment was slow to respond to improved conditions in 1984, but there are clear indications of a major upturn in investment in such areas as plantation agriculture, forestry, and oil exploration, in the current year. However, even with the expected large increase, real investment would remain below levels prior to the recession.

Exports are projected to again grow strongly in 1985 (Table 1). More than all of the expected 19 percent growth in exports is due to exports from Ok Tedi, and other exports are expected to decline by about 5 percent. Agricultural exports are projected to fall by 14 percent as prices for copra, palm oil, and tea are lower and export shipments of coffee, cocoa, and copra fall from high 1984 levels, partly because of special factors. Imports are projected to rise by 7 percent, with general imports rising by 10 percent because of continued strong domestic demand. The net deficit on services and transfers account is expected to widen considerably--in large part because of a sharp fall in the international value of Australian grant aid because of the recent depreciation of the Australian dollar. Even so, the current account deficit is expected to fall for the third successive year to 10 percent of GDP. However, net private capital inflows will decline abruptly as export receipts provide for a large part of Ok Tedi's reduced investment needs. Allowing for sharply increased official borrowing abroad, including an estimated K 88 million of new commercial loans, and assuming no recurrence of the large positive net errors and omissions in 1984 the overall balance of payments is forecast to weaken by K 48 million and revert to a deficit of some K 4 million in 1985. Furthermore, excluding increased government commercial borrowing, the weakening in the overall position in 1985 would be as much as K 121 million.

2. Medium-term prospects

External prospects for the coming few years are not favorable (Table 2). Commodity price projections prepared by the Fund and Bank staff for the period 1986-89 indicate that export prices may rise by 4 percent per annum; metal prices may increase by some 7 percent per annum (although uncertainty surrounding gold prices, in particular, make this subject to much uncertainty) while agricultural prices are forecast to increase by no more than 3 percent per annum. Agricultural export volumes are expected to increase by an average of 5 percent per annum; there would be moderate increases for cocoa and oil palm as new plantings reach maturity, but only modest increases are expected for most other items. Following the large increase in gold production in 1985, the quantity of mineral exports will slowly decline during the remainder of the decade, reflecting falling ore grades at the now aging

Table 1. Papua New Guinea: Balance of Payments, 1981-85

(In millions of kina)

	1981	1982	1983	1984	1985 Proj.
Exports, f.o.b.	566	568	691	813	965
Imports, f.o.b.	-738	-752	-815	-866	-930
Trade balance	-172	-184	-124	-53	35
Services, net	-283	-273	-317	-393	-412
Transfers, net	104	102	134	150	135
Current account balance	-352	-355	-307	-296	-242
(Excluding Ok Tedi)	(-339)	(-221)	(-125)	(-194)	(-330)
Nonmonetary capital (net)	284	356	384	237	238
Official	78	75	127	15	94
Private	189	282	252	204	144
Commercial banks	17	-1	5	18	--
Net errors and omissions	29	-19	6	103	--
SDR allocations	2	--	--	--	--
Overall balance	-39	-22	83	44	-4
(Excluding government commercial borrowing)	(-107)	(-96)	(13)	(55)	(-66)
Memorandum items:					
Current account/GDP	-20.7	-20.1	-15.6	-13.6	-10.0
Of which: Ok Tedi	(-0.8)	(-7.6)	(-9.3)	(-4.7)	(3.6)
foreign aid	(10.8)	(10.9)	(10.9)	(10.8)	(9.1)
other	(-30.7)	(-23.4)	(-17.2)	(-19.7)	(-22.7)
Gross official reserves (SDR mn.)	366	328	431	461	419 1/
(In months of imports)	(4.8)	(4.2)	(5.6)	(6.0)	(4.9)
Medium- and long-term external debt (SDR mn.)	801	1,160	1,622	1,793	1,875
Debt service ratio 2/	8.8	15.2	22.3	29.0	24.0
Exchange rate (SDR per kina)	1.261	1.228	1.122	1.091	1.024 3/

Source: Data provided by the Papua New Guinea authorities.

1/ March 1985.

2/ Relative to current account receipts.

3/ Based on January-April average.

Table 2. Papua New Guinea: Medium-Term Projections of the External Account, 1986-89

(In millions of kina) 1/

	1986	1987	1988	1989
Balance of payments				
Current account	-269	-315	-339	-307
Exports	1,034	1,056	1,205	1,280
Imports	-1,026	-1,092	-1,241	-1,280
Services, net	-426	-447	-482	-499
Transfers, net	149	168	179	192
Nonmonetary capital (net)	196	253	263	255
Official	78	140	114	130
Private	118	113	149	125
Overall balance	-73	-62	-76	-52
External debt				
Debt outstanding (end of period)	1,913	2,001	2,136	2,222
Public	873	992	1,106	1,236
Private	1,040	1,009	1,030	986
(Ok Tedi)	(721)	(659)	(668)	(611)
Debt service payments	376	443	587	585
(Ok Tedi)	(127)	(180)	(247)	(268)
Debt service ratio 2/	26.4	30.0	35.5	33.4
Public	8.4	9.7	11.6	10.4
Private	18.0	20.3	24.0	23.0
Memorandum items:				
Current receipts	1,425	1,479	1,652	1,753
Ok Tedi exports	230	237	256	276
LIBOR (in percent)	10	10	9	9

Sources: Projections provided by the Papua New Guinea authorities; and staff estimates.

1/ Throughout this period, it is assumed K 1 = SDR 1.
2/ Relative to current account receipts.

Bougainville mine. Thus, in aggregate, export volumes are projected to rise by only about 3 percent per annum, and export receipts by 7 percent.

Grant assistance from Australia, which amounted to K 230 million or 29 percent of exports in 1984, is projected to increase by about 6 percent per annum in nominal terms during 1986-89 following the fall of 6 percent in 1985. Discussions are at present under way between the Governments of Australia and Papua New Guinea on an agreement on the amount and form of Australian assistance during the five years beginning in mid-1986. A report commissioned by the Australian Government recommended that Australian assistance to Papua New Guinea be reduced by 3 percent per annum in constant Australian price terms during this period. It also raised the possibility of changing the composition of assistance, at present wholly untied cash grants, to include a rising proportion of tied and project assistance.

Net private capital inflows during 1986-89 are projected to remain at or below the much reduced level expected in 1985. Capital requirements for Ok Tedi investment are not expected to rise significantly until 1988, while repayments on earlier borrowings would rise steeply throughout the period. The authorities emphasize that private capital inflows may well be much larger than projected, especially if one or more of the several projects presently under consideration by foreign investors to exploit the undoubted resource riches of the country moves ahead quickly.

Taking account of rising net invisible payments and official debt repayments falling due, this meager flow of resources would be sufficient to finance a level of general imports, (excluding those for Ok Tedi development) which would be virtually no larger in nominal terms in 1989 than that projected for 1985. However, in their official projections presented in Table 2, the authorities project average annual increases in general imports of 7 percent, or some 2 percent in real terms, sufficient to sustain aggregate growth at around the same moderate rate. These larger imports would be financed by continued official borrowing on foreign commercial markets (which are projected to rise to K 145 million in 1989), and by a persistent drawdown on international reserves to a very low level at the end of the period. The authorities note that this balance of payments scenario is illustrative, but not a realistic forecast outcome, especially because they would not be willing to allow international reserves to fall below about SDR 300 million. They indicate that, as in the past, economic policies, including demand management, external borrowing and exchange rate policies, will be adapted as necessary to ensure external viability.

3. Development objectives

Since independence in 1975, real GDP has increased by no more than 1.5 percent per annum, a disappointingly low rate in view of bountiful resources and persistently high rates of investment. In part, this reflects a generally unfavorable external environment during this period, structural impediments to growth, and the enormous cost of basic infrastructure caused by rugged terrain. Government policies were an additional factor during much of this period, paying particular attention to widening the coverage of basic infrastructure and services in preference to expenditure that stimulated growth directly. One consequence has been that the economy has not been able to generate employment to absorb a growing labor force, and urban income bias has encouraged migration of unskilled workers from rural areas. The high incidence of unemployment, especially in urban areas, has been associated with increasing lawlessness and rising public concern.

Faced with these circumstances, the Government has begun to recast its development policies. In early 1984, it announced a new medium-term development strategy which gives greater emphasis than in the past to economic growth, especially as a means of creating productive work opportunities. To give substance to this new direction, and also strengthen the sectoral cohesiveness of government development policies, the authorities are at present drawing up a five-year National Development Plan to begin in 1986. While this has yet to be completed, the authorities have already identified a number of key policy issues and approaches. These include the need to reduce the economy's high-cost structure; improve land availability and transfer procedures; and reduce government regulations and impediments to private investment. The World Bank staff, which supports the general redirection of policy, is reviewing government proposals on sectoral investments in the context of an economic mission in June 1985; a Fund staff member was attached to this mission to investigate resource mobilization opportunities.

While decisions on the size and allocation of resources in the Plan have yet to be made, the authorities recognize that resources are unlikely to be available to finance a large increase in public investment. Estimates prepared for the latest National Public Expenditures Plan covering the next four years indicate that resources are unlikely to be available to finance an increase in real government spending on goods and services of more than 0.5 percent per annum during 1986-88. Even this modest rate of increase is based on optimistic assumptions concerning future copper and gold prices (which determine sustainable drawings from the Mineral Resources Stabilization Fund) and future levels of Australian grant aid; it also assumes sizable borrowing on foreign commercial markets.

The prospect of balance of payments weakness and a fiscal position which allows little or no increase in real government spending casts a shadow over the Plan. The authorities are focusing particularly on efforts to improve the efficiency of government spending and redirecting existing spending toward priority areas, although they recognize limits to such a strategy. They agree that the disparity between their medium-term development aims on the one hand, and the projected capacity of the economy to finance such development on the other, throws into sharp focus the need for policy adjustment.

IV. Policy Issues

1. Wages and international competitiveness

A high-cost structure stemming principally from unrealistic wages has long been recognized as a major structural problem confronting Papua New Guinea. Wages, especially for unskilled labor, are substantially higher than in most neighboring and competing countries and because of this, most traded goods industries, with the exception of the mining and plantation sectors, are uncompetitive in world markets. The high cost structure has been maintained by the indexation of most wages to the cost of living. In these circumstances, exchange rate policy has been a weak instrument to strengthen international competitiveness. During most of the period since independence, control over the level of domestic demand through fiscal policy has been the main instrument of external adjustment, while the exchange rate, under a so-called "hard kina" policy, has been directed principally at containing inflation.

This policy approach was viable during the buoyant external conditions of the late 1970s, but was less successful in the more difficult years that followed. Tight government spending policies needed to support the balance of payments position exacerbated persistent structural weaknesses. Investment was cut back, including especially that needed for the development of traded goods industries, and rising imbalances in the labor market could not be addressed. Ultimately external pressures forced a departure from the "hard kina" policy in March 1983. Coincident with the devaluation at that time, a new partial wage indexation agreement came into force, under which wages were indexed for only the first 5 percent of consumer price inflation in each year during 1983-85.

During the past two years, the authorities have been implementing exchange rate policy with the aim of taking advantage of the additional flexibility afforded by the partial wage indexation arrangement to reduce real wages and improve international competitiveness. During 1983, real wages declined, and the real effective exchange rate index depreciated by 6 percent (Chart 3). Directors last year endorsed these changes and recommended that policies continue on this path. In the event, by March 1984 the annual increase in consumer prices had reached over 10 percent, and rising public concern with inflation posed a threat to the continued political acceptability of the wage agreement. Because of this, the authorities during 1984 gave increased weight in their exchange rate policy to containing inflation. During 1984, the effective exchange rate was unchanged and consumer price inflation fell sharply over the course of the year. The real effective exchange rate index appreciated by 1 percent during 1984 and wages were adjusted for the full amount of consumer price inflation which fell below the 5 percent threshold.

The authorities note that the rise in inflation in 1983, and its rapid decline in 1984, was due in large part to supply shortages in 1983 of an important domestic food item--betel nut This tended to exaggerate the improvement in international competitiveness suggested by movements in the real exchange rate in 1983 and also cast doubt on the implied deterioration in 1984. An alternative measure of international competitiveness--the change in the price ratio of traded to nontraded goods (excluding betel nut) in the consumer price index--indicated a small improvement in competitiveness in both years. Nevertheless, the reduction in real wages and improvement in international competitiveness achieved during the first two years of the wages agreement (both about 3 percent) represented only about half the progress that had been estimated as being feasible. The authorities indicated that inflation had not been expected to fall as sharply as it did in 1984 and that their overriding concern that inflation be contained had led to a more cautious and less flexible exchange rate policy in 1984 than would have been feasible with the benefit of hindsight. They noted that the decline in inflation had the beneficial effect of allaying inflationary expectations, reinforcing public acceptance of the present partial wage indexation agreement, and establishing a positive environment in which a Minimum Wages Board, to be appointed later this year, will consider wage-fixing arrangements for the three years beginning in 1986.

During the first four months of 1985, the weakness of the Australian dollar led to a depreciation of the effective exchange rate of the kina by $2\frac{1}{2}$ percent; on an export-weighted basis, the depreciation amounts to some 6 percent, with an estimated broadly similar change in real effective terms. The authorities intend to direct their policies to promote the further improvements in competitiveness that are needed to overcome long-standing structural imbalances. The pace of change that can be achieved is dictated largely by the reduction in real wage levels allowed by the centralized wage fixing machinery and acceptable to the community at large. They noted that the Government is committed to maintaining relatively harmonious industrial relations in both the public and private sectors and that this made far-reaching changes in wage determination arrangements allowing for a rapid adjustment in real wages infeasible. Within this constraint, they would encourage the new Minimum Wages Board to establish a system providing for as much flexibility in the wages system as possible. They recognize that this approach, even if successful, implies that wage and competitiveness imbalances will persist over the medium term.

2. Budgetary policy

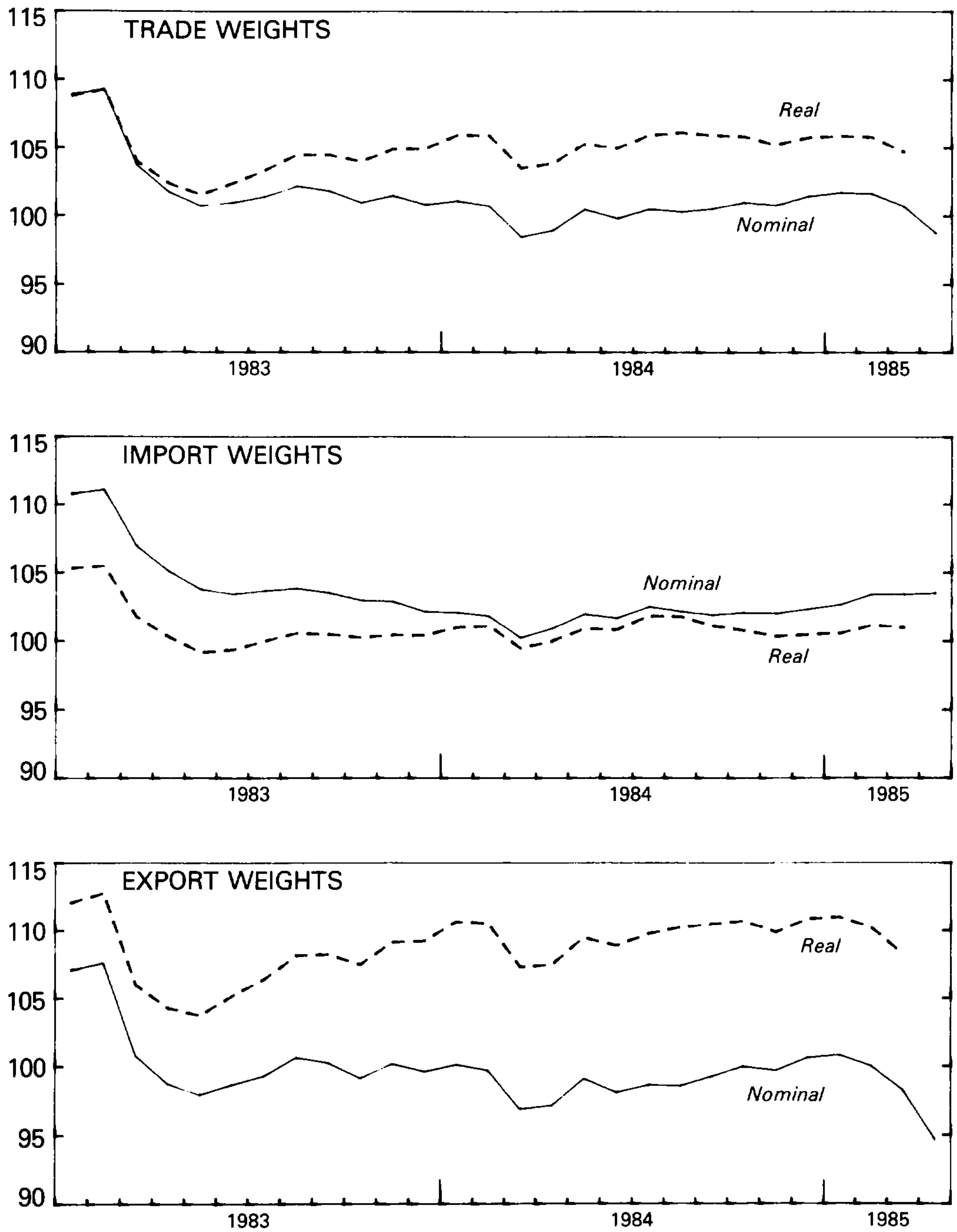
Fiscal policy has a central place in economic management in Papua New Guinea, being the chief instrument both of external adjustment and of economic development. During the last three years fiscal policy has been directed with considerable success toward strengthening the balance of payments. During 1982-84, real government spending on goods and services declined by as much as 8 percent, and by 5 percentage points as a proportion of GDP. The overall budget deficit was also reduced from

CHART 3

PAPUA NEW GUINEA

INDICES OF NOMINAL AND REAL EFFECTIVE EXCHANGE RATES BASED ON VARIOUS WEIGHTS, 1983-APRIL 1985[1]

(1977 = 100)



Source: Staff estimates.

[1] March 1985 for real effective exchange rate.

6 percent of GDP in 1981 and 1982 to 1.1 percent in 1984 (Table 3). While all discretionary expenditure categories were subject to restraint, cuts in capital spending were particularly severe; capital spending fell from 7.2 percent of GDP in 1981 to 4.4 percent in 1984.

During last year's Board discussion, Executive Directors urged that the 1984 budget be implemented effectively and that the tight control on government spending be maintained. In the event spending fell 5 percent short of the amount budgeted, principally because capital spending was reduced slightly whereas a substantial increase had been planned. To a large extent, the shortfall was unplanned, resulting from the postponement of government investment in Ok Tedi, and recurring project implementation delays. The authorities are keenly aware of the need to strengthen development project implementation capacity.

The budget for 1985 represents a clear point of departure from the policy of restraint followed during the previous three years. Revenues were projected to rise by 5 percent from the better-than-expected outcome in 1984, with strong increases in import duties and individual income taxes being partly offset by projected declines in mineral sector revenues. In contrast, expenditures were projected to rise by 14 percent from the lower-than-budgeted 1984 level; capital spending was projected to increase by as much as 32 percent. Real spending on goods and services, the main indicator of expenditure policy monitored by the authorities, was budgeted to rise by 2 percent. The overall budget deficit was estimated to increase sharply to K 93 million, equivalent to 3.8 percent of GDP (Chart 4). The increase in the deficit was to be financed largely from an increase in foreign commercial borrowing; gross foreign borrowing, which fell to K 18 million in 1984, was budgeted at K 65 million in 1985.

Developments since the budget was prepared make it likely that the budget will be more expansionary than originally planned. Revenues are now expected to fall some 6 percent short of the budget estimate. This reflects a larger-than-expected decline in mineral revenues because of adverse copper prices in 1984, and lower-than-budgeted receipts from other income taxes and excise and import duties, based on collections in the early months of the year. In addition, the domestic value of Australian grant assistance is now expected to decline by 7 percent rather than increase by 6 percent as budgeted. On the expenditure side, there are some expected savings, amounting to 1 percent of the total, from lower interest payments and Ok Tedi investment spending. On balance, the budget deficit in 1985 is now estimated to rise to K 128 million, or 5.3 percent of GDP, in the absence of corrective action.

The authorities reaffirmed that their budgetary policy was guided by the intention that, year by year, expenditures should be in line with levels estimated to be sustainable over the medium term. The 1985 budget had been prepared so as to be broadly consistent with this policy, while taking account of the need to restore some of the cuts in basic

Table 3. Papua New Guinea: Summary of Central Government Fiscal Operations, 1981-85 1/

	1981	1982	1983	1984		1985	
				Budget estimate	Estimated outturn	Budget estimate	Revised
				(In millions of kina)			
Total revenue and grants	558.0	559.7	628.9	708.1	719.5	756.5	713.2
Domestic revenue 2/	374.0	373.0	415.7	480.5	487.5	511.3	496.5
Tax revenue	(321.4)	(313.6)	(337.0)	(399.3)	(412.8)	(434.6)	(417.7)
Foreign grants	184.0	186.7	213.2	227.6	232.0	245.2	216.7
Total expenditure 3/	658.8	667.1	713.1	777.1	742.4	849.2	840.8
Current expenditure 4/	536.8	539.7	616.7	628.4	647.4	724.2	718.7
Capital expenditure 4/	122.0	127.4	96.4	148.5	95.0	125.0	122.1
(Expenditure on goods and services) 5/	(597.1)	(592.1)	(625.1)	(674.9)	(655.1)	(728.3)	(728.3)
(Interest payments)	(52.1)	(61.0)	(67.6)	(74.4)	(72.9)	(86.5)	(81.0)
Overall balance (deficit -)	-100.8	-107.4	-84.2	-69.0	-22.9	-92.7	-127.6
External financing (net)	83.7	75.7	110.1	95.1	42.8	75.3	97.8
Concessionary loans	21.3	19.8	48.1	60.8	51.7	41.2	40.9
Commercial loans	56.9	53.8	59.8	30.3	-15.0	31.0	53.6
Drawdown of NDSF foreign assets	5.5	2.1	2.2	4.0	6.1	3.1	3.3
Domestic financing (net)	17.1	31.7	-25.9	-26.1	-19.9	17.4	29.8
Banking system	28.1	30.6	-28.8	...	-36.5	...	9.3
Other (including balancing item)	-11.0	1.1	2.9	...	16.6	...	20.5
				(Annual percentage change)			
Memorandum items:							
Total revenue and grants	-2.8	0.3	12.4	12.6	14.4	5.1	-0.9
Domestic revenue	-6.2	-0.3	11.4	15.6	17.3	4.9	1.8
Tax revenue	(-1.9)	(-2.4)	(7.5)	(18.5)	(22.5)	(5.3)	(1.2)
Foreign grants	4.8	1.5	14.2	6.8	8.8	5.7	-6.6
Total expenditure	10.2	1.3	7.0	9.0	4.1	14.4	13.3
Current expenditure 4/	12.3	0.5	14.3	7.2	5.0	11.9	11.0
Capital expenditure 4/	2.0	4.4	-24.3	20.3	-1.5	31.6	28.5
(Expenditure on goods and services) 5/	(6.9)	(-0.8)	(5.6)	(8.0)	(4.8)	(11.2)	(11.2)
(Interest payments)	(98.1)	(17.1)	(10.8)	(10.1)	(7.8)	(18.7)	(11.1)
				(In percent of GDP)			
Total revenue and grants	32.9	31.7	32.0	32.6	33.1	31.2	29.4
Domestic revenue	22.1	21.1	21.2	22.1	22.4	21.1	20.5
Tax revenue	(18.9)	(17.8)	(17.1)	(18.4)	(19.0)	(17.9)	(17.2)
Foreign grants	10.8	10.6	10.8	10.5	10.7	10.1	8.9
Total expenditure	38.8	37.8	36.3	35.8	34.2	35.0	34.6
Current expenditure 4/	31.6	30.6	31.4	30.5	29.8	29.8	29.6
Capital expenditure 4/	7.2	7.2	4.9	5.3	4.4	5.2	5.0
(Expenditure on goods and services) 5/	(35.2)	(33.5)	(31.8)	(31.1)	(30.2)	(30.0)	(30.0)
(Interest payments)	(3.1)	(3.5)	(3.4)	(3.4)	(3.4)	(3.6)	(3.3)
Overall balance	-5.9	-6.1	-4.3	-3.2	-1.1	-3.8	-5.3
Total public debt	32.1	36.3	42.2	...	42.1	...	42.9

Source: Data provided by the Papua New Guinea authorities.

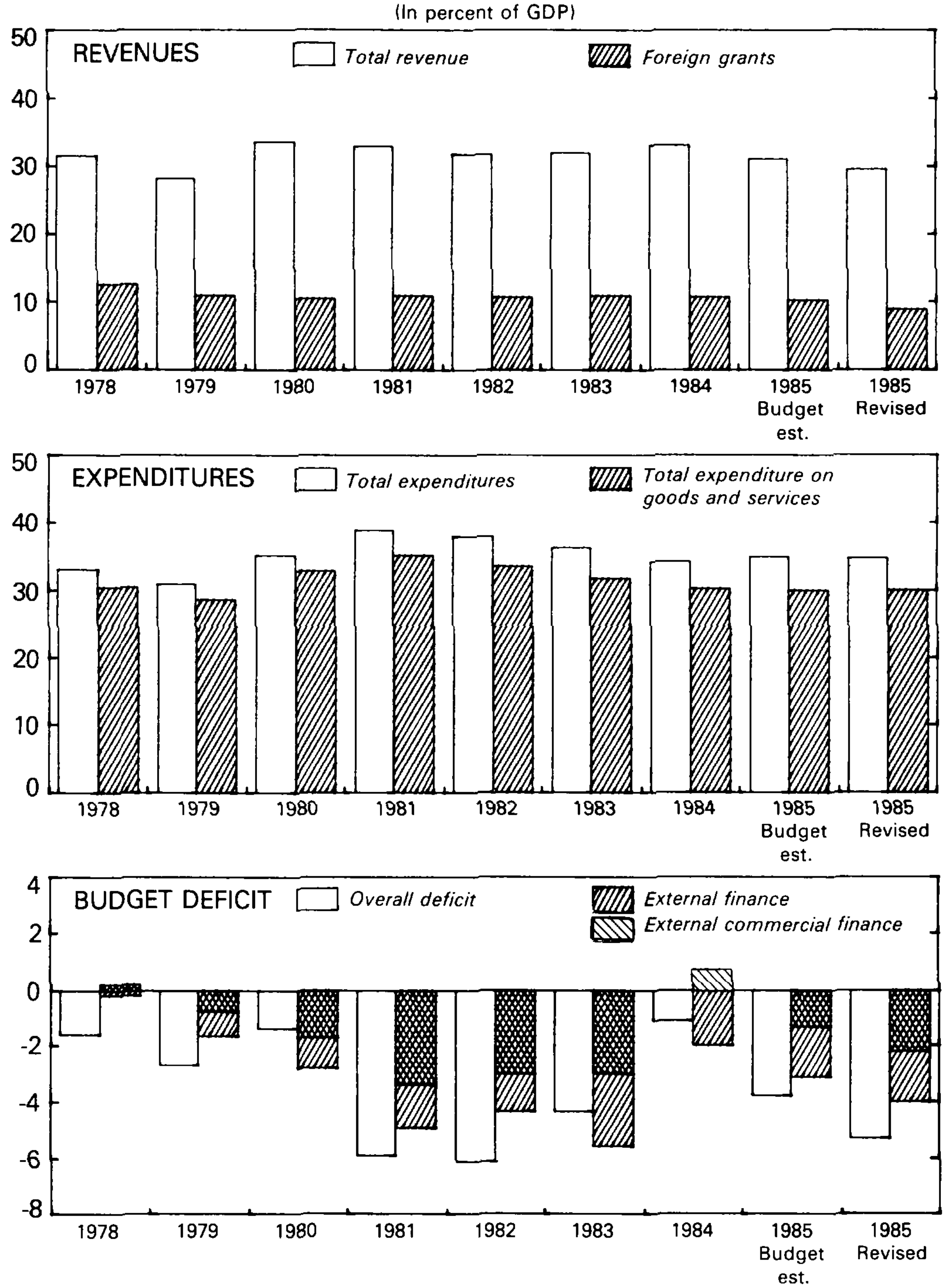
1/ The budget summary shown here is a consolidation of fiscal operations effected through the Consolidated Fund, the National Debt Sinking Fund, and the Mineral Resources Stabilization Fund.
2/ Domestic revenue consists of domestic tax and nontax revenues.
3/ Excludes promissory notes issued by the Government to reimburse the Bank of Papua New Guinea for foreign exchange losses resulting from exchange rate adjustments.
4/ Changes in data series beginning from 1983.
5/ Total expenditures less commercial investments and interest payments on public debt.

CHART 4

PAPUA NEW GUINEA

SUMMARY OF CENTRAL GOVERNMENT FISCAL OPERATIONS, 1978-85

(In percent of GDP)



Source: Data provided by the Papua New Guinea authorities.

government services that had been made during the recession. However, it was now apparent that some of the basic assumptions underlying the budget estimates, especially those relating to gold and copper prices, and the value of the Australian dollar, had been overly optimistic. The authorities recognized that, since revenues could not be augmented quickly, steps were needed to sharply reduce government spending in 1985.

Normal slippages in capital spending and lower import costs from Australia would constitute part of the necessary savings. However, government action to firmly reduce spending in other areas would also be needed, and the authorities intended, following approval at the political level, to implement these cuts during normal quarterly expenditure reviews in the next few months. At this stage, they did not have a firm view as to the magnitude of the likely adjustment to the 1985 budget, but indicated that it would be extremely difficult to reduce the deficit below that originally budgeted.

Despite the successful fiscal adjustment of recent years, government debt has increased rapidly, from the equivalent of 28 percent of GDP in 1980 to 42 percent in 1984. To contain the growth of debt, the budget deficit will need to be held to a low level over the coming years. Action to increase nonmineral revenues has been made all the more necessary by the delay, until at least 1992, in the receipt by the budget of Ok Tedi revenue because of development setbacks. Preliminary consideration is being given to measures to widen the tax base through increases in indirect taxes designed to minimize disincentives to growth and employment, consistent with the advice of Executive Directors at last year's Board discussion. Nevertheless, the authorities recognize that the major part of the budgetary adjustment over the medium term will necessarily fall on the expenditure side, and may involve cuts in the already modest spending increases previously foreseen.

3. External debt

External debt has risen sharply over recent years. Total medium- and long-term debt increased from the equivalent of 24 percent of GDP in 1980 to 76 percent in 1984; short-term debt is small. Private debt, largely associated with the Ok Tedi project, accounts for 70 percent of the increase in debt during this period and, at the end of 1984, accounted for 56 percent of the total outstanding. Public debt doubled between 1980 and 1983 before declining in 1984 as outstanding borrowings from the Fund and commercial sources were reduced moderately. Debt service payments increased fivefold between 1980 and 1984, rising from the equivalent of 7 percent of current receipts in 1980 to 29 percent in 1984. During the same period, the public sector debt service ratio rose from 4 percent to 9 percent.

On present prospects, the ratio of outstanding debt to GDP is expected to remain broadly unchanged in the period up to 1989. There would be a moderate increase in public debt but private debt would be stable, given present forecasts for Ok Tedi development. However, debt service payments, which were unusually high in 1983 and 1984 as BCL sharply reduced outstanding borrowings, would rise from an expected 24 percent of current receipts in 1985 to a peak of about 36 percent in 1988; during this period the public debt service ratio would rise from 9 to 12 percent. The aggregate debt service ratio would be expected to decline considerably in the 1990s as Ok Tedi copper exports come on stream.

The authorities believe that this external debt outlook is viable. It had been their intention to eliminate government general purpose foreign commercial borrowing by 1987, and during last year's Board discussion Executive Directors welcomed this policy. However, delays in the development of the Ok Tedi mine and its promise of large copper export earnings, and weak commodity price prospects, have made it impossible to meet this target while providing for even moderate increases in imports and development expenditure. The Government has therefore announced that it plans to continue borrowing in sizable amounts over the coming few years, although this would remain contingent upon a careful monitoring of the economic situation. The authorities note that, in some respects, the above debt service ratio projections represent a worst case scenario, and that the outlook would be more favorable if commodity prices are less depressed than now forecast, or if one or more resource-based projects now under study goes forward quickly. The Government's foreign debt policy is conceived as a comprehensive one, taking account of both public and private debt, mainly because lenders on foreign capital markets also take into account total exposure when considering new commitments. The authorities note, however, that the bulk of the private debt is guaranteed by the large foreign corporate partners in the Ok Tedi project, and that risks associated with the still uncertain future of this project are borne mainly by these companies. In these circumstances, the total debt burden projected for the second half of the 1980s involves substantially less direct risk to the balance of payments than if a larger proportion were made up of public or publicly guaranteed debt.

4. Monetary policy and interest rates

Credit policy remained relaxed in 1984, aimed at supporting the recovery in activity and employment. During last year's Board discussion, Directors supported the staff's view that monetary growth should be reduced from the accelerated rates that emerged in mid-1983. In the event, private credit expansion in 1984 exceeded the authorities' liberal ceiling by a substantial margin, and total liquidity (excluding stabilization deposits) continued to rise strongly (Table 4).

The authorities believe that monetary developments during 1984 were broadly appropriate to the circumstances. A large part of the increase in private credit reflected the substitution of domestic financing for foreign bank borrowing, with no impact on monetary growth or domestic demand; adjusting for these amounts, private credit expansion would be

Table 4. Papua New Guinea: Monetary Survey, 1981-85

(Amounts outstanding at end-period; in millions of kina)

	1981	1982	1983	1984				1985
				March	June	Sept.	Dec.	March
Net foreign assets 1/	221.8	205.0	320.6	336.4	337.8	403.9	348.5	332.2
Domestic credit	365.0	425.8	417.3	426.5	445.9	428.4	495.7	545.2
Government (net) 1/2/	43.4	71.2	4.8	8.4	5.9	-24.5	-5.4	14.2
Private sector	321.6	354.6	412.5	418.1	440.0	452.9	501.1	531.0
Of which: (seasonal loans)	(289.0)	(327.0)	(369.7)	(388.8)	(399.6)	(425.4)	(470.9)	(503.2)
Other items (net)	-32.2	-63.0	-88.4	-100.1	-83.4	-100.9	-98.9	-125.5
Total money (M3)	553.6	567.8	649.6	663.6	700.3	731.4	745.3	723.5
(12-month percentage change)	(0.3)	(2.4)	(14.4)	(8.3)	(18.8)	(12.2)	(14.5)	(9.0)
Deposits of stabilization funds	137.2	130.4	125.6	134.7	143.2	148.7	154.8	156.0
Deposits of Bougainville Copper Ltd.	4.6	2.9	25.2	27.2	5.3	12.2	3.3	10.0
Broad money (M3*) 3/	412.8	434.5	498.8	506.7	551.8	570.5	587.1	557.5
(12-month percentage change)	(7.9)	(5.3)	(14.8)	(20.6)	(23.6)	(16.8)	(17.7)	(11.1)
Money	193.2	187.6	203.2	190.6	217.1	219.3	223.0	188.3
Currency	(73.5)	(72.4)	(79.9)	(72.2)	(86.1)	(86.4)	(88.9)	(77.2)
Demand deposits	(119.8)	(115.2)	(123.3)	(118.3)	(131.0)	(132.8)	(134.1)	(111.1)
Quasi-money	219.6	246.9	295.6	311.1	334.7	351.2	364.0	369.2

Sources: *Data provided by the Papua New Guinea* authorities; and Bank of Papua New Guinea, Quarterly Economic Bulletin.

1/ Trust Fund loan of K 7.2 million is included in foreign liabilities and credit to the Government from September 1978.

2/ Banking system financing of the Government differs from that in the Summary of Central Government Fiscal Operations for three reasons: (i) for reporting purposes, the calendar year ends several days earlier in the case of the Central Bank; (ii) the transfer of profits from the Central Bank to the Government is captured one calendar year earlier in the fiscal accounts; and (iii) the fiscal accounts exclude liabilities in the form of non-negotiable promissory notes issues to finance the Government's payments to the Central Bank for the Bank's book losses due to revaluatiosn of the kina.

3/ Broad money supply (M3) less deposits of the three stabilization funds for coffee, cocoa and copra held with the commercial banks *and the Bank of Papua New Guinea, and deposits of* Bougainville Copper Ltd. held with the commercial banks.

within the ceiling. While credit policy remained liberal throughout the year, the liquidity of the banking system tightened considerably. Liquid asset holdings of the banking system in excess of the minimum requirement fell progressively from a peak of 13 percent of deposits in March 1984 to 4 percent by the end of the year. In part, this was due to a 4 percentage point increase to, 18 percent, in the minimum liquid asset ratio during the September quarter. This adjustment was not aimed at immediately reducing credit growth which, at that time, they considered to be satisfactory, but at reducing free reserves so that policies would be rapidly effective if restraint were desired subsequently. The reduction in free reserves fell unevenly among the banks, and recourse to the discount facility increased considerably toward year's end.

The authorities indicated that monetary policy has remained accommodative so far in 1985. The private credit ceiling has been set at K 70 million, unchanged from that in 1984, with the objective of extending the economic recovery and contributing to job creation. However, adjusting for the refinancing abroad of a large loan advanced in 1984, the ceiling is consistent with a net expansion in private credit of only about half that in 1984. Taking account also of the expected shift in the impact of external transactions, which are expected to be broadly in balance in 1985, credit policy is consistent with sharply lower monetary growth, which the authorities estimate at 8-11 percent during 1985.

Despite the tightening of bank liquidity toward the end of 1984, credit has expanded rapidly in the early months of 1985, in part supported by continued recourse to the Central Bank's discount facility. Preliminary data for March 1985 indicate that private credit accelerated to a level 27 percent higher than one year earlier, compared with an increase of 21 percent in 1984; however, because of a turnaround in the impact of external transactions, monetary growth slowed to about 11 percent in the year to March 1985. Data for April 1985 reveal a further surge in private credit. Even allowing for the normal seasonally strong credit growth during the recent period, this poses a serious test for monetary policy. The authorities are now seeking information on the factors accounting for the recent credit surge and likely credit demands for the period ahead. Should this review indicate that the ceiling is likely to be breached for the year as a whole, consideration would be given to restraining measures. Possible steps to restrain credit would embrace a range of instruments, including a further increase in the minimum liquid asset ratio and, in the first instance, an increase in interest rates.

The last remaining direct control on bank interest rates--that on passbook savings accounts--was lifted in January 1985. The banks are now setting interest rates freely, subject to competitive pressures and central bank interest rates. During the past year interest rates throughout the financial system have been virtually stable. The authorities estimate that underlying inflation (excluding the impact of betel nut) remains at about 7 percent, suggesting that real interest rates continue to be relatively low and, in some cases on the deposit side, negative in real terms. Last year, Directors noted the need for positive real interest rates to encourage savings over time. The authorities note that competition among the banks has increased markedly since two new foreign banks began operations in 1983. While competition had reduced the average margin between deposit and lending rates, greater competition had not had any noticeable impact on the general level of rates. The apparent paradox of relatively low, but market determined interest rates is partly a reflection of reluctance by the banks to lend to new and small-scale businesses, including those in the agricultural sector, because of high risks of default. To better meet the credit needs of such businesses, the former Development Bank is being transformed into the Agricultural Bank of Papua New Guinea. It is targeted that 80 percent of the lending by this bank will be to the agricultural sector.

V. Staff Appraisal

Economic developments during 1984 were generally favorable but it appears that the peak of the cycle has passed, and the outlook for 1985 and beyond is less auspicious. While the first full year of Ok Tedi gold production is expected to result in an acceleration in growth to about 7.5 percent in 1985, output and incomes in the rest of the economy are likely to expand more slowly as the terms of trade and agricultural production weaken. However, demand conditions, which recovered during the course of 1984, are likely to remain strong in the current year. In particular, business investment outside the mining sector seems likely to surge, recouping most of the ground lost during the earlier recession, with welcome implications for future growth. Imports, other than those for the further development of Ok Tedi, which has been postponed for several years, are expected to again grow rapidly, while agricultural exports are likely to decline. Nevertheless, the magnitude of Ok Tedi is such that its first year's exports add a quarter to the previous export total. As a result, the current account deficit as a proportion of GDP is expected to fall for the third successive year. Nevertheless, with lower private capital inflows, the overall balance of payments position is likely to weaken significantly and a small deficit is now forecast following sizable surpluses in the past two years.

Medium-term prospects are generally not favorable and have deteriorated somewhat since the last consultation. Export volumes are not likely to increase markedly--in part because of the postponement of investment to mine Ok Tedi's copper lode--while price prospects for both agricultural and mineral exports are poor and have weakened over the past year. Together with a likely cutback in Australian assistance, resources may not be available to finance any increase in imports in real terms over the next few years. Likely external pressure, together with the severe restraint on budgetary spending that it implies, means that the Government's first five-year Development Plan will be launched in a most austere environment. This sets a challenge for the authorities to devise policies which will allow them scope to address their objectives of achieving faster economic growth and generating employment opportunities while maintaining external viability.

Economic policies were adapted to the enormous task of external adjustment presented by the recession of the early 1980s. At the same time, a start was made in addressing some long-standing structural difficulties inhibiting growth and international competitiveness. In most areas, including notably budgetary and external debt management, 1984 was a year of positive policy implementation and achievement. The improved circumstances of the past year do not allow a relaxation of policy efforts. Indeed, prospects for the coming few years demand that rigorous and sustained adjustment policies be implemented if the economy is to traverse this period smoothly. Especially in the areas of demand management and external debt, policy corrections are urgently needed from the course that is being set in 1985.

The 1985 budget stands out in sharp contrast to the past three years of fiscal restraint. Even when measured against prospects at the time it was prepared, the budget was strongly expansionary, and subsequent developments make it likely that the expansionary impetus will now be even stronger. The prospective increase in government spending is not warranted by domestic demand conditions, which remain buoyant, and would establish government spending on an unsustainable path for the future. The prospective increase in the budget deficit to over 5 percent of GDP would reverse the hard-won progress achieved since 1982. While such a deficit could no doubt be financed in the current year, it would involve an undesirable increase in public debt which has already doubled since the beginning of the decade. The staff believes measures are urgently needed to significantly reduce the prospective budget deficit for 1985, primarily through a cutback in planned spending levels. Even a deficit of the originally budgeted level would still be excessive in present circumstances.

Moreover, the need for spending restraint is likely to persist over the coming years to ensure external viability. In setting targets for the new Development Plan, few opportunities will exist to pursue development aims by increases in aggregate expenditure. The potential to develop programs to promote employment will depend critically on the capacity to reduce spending in other areas. In particular, this would involve steps to contain the Government's wages bill, and the high share of revenues absorbed by general administration. At the same time, the existing scope to increase nonmineral tax revenues, especially by broadening the tax base, should be pursued vigorously.

With heightened concern to generate employment opportunities, the Government has reacted to the less-favorable resource outlook that has emerged over the past year by postponing its decision to eliminate foreign commercial borrowing. The staff believes, on the contrary, that the more austere resource outlook reinforces the need to reduce borrowing, as fewer resources will be available to service it. External debt and debt servicing payments are estimated to rise considerably over the next few years. Without challenging the authorities' judgment that this position would be manageable, the staff believes a more cautious approach is required. Especially in view of the unreliability of market sentiment, which is heightened by uncertainties surrounding the Ok Tedi project, government commercial borrowing should be quickly wound down.

Monetary policy was relaxed throughout 1984 and private credit and liquidity growth expanded at a rapid rate, contributing importantly to domestic demand. Although monetary policy in 1985 aims at maintaining support for expanding activity, the official credit ceiling is consistent with a much slower expansion in private credit and a reduction in monetary growth to about 8-11 percent. This appears broadly appropriate to the circumstances of 1985. However, credit growth has recently accelerated, and it now appears that, in the absence of adjustments, it will exceed the ceiling. This calls for restraining action which should not be delayed. An increase in central bank interest rates would be a useful first step in this direction, especially as it would have the additional benefit of raising interest rates generally, but interest rate policy may need to be supported by other more direct-acting measures.

Real wages have been reduced moderately in the first two years covered by the present wages agreement, and exchange rate policy has been deployed more flexibly with the aim of strengthening international competitiveness. The task of implementing these policies has been complicated by wide fluctuations in domestic prices. The recent weakening of the Australian dollar has had a favorable impact on Papua New Guinea's competitiveness and provides an opportunity for further flexible use of exchange rate policy to ensure that a reasonable real wage adjustment is achieved during the final year of the current wages agreement. In decisions on the new wages agreement to be negotiated later this year, the Government's role must be to provide strong leadership in support of an agreement which maintains, and strengthens to the maximum extent possible, the movement toward real wage adjustment. Significant progress in reducing real wages and improving international competitiveness is essential over the medium term if it is to be possible for the Government to effectively pursue its development objectives.

It is recommended that the next Article IV consultation with Papua New Guinea be held on the standard 12-month cycle.

Papua New Guinea - Fund Relations
(As of June 30, 1985)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership Status

(a)	Date of membership:	October 9, 1975
(b)	Status:	Article VIII

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 65.9 million

		Amount	Percent of quota
(b)	Total Fund holdings of currency:	70.7	107.2
(c)	Fund credit:	10.1	15.3
	Of which: CFF	10.1	15.3
(d)	Reserve tranche position:	5.4	8.1

(e) Current Operational Budget: An early repurchase of SDR 13.5 million was made in the March-May period and a further early repurchase (SDR 7.4 million) is expected in the June-August period.

(f) Lending to the Fund: None

III. Current Stand-by or Extended Arrangement and Special Facilities

(a)	Current stand-by or extended arrangement:	None
(b)	Previous stand-by and extended arrangements during the last 10 years:	None
(c)	Special facilities in the past two years:	None

IV. SDR Department

		Amount	Percent of allocation
(a)	Net cumulative allocation:	9.3	100.0
(b)	Holdings:	6.4	68.3
(c)	Current Designation Plan:	Not included	

V. Administered Accounts

		SDR mn.
(a)	Trust Fund Loans:	
	(i) Disbursed:	19.5
	(ii) Outstanding:	17.1
(b)	SFF Subsidy Account	None

VI. Overdue Obligations to the Fund — None

(B) Nonfinancial Relations

VII. Exchange rate arrangement

Since December 1976, the kina has been pegged to a basket of currencies of major trading partners. The exchange rate on March 29, 1985 was K 1 = US$0.99. Since April 1980, the U.S. dollar has been used as the intervention currency. The representative rate of kina against the U.S. dollar is the mid-point between buying and selling rates for spot transactions in U.S. dollars as determined daily by the Bank of Papua New Guinea.

VIII. Last Article IV Consultation

The last Article IV consultation took place during May 7-18, 1984 and the discussion by the Executive Board was held on August 8, 1984. It was proposed to hold the next Article IV consultation on the standard 12-month cycle.

IX. Technical Assistance:

(a) Central Banking Department: Three experts assigned to the Bank of Papua New Guinea to assist in the management of the Bank.

(b) Bureau of Statistics: During 1985, the Bureau of Statistics undertook statistical missions to Papua New Guinea in the field of money and banking statistics (January) and general economic data (February).

X. Resident Representative/Advisor: None

Papua New Guinea--Relations with the World Bank Group 1/

(In millions of U.S. dollars)

A. IBRD/IDA Operations: 2/ (as of March 31, 1985)	Disbursed		Undisbursed	
	IBRD	IDA	IBRD	IDA
Agriculture and rural development	13.5	46.8	28.4	1.7
Education	1.9	15.7	53.4	0.3
Power	34.0	1.8	--	1.2
Telecommunications	17.0	--	--	--
Transportation	28.0	44.7	28.0	--
Total 3/	94.4	109.0	109.8	3.2
Of which has been repaid	14.2	1.0		
Total now outstanding	80.2	108.0		

B. Annual net disbursements:	IBRD	IDA	Total
1978	1.4	8.5	9.9
1979	3.3	6.1	9.4
1980	3.6	5.2	8.8
1981	2.5	15.0	17.5
1982	2.7	7.2	9.9
1983	9.5	4.8	14.3
1984	10.1	13.5	23.5

C. Technical assistance: The IBRD provides technical assistance to Papua New Guinea through its standard lending operations for projects as well as in the context of its economic and sector analyses.

D. Recent economic and sector missions: Economic Mission, June 1985. A Fund staff member from FAD is attached to this mission. Energy Assessment Report, June 1982. Public Administration/Resource Management, September 1982 and April 1985. Mineral Sector Mission, October 1982.

1/ IFC has so far made no loans.
2/ Effective loans.
3/ Due to rounding and to fluctuations in SDR equivalents, columns may not add up to totals.

Papua New Guinea

Selected Economic and Financial Indicators

Area: 178,260 square miles (461,693 sq. km.)

Population (population growth): 1984; 3.25 million (2.1 percent per annum since mid-1960)

GDP (GDP per capita): 1984; SDR 2,368 million (SDR 728)

Exchange rate: May 30, 1985 K 1 = SDR 0.97401

	1981	1982	1983	1984	1985 Proj.
		(Annual percentage change)			
National income and prices					
GDP at constant prices	1.5	-0.2	0.8	2.2	7.7
GDP adjusted 1/	-9.6	-2.4	4.9	3.7	5.7
GDP deflator	-2.1	4.2	10.5	8.1	3.5
Consumer prices	5.6	6.9	8.5	4.4	4.5 2/
External sector (kina basis)					
Exports, f.o.b.	-14.2	0.4	21.7	17.7	18.7
Imports, f.o.b.	7.9	1.9	8.3	4.3	9.4
(Excluding Ok Tedi)	(6.9)	(-10.1)	(5.5)	(15.2)	(12.8)
Terms of trade (deterioration, -)	-26.8	-8.7	10.9	10.6	-2.7
Nominal effective exchange rate (depreciation, -) 3/	5.2	-0.5	-8.9	--	-2.6 4/
Real effective exchange rate (depreciation) 3/	2.4	0.1	-5.6	0.9	-1.1 5/
Government budget					
Revenue					
Excluding foreign grants	-6.2	-0.3	11.4	17.2	1.8
Including foreign grants	-2.8	0.3	12.4	14.4	-0.9
Total expenditures	10.2	1.3	7.0	4.1	13.3
Money and credit					
Domestic credit	27.2	16.7	-2.0	19.0	27.8 2/
Of which: private sector	15.4	10.3	16.3	21.0	27.0 2/
Broad money (M3*) 6/	7.9	5.3	14.8	17.7	11.0 2/
Velocity (GDP/M3*) 6/	4.1	4.1	4.0	3.7	...
Treasury bill rate	14.6	11.7	9.0	9.5	9.8 7/
		(In percent of GDP)			
Gross domestic investment	26.5	32.3	30.6	23.9	23.5
Private	16.5	24.9	24.3	...	...
Of which: BCL and Ok Tedi	3.6	14.5	15.6	7.8	3.6
Public	8.9	7.7	7.0	...	...
Gross domestic savings	6.2	8.9	12.2	10.4	14.4

Papua New Guinea

Selected Economic and Financial Indicators (concluded)

	1981	1982	1983	1984	1985 Proj.
			(In percent of GDP)		
Central Government budget deficit (-)					
Excluding foreign grants	-16.7	-16.7	-15.1	-11.8	-14.2
Including foreign grants	-5.9	-6.1	-4.3	-1.1	-5.3
Domestic bank financing	1.7	1.7	-1.5	-1.7	0.4
Foreign financing	4.9	4.3	5.6	2.0	4.0
Tax revenue	18.9	17.8	17.1	19.0	17.2
Central Government expenditure	38.8	37.8	36.3	34.2	34.6
External current account surplus or deficit (-)	-20.7	-20.1	-15.6	-13.6	-10.0
Excluding official transfers	-31.9	-31.1	-26.6	-29.4	-19.1
Excluding Ok Tedi	-12.9	-12.5	-6.3	-8.9	-13.6
External debt	36.9	52.5	75.6	76.2	75.5
(Excluding Ok Tedi)	(36.4)	(44.5)	(48.3)	(44.2)	(44.8)
External debt service ratio 8/	8.8	15.2	22.3	29.0	24.0
Interest payments ratio 8/	5.5	9.5	9.9	10.3	12.3
			(In millions of SDRs)		
Exports	714	698	775	887	988
Imports	-931	-924	-914	-945	-952
(Excluding Ok Tedi)	-922	-807	-777	-888	-921
External current account	-443	-436	-344	-323	-248
Overall balance of payments	-49	-28	93	48	-4
Gross official reserves	366	328	433	461	41.9 7/
(In months of imports)	(4.8)	(4.2)	(5.6)	(6.0)	(4.9)
External payments arrears	--	--	--	--	--
External debt outstanding	801	1,160	1,621	1,793	1,875

Sources: Data provided by the Papua New Guinea authorities; and staff estimates.

1/ Adjusted for terms of trade by deflating exports of goods and nonfactor services by import prices.
2/ To March 1985.
3/ Fourth quarter to fourth quarter.
4/ During the first four months of 1985.
5/ During the first three months of 1985.
6/ Excludes deposits of Bougainville Copper Limited and those of the commodity stabilization funds.
7/ March 1985.
8/ Relative to current account receipts (including official transfers).

Papua New Guinea--Statistical Issues

1. Outstanding statistical issues

a. Real sector

A STAT technical assistance mission, which visited Papua New Guinea in February 1985, undertook a review of the methodologies underlying the compilation of statistics on the national accounts, production, and prices. A report on the mission is currently under preparation and will be submitted to the authorities soon.

In the area of national accounts statistics, the mission suggested that the results of the annual censuses and the proposed quarterly surveys of agricultural activities and secondary industries be used to update the estimates of GDP by industrial origin. There is a considerable lag in the availability of data on this series. In addition, the mission recommended improvements be made in the estimation of the nonmarket component of GDP through the execution of a benchmark survey of subsistence agriculture supplemented by the use of nutritional surveys for the rural areas.

Data are currently lacking on indices of agricultural and industrial production. On the basis of available annual data, the mission computed an index of agricultural production for the period 1972-81 and suggested that the calculation of this index be maintained on a quarterly basis through the use of data derived from the conduct of quarterly surveys of agricultural production in addition to the annual census. In addition, the mission recommended that volume data on industrial production be collected on a quarterly basis with a minimum lag; this will facilitate the computation of an industrial production index on a regular basis.

The weights underlying the calculation of the consumer price index are derived from the household expenditure survey of 1975-76. The mission recommended that a new household expenditure survey, based on larger samples and more appropriate classification, be conducted as soon as resources permit. This would permit the incorporation of a more recent weighting structure in the index.

b. Monetary accounts

A STAT technical assistance mission in money and banking statistics visited Papua New Guinea in January 1985 with a view to reviewing the monetary data and to assessing the feasibility of extending the coverage of Papua New Guinea's financial statistics. The report of the mission is presently under preparation and will be forwarded to the authorities shortly. The mission noted that there were no major deficiencies in the data currently provided for the central bank and the commercial banks. It was also established that it will be possible to broaden the scope of the financial system to encompass data for nonmonetary financial institutions.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Papua New Guinea in the July 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Papua New Guinea, which during the past year have been provided on a timely basis, although the currentness of the data on prices and external trade could be improved somewhat.

Status of IFS Data

		Latest data in July 1985 IFS
Real sector	- National accounts	1983 (partial)
	- Prices: Consumer	Q4 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government finance	- Deficit/surplus	1983
	- Financing	1983
	- Debt	1983
Monetary authorities	- Monetary authorities	March 1985
	- Deposit money banks	March 1985
	- Other financial institutions	n.a.
External sector	- Merchandise trade:	
	Value	
	Exports	Q4 1984
	Imports	Q3 1984
	Unit value	
	Exports	Q4 1983
	Imports	December 1984
	- Balance of payments	Q3 1984
	- International reserves	April 1985
	- Exchange rates	April 1985