February 27, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/99-2

11:00 a.m., November 26, 2018

2. Papua New Guinea—2018 Article IV Consultation

Documents: SM/18/267 and Correction 1; and Supplement 1 and Supplement 2

Staff: Roger, APD; Gonzalez Miranda, SPR

Length: 30 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	J. Essuvi (AE), Temporary
	F. Sylla (AF)
	J. Corvalan (AG), Temporary
N. Ray (AP)	
	A. Souza (BR), Temporary
	K. Lok (CC), Temporary
	J. Montero (CE), Temporary
	D. Hart (CO), Temporary
	S. Benk (EC)
	A. Castets (FF)
	S. Buetzer (GR), Temporary
S. Gokarn (IN)	
	P. Di Lorenzo (IT), Temporary
	Y. Saito (JA)
	S. Alavi (MD), Temporary
	P. Al-Riffai (MI), Temporary
	V. Rashkovan (NE)
	K. Virolainen (NO)
	S. Potapov (RU), Temporary
	B. Alhomaly (SA), Temporary
	K.Tan (ST)
P. Inderbinen (SZ)	
	M. Cowie (UK), Temporary
	A. Grohovsky (US), Temporary

G. Bauche, Acting Secretary
J. Morco, Summing Up Officer
R. Smith Yee, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: O. Brekk, R. Nakatani, S. Roger, A. Stuart. Monetary and Capital Markets Department: C. de Barros Serrao. Strategy, Policy, and Review Department: M. Gonzalez Miranda. Alternate Executive Director: M. Siriwardana (IN), P. Sun (CC). Senior Advisors to Executive Directors: G. Preston (AP), J. Shin (AP), O. Stradal (EC). Advisors to Executive Directors: E. Amor (AP), P. Braeuer (GR), S. David (AP),

G. Khurelbaatar (AP), M. Kikiolo (AP), G. Kim (AP), T. Manchev (NE), H. Mori (JA), E. Ondo Bile (AF), A. Park (AP), I. Skrivere (NO).

2. PAPUA NEW GUINEA—2018 ARTICLE IV CONSULTATION

Mr. Ray, Mr. Johnston and Mr. David submitted the following statement:

Papua New Guinea is the largest Pacific island country and one of the most culturally diverse nations in the world, with over 800 different ethnic languages. Around 85 percent of the population lives in rural and remote areas, where government services are difficult to access. Almost all land is in customary ownership. Much of it, however, comprises swamps, steep mountains, dense forests, rivers and rugged terrain, and PNG suffers frequently from natural disasters. The physical and climatic conditions create logistical and infrastructure challenges and many development indicators remain low. The country is richly endowed with natural resources, and the oil, gas and mining industries make up a significant part of the economy. While this exposes PNG to commodity-driven cycles, the country has a sound financial system and a stable political environment, and the Government is committed to sound macroeconomic management.

Developments and Outlook

The 2018 Supplementary Budget and the 2019 Budget were presented to Parliament in mid-November. These show the budget deficit and debt-to-GDP ratios on declining paths, in compliance with the Fiscal Responsibility Act and the Medium Term Fiscal Strategy. Revenue in 2018 has been higher than expected but so has expenditure, with spending increases primarily due to higher employment in the Government’s priority areas of education, health and law and order. The expected Budget outturn in 2018 has improved, despite a large earthquake that cost many lives and disrupted operations at oil and gas fields and at a gold mine. The PNG authorities expect 0.3 percent growth in 2018, compared to staff’s zero percent, due to a faster-than-anticipated recovery from the earthquake, improved commodity prices and APEC-related activities. They agree the economy will pick up substantially next year, boosted by a recovery in the oil and gas sector and by activity associated with large mining and petroleum projects.

PNG issued its first sovereign bond in October, raising US$500 million for a 10-year maturity that was heavily over-subscribed. In addition, budget support loans were secured from the ADB and World Bank, with the first tranches of US$100 million and US$150 million, respectively, occurring in 2018. Other external financing efforts in 2018 include the final, US$190 million, disbursement of a Credit Suisse commercial loan.

Fiscal Policy

The authorities are committed to prudent financial management. Although fiscal consolidation has been challenging, the authorities have made good progress on tax collection and public financial management. Resident TA from the Fund has helped implement a five-year Medium-Term Revenue Strategy aimed at mobilizing domestic revenue. A large taxpayer office was opened in September to improve service and compliance.

On the expenditure side, the authorities note staff's suggestions for spending cuts but recognise that these are in difficult and sensitive areas. As part of the 2019 Budget, the Government is establishing tighter controls in the payroll system to ensure salaries are linked to budget warrants, as is the case for goods and services. It is also instituting tighter controls on the in-take of teachers, health workers, police and the military, but their impact will be gradual because of programmed throughput from training colleges. Provincial and district grants, while opaque, have brought direct benefits to areas and regions that have not previously experienced much in terms of government services and are part of the Government's decentralization strategy.

The Government's Medium Term Fiscal Strategy 2018-22, incorporating requirements of the Fiscal Responsibility Act, limits public debt to within a band of 30 to 35 percent of GDP, trending towards the lower limit in the medium term. Successive Budgets have been designed around this requirement, with the 2019 Budget showing debt falling below 30 percent of GDP in 2021. Earlier this year, new National Accounts data for 2014 and 2015 was released that incorporated a change in deflator methodology. This indicated a significantly lower nominal GDP level than previously reported and therefore a considerably higher debt-to-GDP ratio, threatening a breach of the Fiscal Responsibility Act. The new numbers took the authorities by surprise, with no opportunity for a transition strategy and associated communications strategy. The Budget, the Government's fiscal strategy and its public communications have been based around the previous methodology, so this abrupt change has been the source of some frustration to the authorities, who are now focusing on the best way forward.

Monetary and Financial Sector Policies

The Bank of Papua New Guinea (BPNG) has maintained its neutral monetary policy stance given the easing in inflation, relative stability of the kina exchange rate and moderate global economic growth. While liquidity levels remain high, lending to the private sector has been relatively weak, although it is expected to pick up with increased economic activity. BPNG is refining its monetary policy framework to improve the transmission of monetary policy and liquidity management. This includes introducing quantitative targets for the reserve money framework, a new overdraft facility (the Intra-day Liquidity Facility), and a collateralized repo facility with an interest rate corridor. The authorities are grateful for the Fund's policy advice and technical assistance in this area.

The authorities agree with staff on exchange rate flexibility and the need for orderly adjustment. But they consider a more gradual depreciation to be appropriate, especially given structural issues with a shallow domestic market and few dealers. The government's foreign borrowing, including the bond issue, has helped clear most of the back log of foreign exchange orders. The kina equivalent is being used to restructure and reduce short-term domestic debt. This will reduce high domestic interest costs, reduce refinancing risks and extend the maturity of the government's debt portfolio. BPNG and Treasury will work together to coordinate their actions and manage liquidity.

PNG's financial system is sound, and dominated by commercial banks which are well-capitalized, profitable and have low NPL ratios. The authorities agree they should remain vigilant on financial stability in light of the proposed monetary and FX reforms, liquidity management challenges and the proposal to change the Government's domestic debt maturity structure. In addition, the proposed take-over of ANZ's retail and SME business operations by Kina bank will require careful monitoring by BPNG.

Structural Policies

In the medium term, growth in PNG could be boosted by several major resources projects currently being developed, including expansion of the existing PNG LNG project, development of another LNG project and the Wafi-Golpu gold project. The authorities consider that, subject to overall investment risks, the government's involvement in future resource projects should be tilted more towards higher payments earlier in the project cycle, to reduce fiscal risk and ensure that revenue is derived from production rather than profitability.

A sovereign wealth fund is currently being established, to invest proceeds from the non-renewable resources sector. A board will be appointed shortly, to start the process of operationalizing the fund. While the resources sector is likely to drive growth in the future, the authorities also recognize the need to diversify the economy into sectors such as agriculture, tourism and services, and have assisted these sectors in the 2019 Budget. The Government is supporting, for example, production of locally-grown rice, vegetables, meat and dairy product. PNG hosted APEC this year and the authorities considered this an important opportunity to showcase the country and promote investment.

The authorities are committed to addressing governance issues, recognizing the important role good governance plays in development. Substantial progress has been made in this area, including enhancing the AML/CFT framework, undertaking a national risk assessment and getting a National Procurement Act and revised Public Finance Management Act approved by Cabinet. Legislation on an Independent Commission Against Corruption (ICAC) is awaiting approval. Civil society organizations in PNG also welcome the new focus of the IMF in addressing governance issues.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for the comprehensive reports and Mr. Ray, Mr. Johnston and Mr. David for their informative buff statement. It is encouraging that a stronger macroeconomic performance is expected in 2019 supported by a recovery from earthquake in 2018, higher commodity prices and improvement in FX supply. It is also encouraging that the authorities secured external financing thorough its first sovereign bond issuance and budget support loans from the ADB and World Bank. However, we note that public debt indicator is well above the medium-term target based on the revised statistics, improved tax revenues are offset by expenditure slippages, and overvalued Kina causes imports compression and buildup of backlog of FX orders. Against this background, we encourage the authorities to take measures including further fiscal consolidation, more flexible exchange rate adjustment and tackling statistical problems. As we broadly agree with the thrust of staff's appraisal, we would like to make following comments for emphasis.

Fiscal Policy

We commend that the authorities have implemented fiscal reform measures including the strengthening of public financial management and the development of medium-term revenue strategy (MTRS). We also welcome that the authorities adopted medium-term targets of a zero non-resource primary balance and a below 30 percent debt to GDP ratio. Having said so, we take note the staff's suggestion that further fiscal consolidation is needed and the primary focus should be on the expenditure side including personnel emoluments and District and Provincial Service Improvement Program grants. In this relation, we would like to hear staff's assessment on the recently submitted 2019 budget. Do staff think the 2019 budget appropriately incorporate staff's policy advice?

On the issuance of a debut sovereign bond, while we share the staff's view that it will help lengthen the maturity profile of domestic public debt and reduce the FX orders backlog, we encourage the authorities to cautiously monitor the situation as it will involve new risks such as FX risks and rollover risks in particular when the exchange rate is expected to depreciate.

Monetary and Foreign Exchange Policy

We agree with staff that the pace of exchange rate adjustments should be stepped up somewhat so as to increase FX supply and eliminate the backlog of FX orders while giving due consideration to inflation. We note that interest rate transmission is currently weak and needs to be improved. In this regard, we positively note that the BPNG is adopting broad-ranging reforms to monetary and foreign exchange policies which include improvement of monetary policy communication and strengthening of the monetary operations framework. We encourage the authorities to implement reforms with a support from the Fund TA as needed.

Structural Policies

We agree with staff that better management of natural resource wealth and addressing challenges in governance and corruption are required to achieve development. We support the staff's recommendation that the authorities should seek better terms in negotiations for new resource projects so that the authority can receive the revenue of the project and also should develop a framework for management and use of resource revenues. On the governance and corruption, strengthening governance and reducing corruption are crucial to increase transparency of the government and hence increase the attractiveness of the country as a destination for investment. We welcome the roll-out of the IFMIS budget monitoring system and the passage of a National Procurement Act.

Statistics

We are concerned about the significant deviation of GDP figures between the National Statistical Office (NSO) data and the Treasury estimates. We note that the Budget, Government's fiscal strategy and its public communications have been based on the previous methodology as the new National Accounts data for 2014 and 2015 is significantly lower than previously reported. As staff rightly point out, timely production, compilation, and dissemination of macroeconomic statistics is essential to effective fiscal and monetary policy formulation. To this end, we urge the authorities to take necessary measures on top of the key stakeholders meeting that Treasury has initiated. In this relation, we note from BOX1 that the difference of nominal GDP reflects not only incorporation of an improved methodology but also different information on activity and prices in sectors such as oil, gas, and construction. Could staff elaborate more on the accuracy and adequacy of information obtained by NSO? Does staff envisage upward revision of NSO data once necessary data become available?

Mr. Rashkovan and Mr. Manchev submitted the following statement:

We thank staff for the focused report and Messrs. Ray, Johnson and David for the informative buff statement. Despite significant progress with strengthening the public finance management since the last Article IV Consultation, a combination of adverse factors in addition to the large earthquake in 2018, pose risks and continue to impede Papua New Guinea (PNG)'s sustainable development in the medium-term. Nonetheless, we are encouraged by the authorities' closer cooperation with the Fund to mitigate these risks through increasing the exchange rate flexibility and preparing further monetary and fiscal policy adjustments. Since we broadly agree with the staff's appraisal and recommendations the comments below are provided to emphasize that a sustainable development strategy is needed to safeguard macro-financial stability while pursuing PNG's development objectives.

Fiscal Policy and Debt Management

Further fiscal consolidation is warranted to sustainably reduce the debt-to-GDP ratio and ensure the non-resource fiscal balance in the medium term. Public communication should be strengthened to ensure the necessary popular and political support for the needed fiscal structural reforms. We agree with staff that the recent introduction of an integrated Financial Management Information System (FMIS), supported by the EU, provides the PNG with a unique opportunity to substantially improve transparency, accountability monitoring and the overall control of fiscal operations and public procurement. Building on that, the authorities need to improve the budget allocations, reduce personnel cost, and eliminate payment delays and arrears. The government finance and national account statistics should be brought in line with the well-established international standard and reporting practices. If the revenue mobilization under the recently adopted medium-term revenue strategy takes time to be fully realized, painful expenditure restraints may be needed. As also underscored by staff, the recently established proactive approach toward public debt management needs to be closely coordinated with the Bank of PNG's (BPNG) FX market interventions to minimize volatility in the domestic liquidity conditions.

Monetary Policy Framework and Financial Stability

We welcome the evolving principal debate on the BPNG's Monetary Policy Framework aiming to increase both credibility and policy effectiveness. Fund engagement with the authorities should continue to provide the necessary TA for preparing the reform plan and implementation strategy. We note the authorities' concerns that depreciation of the Kina may have limited impact on the external balance while increasing inflationary expectations and price volatility. Going forward, it would be critical that the authorities establish an adequate liquidity management capacity and together with staff develop credible liquidity forecasting tools, which would help clear the backlog FX orders without adversely affecting market liquidity. Well-sequenced reforms in the financial sector should also allow the authorities to better manage liquidity, finance the government deficit and private sector growth.

We note that PNG's financial sector is well capitalized and over-liquid. The domestic interbank market, however, remains an inefficient instrument for liquidity provisioning and management, which poses substantial financial stability risks. We also observe that the BPNG has made some progress, with assistance from the Asian Development Bank, with designing an appropriate risk-based AML/CFT framework and strengthening financial supervision. Building on the recent progress, the authorities need to adopt and implement several strategic documents on AML/CFT and strengthen the regional cooperation. Staff's further engagement with the BPNG is essential to sequence the needed financial sector reforms with envisaged changes in the monetary and foreign exchange regimes. We would appreciate staff's detailed comments on how to mitigate financial stability risks arising from the capacity constraints.

Economic Diversification and Sustainable Development

Better management of the natural resource wealth and greater diversification of the economy remain critical for PNG's sustainable long-term development. We welcome the authorities' recent measures, summarized in paragraph 29, to strengthen governance and reduce corruption. Despite abundant potential, however, the sectors outside of mining and energy seem underdeveloped in comparison to PNG's regional peers. We agree with staff that the authorities' development policies need to focus on removing the significant obstacles to development in non-resource sectors. Nevertheless, staff's analysis on structural reforms is rather limited and does not comment on macrocritical issues like the restrictive business environment, discrimination of women, high levels of domestic violence, and low levels of financial access and inclusion. In this regard, further information is also sought on the Fund's plan for cooperation with the other development partners in PNG.

Mr. Inderbinen and Mr. Imashov submitted the following statement:

We take good note of the projected economic recovery in Papua New Guinea, following difficult years of exogenous shocks and subdued growth. Output was affected by the decline in oil prices and a severe drought. Also, as emphasized in Messrs. Johnston and David's informative buff, the earthquake earlier this year in Hela Province entailed significant damages and a high cost of reconstruction. The anticipated recovery should be seen as an opportunity to firmly establish macroeconomic stability and durably strengthen policy frameworks.

Further measures are needed to ensure fiscal stability. We note the improved budget outturn for 2018. Also, we welcome the recent improvements in PFM. Nonetheless, further steps are required to reverse the decline in revenue as a share of GDP, and to strengthen the fiscal framework. A predictable public resource envelop will be critical for the success of the authorities' economic development and poverty reduction goals. We encourage the authorities to consider an expenditure rule, as recommended by staff, and to take the measures listed in paragraph 20 of the report under advisement. We note the substantial differences in the debt-to-GDP projections between staff and the authorities, and also the current difficulties associated with the recently revised National Accounts data.

We encourage the authorities to take the necessary steps to restore exchange rate flexibility. As the staff report shows, foreign exchange rationing is causing a misallocation of resources, and the effects of the current overvaluation run counter to the authorities' development strategy. We support the suggestions for exchange rate liberalization laid out in paragraph 23, but note that the authorities are opting for a more gradual approach. Will staff be providing TA for the transition to a more market-driven exchange rate regime?

The authorities' commitment to improve governance is welcome. We take good note of the passage of the National Procurement Act, the establishment of the ICAC, as well as the authorities' ambition to improve the management of natural resource wealth. We support staff's call to further strengthen the AML/CFT regime, building on recent improvements, including by a timely publication of the NRA and stepped-up cross-border collaboration.

Poverty and inequality remain a challenge. From a global as well as a regional perspective, the prevalence of extreme poverty in PNG remains high. The incidence of poverty is higher than in many of PNG's lower middle-income and resource-rich peer countries. To diversify the economy and increase employment, efforts are needed to strengthen capacity in institutions, human capital, and physical infrastructure. Electricity, telecommunications, and transport infrastructure remain critical to enabling private sector-led growth.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the well written reports and Mr. Ray, Mr. Johnston and Mr. David for their informative buff statement.

Papua New Guinea (PNG) continues to face challenging macroeconomic conditions. Growth remains sluggish as a result of low commodity prices, end of large resource project investments, drought and the recent large earthquake. The fiscal deficit has declined, and inflation has eased, but private sector credit growth remains weak despite the accommodative monetary policy. The current account surplus remains high as a result of large LNG exports and continued import compression due to restricted access to foreign exchange. Large financial outflows due to project related repayments have continued, leading to a persistent foreign exchange shortage. While near term risks to the outlook remain balanced, sound economic management seems to be essential to sustain high growth to reduce poverty and income inequality while effectively facing commodity-driven cycles as a country endowed with natural resources. We broadly concur with the thrust of the staff's analysis and wish to make following remarks for emphasis.

We encourage the authorities to push forward pro-growth fiscal consolidation to reduce public debt and safeguard fiscal buffers to face macroeconomic shocks and natural disasters. In this regard, we positively note the target of achieving a zero non-resource primary balance in 2021 as per the 2019 Budget Strategy Paper. This requires steadfast efforts in revenue mobilization and expenditure control. While taking measures to improve revenue from non-resource sectors, we agree with staff that better management of natural wealth is essential to increase revenue from resource sectors as well. Could staff comment on the proposal to develop a framework to manage natural resource revenues, including the operationalization of Sovereign Wealth Fund? We positively note the introduction of Medium Term Revenue Strategy (MTRS) in 2017 to shield government spending on education, health and other infrastructure from revenue volatility. We would welcome staff comments on the progress of implementing MTRS with the support of resident TA from the Fund. In the context of managing spending, streamlining of public employment, reducing payroll costs, including through payroll audits, and project prioritization remain crucial to free additional resources for productive areas. We also welcome the recent improvements in Public Financial Management.

We encourage the Bank PNG (BPNG) to increase exchange rate flexibility. It will help ease the foreign exchange shortage, promote competitiveness, boost exports and support growth in the medium term. However, we would welcome staff comments on the pace of exchange rate flexibility that would not put overall macroeconomic position at risk. Moreover, we note the BPNG's concerns on the possible pass-through effects of exchange rate depreciation on domestic prices. Could staff comment? Going forward, we support the monetary and exchange rate reforms adopted by BPNG, including the improvements in monetary policy communication and strengthening of monetary operations with supportive instruments. This would enable authorities to effectively adjust monetary policy stance, while gradually clearing the backlog of foreign exchange orders prior to the floating of exchange rate.

The financial system of PNG remains generally sound. Banks are well-capitalized, NPLs remain low and return on equity is high. We welcome the authorities' commitment to take financial sector development forward while promoting financial inclusion in the medium term. Addressing structural impediments that inhibit private sector credit flows is also important to support growth. Furthermore, we positively note the significant progress achieved in improving AML/CFT framework.

Strategic structural reforms are critical to support the efforts towards diversifying PNG's economy. Removing structural impediments and improving the business environment, coupled with providing right incentives are essential to stimulate private investments, particularly in the non-resource sectors, including agriculture, tourism, services and non-resource enterprises. In this regard, we echo staff's view on the need for complementary government support by providing essential public goods, including education, health, telecommunication and improved law and order etc., of which financing will need sustained increase in government revenue. Like staff, we also support the measures to address PNG's governance and corruption challenges to achieve its development objectives. In this regard, the establishment of an Independent Commission of Corruption is an important step forward. In the context of natural disasters, we emphasize the need for appropriate mitigation and adaptation measures with suitable financing mechanisms to better face such events.

With these remarks, we wish PNG authorities all the very best in their future endeavors.

Ms. Levonian, Ms. McKiernan and Mr. Williams submitted the following statement:

We thank staff for their comprehensive report and Messrs. Ray, Johnston, and David for their informative buff statement. As the Papua New Guinean (PNG) economy continues to recover from external and natural disaster shocks, including a devastating earthquake this year, it is imperative that the authorities sustain efforts to invigorate inclusive growth through improving monetary policy effectiveness, correcting misalignments in the foreign exchange market, keeping debt sustainable, and enhancing the business environment. We broadly concur with staff's assessments and recommendations and will offer the following remarks for emphasis.

We urge the authorities to step up efforts to restore fiscal consolidation. While welcoming the authorities' pursuit of stronger revenue mobilization, we wish to emphasize the criticality of prudently managing the additional revenue inflows. Furthermore, it will take time for the authorities' revenue strategy to yield the desired results. In this regard, we agree with staff that PNG should focus primarily on spending restraint. Given staff's assessment that fiscal consolidation has constrained growth, the quality of fiscal adjustment going forward will be crucial to minimize output losses. Reducing compensation costs will free up resources to scale up growth-friendly public investment, clear arrears, and facilitate timely payments by the government. These, alongside ongoing actions to strengthen public financial management, would bode well for longer-term fiscal sustainability.

PNG is taking noteworthy steps toward modernizing the monetary framework and promoting flexibility in the foreign exchange market. The Bank of Papua New Guinea (BPNG) is rightly concerned about the expected inflationary impact of a sharp depreciation given its limited monetary policy toolkit. In this context, the BPNG has moved cautiously to discourage rationing of foreign exchange (FX) while allowing gradual adjustments in the exchange rate as it works toward enhancing its monetary toolkit. Ongoing efforts to ease the FX shortage will help to pave the way for greater exchange rate flexibility. At the same time, the BPNG faces the challenge of managing increased liquidity, including from the government's debt operations, with limited instruments. We welcome the Fund's support, as outlined in the buff, in assisting the authorities to design a raft of tools to strengthen liquidity management while preserving macro-financial stability.

We welcome the focus on policies to support inclusive development. In this context, we commend the authorities' actions to enhance PNG's infrastructure, human capital, and the AML/CFT regime. At the same time, we encourage further effort to strengthen the governance framework and we concur with staff that there is scope for improvement in the areas of procurement, payroll control, and transfers to provincial and electoral districts. These enhancements will be integral to promoting fiscal credibility and transparency, improving the business environment, and encouraging private investment, including in the non-resources sector. Can staff comment on the authorities' strategy to build resilience to natural disasters?

Finally, we urge the authorities to swiftly address discrepancies in GDP between the treasury and the NSO, which have implications for policy decisions, including additional measures that may be needed to keep debt within the legislated ceiling. We invite staff to elaborate on what factors, apart from methodological changes, mainly accounted for these differences.

Ms. Pollard and Mr. Grohovsky submitted the following statement:

Papua New Guinea's economy has been negatively affected by low commodity prices and natural disasters, but growth should accelerate in the coming years as the effects of these shocks ease. Fiscal consolidation is still needed, as are policies to rectify the FX shortage, improve the functioning of the interbank market, and strengthen governance and reduce corruption. We generally concur with staff's assessment and endorse their proposed adjustment scenario and policies. We limit our comments to the following important issues, all of which highlight the need for accurate and transparent data in surveillance.

The authorities have taken significant steps to improve public financial management, but data shortfalls hinder the analysis on the overall stock of state-owned enterprise (SOE) debt. Combined with weaknesses in governance and corruption, there is potential for serious and rising contingent liabilities. This is an area that both the authorities and staff should focus their attention on going forward. Could staff comment on efforts to obtain relevant data on SOE creditors, and the terms and conditions of public and publicly guaranteed borrowing?

Aside from uncertainty over SOE debt, public debt levels remain moderate, but we are concerned about the rapid increase in those levels over the last several years, including a near doubling of public debt to GDP over a five-year period. This increase underscores the need for renewed fiscal consolidation measures and primary fiscal surpluses to prevent the debt distress risk from rising. We also note the significant increase in external debt owed to non-Paris Club bilateral and commercial creditors which has driven the recent bump in external debt and would welcome further analysis on the risks this may pose.

Analysis of the external sector could also be enhanced by recent technical assistance that has provided recommendations to improve balance of payments data. Staff notes that incorporating these recommendations and information from extractive industries would make a large difference to the picture of the balance of payments. Could staff elaborate on what those differences could be and how it would change their assessment?

Finally, continuing the topic of data, we urge the authorities to strengthen governance, management, and performance at the National Statistics Office. We note that the Australian Bureau of Statistics has suspended its TA program as a result of these problems. Could staff comment on whether Fund-provided TA on statistics is also being held up pending improvements at the National Statistics Office? The disagreements among the authorities on the new official GDP numbers also complicate policymaking by weakening the information provided by fiscal and external ratios.

Mr. Virolainen and Ms. Skrivere submitted the following statement:

We thank staff for the report and Mr. Ray, Mr. Johnston, and Mr. David for their informative buff statement. We broadly share staff's appraisal and offer the following points on the need to pursue fiscal consolidation, improve statistics, and strengthen governance for emphasis.

We share staff's views that additional fiscal consolidation measures are necessary. In particular, the authorities should aim to achieve a zero non-resource primary fiscal balance and to bring the debt-to-GDP ratio below 30 percent over the medium term. We are encouraged by the authorities' efforts to strengthen tax compliance, public financial management, and procurement processes. However, we share staff's concerns regarding expenditure slippages. In this respect, we strongly encourage the PNG authorities to improve controls over the Personnel Emoluments and ensure the accuracy of data on payroll receivers. Public sector payroll is one of the costliest areas in public sector and addressing this challenge would go a long way in helping the authorities with their fiscal consolidation strategy.

Deficiencies in national data and statistics need to be urgently addressed. Accurate and timely production, compilation, and dissemination of macroeconomic data and statistics is vital for appropriate economic policy making. We urge the authorities to strengthen the National Statistical Office, and, where relevant, draw on the expertise and advice given by the Fund and others through technical assistance.

We strongly encourage the authorities to eliminate corruption and strengthen governance. In addition to implementing a framework for managing future resource revenues and developing the non-resource sector, addressing challenges in governance and corruption is key to achieve PNG's development objectives. We are encouraged by recent progress on establishing the Independent Commission Against Corruption. However, we emphasize the importance for the commission to have a high degree of autonomy and independence.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the informative report and Messrs. Ray, Johnston, and David for their useful buff statement. Domestic and external challenges continue to weigh on the economy of Papua New Guinea (PNG). To safeguard economic stability and development, the authorities face a tough task ahead, requiring well-calibrated reforms on different fronts. We agree with the thrust of staff's appraisal and would limit our comments to the below.

To ensure fiscal stability and sustainability going forward, further fiscal consolidation measures are needed, on both expenditure and revenue sides. While challenging, we encourage the authorities to exercise greater control over the public payroll system. We welcome the authorities' strong commitment to the Medium-Term Revenue Strategy (MTRS). Implementation of a strategy of such scale would require significant effort and coordination. We also support measures to raise tax compliance, which is key to improving domestic revenue.

The authorities face a difficult task of restoring exchange rate flexibility in an orderly manner while strengthening monetary policy implementation. To avoid significant disruptions, a coordinated and well-communicated approach is necessary. While the PNG financial system appears generally sound, we share staff's view that certain developments deserve careful monitoring, including the ongoing changes on the monetary and FX fronts. Meanwhile, the progress in enhancing PNG's AML/CFT regime is welcome, and we look forward to greater compliance going forward. Could staff elaborate further on the BPNG's latest efforts to promote financial inclusion?

A multi-pronged approach is required to achieve sustainable and inclusive development in PNG. To fully capture the benefits of PNG's resource wealth, effective management is key. In particular, we share staff's view that it is important to develop a framework to efficiently manage and use the revenues generated from natural resources to build buffers and raise resilience to macroeconomic and climate-related shocks. The setting up of a sovereign wealth fund is a welcome development in this regard. The promotion of non-resource sectors including agriculture, tourism, and services would complement the authorities' development efforts. Meanwhile, we encourage the elimination of government payment delays and arrears to raise business confidence and encourage private sector investment. In staff's view, what incentives could be provided by the government to encourage further private sector activity and investment? Addressing governance weaknesses would also be conducive to improving PNG's business environment.

Finally, improving data quality would support sound macroeconomic policy formulation and management. We look forward to progress in strengthening the National Statistical Office.

With these remarks, we wish the authorities every success with their policy endeavors.

Mr. Tan and Ms. Latu submitted the following statement:

We thank staff for the comprehensive report and Mr. Ray, Mr. Johnston and Mr. David for their helpful buff statement.

Economic growth in Papua New Guinea (PNG) continues to be dampened by fiscal consolidation efforts and foreign exchange (FX) shortages, and external shocks such as the 2018 earthquake. This is notwithstanding the commendable efforts by the authorities to address recommendations from the 2017 Article IV consultation. We concur with staff's assessment that the authorities should prioritize and complete the reform agenda to enhance the fiscal and monetary policies. We also appreciate staff's detailed analysis of specific measures to strengthen governance and reduce corruption for more effective policy implementation. We agree with the main thrust of staff's appraisal and would like to add the following comments for emphasis.

Fiscal policy framework should maintain the consolidation momentum and build on the measures that the authorities have imposed to date. We welcome the authorities' progress in implementing the Medium-Term Revenue Strategy for revenue mobilization. We are also pleased to know about the proposed strategies to address discrepancies on the government wage bill and to increase transparency in the procurement practices for grants. The achievement of these objectives will assist in bringing the public debt-to-GDP ratio towards the medium-term target of 30 percent and taking the country forward on its long-term development path. Can staff provide more details on the uncertainty about the size of the gap to be closed and indicate the next steps for addressing the issue going forward?

Effective strategy design and implementation to address FX challenges is crucial in light of staff's assessment of PNG's external position to be weaker than implied by fundamentals and the kina being overvalued. A coherent and well-executed strategy would go a long way in restoring exchange rate flexibility and a market-determined exchange rate. While more should be done, we acknowledge the progress made by the authorities in making gradual adjustment to the exchange rate, conducting market interventions to increase FX supply, and arranging foreign borrowings to resolve FX order backlogs.

Strengthening the monetary policy transmission mechanism through more effective use of interest rates for liquidity management is essential, particularly with PNG's flexible exchange rate regime. The government's foreign borrowing and other measures to increase FX inflows on a sustained basis, and the expected improved economic activities in the coming years, will require vigorous monitoring of the domestic liquidity conditions. We acknowledge the authorities' reform plan to strengthen the monetary operations framework and encourage the continued leveraging on the Fund's technical assistance to implement these reforms.

We encourage the authorities to ramp up efforts to enhance the capacity and management of the National Statistical Office (NSO) to produce accurate and timely macroeconomic statistics. Besides serving as a key input to effective fiscal and monetary policy formulation, this is also important for measuring the effectiveness of reforms undertaken by the authorities. Incorporating vital information from the dominant extractive industries into the balance of payment account would also better reflect the benefits from the use of the country's resources. We therefore support staff's recommendations for the establishment of the NSO Reform Committee and encourage the authorities to seek the Fund's expertise to support this initiative.

With the above remarks, we wish the authorities of Papua New Guinea continued success in their reform efforts.

Mr. Villar and Mr. Montero submitted the following statement:

We thank staff for its candid and well written report and Messrs. Ray, Johnston, and David for their helpful buff statement. We broadly share the staff's appraisal and would like to offer the following comments for emphasis.

The Papua New Guinea (PNG) economy has grown sluggishly in recent years, reflecting a combination of domestic and external factors, whose effects are expected to wane over the near future. Going forward, apart from certain enhancements in the framework for fiscal and monetary policies, we fully share staff's concerns regarding the need for the development strategy to forcefully address management of future natural resource revenues, and governance and corruption issues.

One question that should be given utmost priority is the review of National Accounts data for 2014-2015. Without addressing this shortcoming, it is very difficult to devise and implement a consistent set of macroeconomic policies. We thus share staff's view that urgent action is needed to strengthen governance, management and performance at the National Statistics Office (NSO), along the lines suggested by staff.

This being said, we note with concern the slow progress in the control of the public wage bill, as well as in the District and Provincial Service Improvement Program (DSIP and PSIP) grants. We support staff's call to strengthen the fiscal framework regarding the control of the wage bill and grants. We also note staff's suggestion to adopt an expenditure rule to reconcile the fiscal targets and guide budget policy. Given that PNG already has a zero non-resource primary balance target and a long-term debt-to-GDP target ceiling of 30 percent, we wonder whether the proposed expenditure rule would provide enough value added, especially if the authorities also go along with the proposal to establish a sovereign wealth fund. What type of expenditure rule does staff have in mind?

On monetary and exchange rate policy, we agree with staff's gradual approach to restore FX flexibility and to strengthen the central bank's capacity to use interest rates to manage monetary conditions. In this vein, we welcome the recent measures to refine the monetary policy framework being adopted by the BPNG. We note the government's intention to use revenues from foreign borrowing, including the bond issue, to clear most of the backlog of FX orders. Notwithstanding this intention, we concur with staff in the suggested measures to prevent this problem from becoming permanent. However, it must be acknowledged that developers of major resource projects keeping offshore accounts are not helping to ease the foreign exchange crisis faced in PNG. We wonder whether this is due to the overvalued exchange rate or to any other reason. Could staff comment on this?

We welcome the significant efforts by the new government to design and implement a comprehensive development strategy encompassing areas such as infrastructure spending, law and order, and education and health services. We call on authorities to persevere in the enhancement of natural resource management, development of the non-resource sector and tackling governance and corruption issues along the lines suggested by staff.

With these comments, we wish PNG and its people every success in their future endeavors.

Mr. Castets and Ms. Gilliot submitted the following statement:

We thank staff for the comprehensive set of documents and Mr. Ray, Mr. Johnston and Mr. David for their informative buff statement. Papua New

Guinea is one the most vulnerable territories to naturel disaster risks. The economic activity expansion has been hampered by a series of adverse occurrences and a deterioration in external conditions that have all together weighted on the resource sector output, as well as on investment and more generally on domestic demand. In view of the difficult environment, we commend the authorities' efforts to strengthen public finance management and to put the budget deficit and debt-to-GDP ratios on declining paths. As the growth performance in 2019 is expected to be higher, we concur with staff that fiscal consolidation and exchange rate adjustments should be pursued to maintain public finances on a sustainable trajectory. Furthermore, adequate policy actions are required to bolster inclusive development and reinforce governance and institutional capacity.

Economic Outlook

We acknowledge that the economic activity has been slower than expected over the recent years in a context of low commodity prices, the ending of the PNG LNG gas project and natural disasters. Growth has also suffered from policy developments as fiscal consolidation in a time of high domestic and external constraints has restrained aggregate demand. Following staff's recommendations, we believe that as full recovery of production and exports from the 2018 earthquake is expected, specific attention should be given to the strengthening of the macroeconomic framework and fiscal consolidation. PNG's economy remains highly independent from a few export-led resource sectors like oil, gas and mining, implying therefore a high dependency of budget on volatile financing revenue sources. Therefore, we concur with staff that the development of the non-resource sector (manufacturing, construction, transport) is essential to achieve a more inclusive and durable growth while reducing poverty. In this respect, we encourage the authorities to incentivize the participation of private sector in investment through the provision of basic public goods including infrastructure, education, healthcare, electricity and telecommunication.

Fiscal Policy

We welcome the progress made by the authorities to provide fiscal stability and sustainability as well as promote intergenerational sharing of benefits from natural resources. We fully support staff's recommendation on an additional fiscal consolidation over the medium-term to narrow the fiscal deficit and curb public debt to the 30 percent of GDP ratio ceiling target. Cutting spending on personnel costs seems particularly relevant as specific progress margins have been clearly identified although we understand that payrolls and grants are sensitive areas. Going ahead, the fiscal framework need to be further strengthen with a better accountability of the authorities on public spending. In this respect, the role of the Organizational Structural and Personal Emoluments Audit Committee is crucial. In line with staff, we salute the authorities' commitment to improve domestic revenues through the implementation of the Medium-Term Revenue Strategy. As a matter of fact, identifying and addressing tax non-compliance issues, especially in the high-risk industries like gold mining, logging and fisheries is a key objective. More generally, we agree that more efforts should be made to achieve tax enforcement by all tax payers.

Exchange Rate Flexibility

We encourage the authorities to further increase the exchange rate flexibility regime as well as boost supply of foreign exchange (FX) to market participants. We salute the efforts made by the authorities to facilitate exchange rate adjustment translating to higher export revenues and lower imports without resorting to rationing as underlined in the report. Increase in inflows though better tax compliance of export earners is also a useful way to bolster supply of FX to the market. Likewise, backlog of exchange rate orders should be removed to the help restore the functioning of the interbank FX market. Since the Kina is overvalued by 10,7 percent according to staff's assessment and as the exchange rate overvaluation needs to be addressed, we may have doubt on staff's recommendation to step up the pace of adjustment to avoid persistent FX shortages. Could staff elaborate on the reason of this advice? Similarly, international reserves adequate levels need to be restored to rebuild capital buffers in case of exogenous shocks.

Structural Reforms

We concur with staff's analysis that restoring growth should go along with a more inclusive development agenda including an increase in infrastructure investment, law and order, education and health services. Hence a greater participation of the private sector and a more transparent management of public finances are required. Regarding the latter, we agree that management of natural disaster wealth should be improved and seize the opportunity to underline that coordination among Technical Assistance providers is key in this area, namely when it comes to budgetary support.

Closely related to the above on the economy's structural diversification is the requirement to upgrade governance and reduce corruption. Recent actions taken by the authorities to improve accountability and monitoring of public finances are encouraging. We salute the establishment of the Independent Commission Against Corruption (ICAC), the passing of the National Procurement Act and the introduction of an Integrated Financial Management Information System (IFMIS) with the technical support of the European Union.

Mr. Raghani and Mr. Ndong Ondo Bilee submitted the following statement:

We thank staff for the comprehensive report, and Mr. Ray, Mr. Johnston, and Mr. David for their useful buff statement.

Papua New Guinea (PNG) continue to face headwinds from adverse terms of trade shock, weather conditions and the 2018 devastating earthquake. Economic activity remains subdued, the fiscal position is challenging, and FX shortages persist. We commend the authorities for the steps taken to address these challenges, but agree with staff that further efforts are needed, particularly the adoption of stronger economic policies, with sustained fiscal and exchange rate adjustments bold structural reforms while pursuing the country 'development objectives. We broadly agree with staff's appraisal and would like to limit our comments as follows.

Further fiscal consolidation is needed to meet the country medium-term fiscal targets and put public debt on a downward path. These should be achieved with both revenue and expenditures measures. On revenue side, the authorities' commitment on domestic revenue mobilization under the five-year Medium-term Revenue Strategy (MTRS), and the new large taxpayer office opened in September as indicated in the buff statement are welcomed. We are also pleased to note tax collection actions by the Internal Revenue Commission (IRC) and the Custom aiming at increasing non-tax revenue. On the expenditure side, we support staff's recommendations, including keeping the wage bill and grants under better control. Moreover, measures that will help improve public finance management such as the expenditure control measures at districts and provinces levels are good steps in the right direction and will certainly contribute to enhance compliance and transparency.

With regards monetary and exchange rate policies, we agree with Staff recommendation to move toward greater exchange rate flexibility and further strengthening the Bank of Papua New Guinea (BPNG) monetary policy framework. We encourage the authorities to take the necessary measures to restore a properly functioning FX market that will boost exports and the supply of FX. Could staff comment on the adequate speed of the adjustment of exchange range. In this regard, the recent issuance of the $500 million bond with 10 years maturity is commendable and should give further flexibility to accommodate the FX shortages and preserve spending in productive sectors as fiscal consolidation proceed. Looking ahead, the monetary policy and its operational framework need enhancement and effective tools - including use of interest rate for monetary management. The ongoing reforms undertaken by the BPNG are welcomed and we support technical assistance from the Fund in this regard.

We concur with Staff that structural reforms that will enhance revenue resources management, diversify the economy away from the resource sector and address governance issues are key to ensure sustained and inclusive growth. We, therefore, commend the authorities for their policies and for the progress made so far under their Vision 2050 development strategy. We support the authorities' initiatives towards establishing a sovereign wealth fund and the economic diversification into agriculture, tourism and services, as indicated by Mr. Ray et al. buff statement, all such actions will improve growth prospects going forward. We welcome the progress made in governance, including enhancing the AML/CFT framework as well as recent measures such as the establishment of Independent Commission Against Corruption (ICAC) aimed at strengthening governance. We believe that these will highly contribute to PNG's business environment and help achieve its development objectives.

Finally, we urge the authorities to continue with improvements of the National Statistical office (NSO) and encourage them to steadfastly implement the recent TA recommendations especially on improvement of the balance of payments.

Mr. Lopetegui and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for the report on Papua New Guinea and Mr. Ray, Mr. Johnston and Mr. David for their informative buff statement. In particular, the considerations made in the buff have allowed us to have a better understanding of Papua New Guinea's context and challenges.

While we welcome the improvement of fiscal outcomes, Papua New Guinea's policy framework needs further strengthening. We concur with staff that further efforts are needed on the fiscal and monetary fronts to gain the trust of foreign and domestic investors. Relying too heavily on resource growth makes the economy subject to risks and volatility, as we have seen in the past four years, and the country's dependency on Liquefied Natural Gas

(LNG) for fiscal revenues in the long run needs to be well managed. Diversifying the economy away from resource growth and promoting the non-resource sector in order to achieve broad-based development might require a well-designed strategy and the involvement of all stakeholders.

A well-designed strategy that aims to promote growth and employment in the long run will require a reliable set of basic statistics. Considering what is exposed in Box 1 "Papua New Guinea: National Accounts" and the authorities' views expressed in the buff statement, it seems to us that important ground work must be done to build up trust among economic agents on the basic economic data of the country. All major references of economic performance such as economic growth, debt-to-GDP, compliance with the Fiscal Responsibility Act, Debt/GDP ceiling, debt dynamics, etc. are under scrutiny and doubt. We can certainly imagine the frustration of the authorities who were caught by surprise by the abrupt change of the new National Accounts data for 2014 and 2015. We would appreciate further clarification from staff on how to reconciliate the figures expressed in this report versus the authorities' views of the situation.

We take positive note of the authorities' willingness to put in place a Medium-Term Fiscal Strategy 2018-22. The speed of growth of the public debt is a warning sign to take into consideration and, considering the country just issued its first sovereign bond last October, further efforts will be required on the fiscal front to provide high quality information on macro variables and serious and reliable projections of debt dynamics for domestic and foreign investors. Relatedly, last year, staff was overly concerned about a possible fiscal and financial crisis: can staff comment on how that outcome has been avoided and whether the risk of such crisis is now assessed to be low? On the fiscal front, more consolidation efforts are needed and, according to the report, a good space for expenditure efficiency exists with better control over the personnel emoluments. This step will not only save fiscal resources to around 0.7 percent of GDP but will also tackle an important issue of Governance in the public sector. The report repeatedly mentions that more transparency and accountability are needed. Staff's elaboration on the rationale behind the proposed zero non-resource primary balance would be welcome.

Given current circumstances, such as the external shocks the economy is exposed to, there is a need for more flexibility of the exchange rate. As we learned from the staff report, in the recent past the Kina exchange rate was more flexible and adjusted to global changes, but today the de facto regime classification has moved from floating to a crawl-like arrangement. Foreign-exchange rationing introduces costly disruptions to business activities and may even deteriorate the supply of foreign exchange. The simple delay of monetary corrections could bring more harm than good to the economy, especially if the external shock is persistent. Could staff explain how the central bank rations foreign exchange? In addition, could staff clarify if it is recommending clearing the backlog of FX orders at current exchange rate levels, since there seems to be evidence that the currency is overvalued? We encourage the authorities to continue with the technical assistance from the Fund and other regional or international organizations to move forward in the modernization of the monetary policy.

With these comments, we wish the people of Papua New Guinea every success in their future endeavors.

The Acting Chair (Mr. Zhang) made the following statement:

Let me offer my congratulations to the Papua New Guinea authorities for successfully hosting the most recent Asia-Pacific Economic Cooperation (APEC) summit, and the many APEC sessions throughout the year, culminating in the APEC Economic Leaders’ meeting, which was in the middle of the month. The Managing Director also had the opportunity to attend that summit.

Directors noted the challenges the country is facing, both domestically and externally. Directors commended the authorities for their progress in narrowing the fiscal deficit and also for the adoption of a medium-term revenue strategy. Further effort is needed to promote economic stability and strengthen the long-term development framework.

Mr. Braeuer made the following statement:

We thank the staff for this well-written report, and Mr. Ray, Mr. Johnston, and Mr. David, for their helpful buff statement. We did not issue a gray statement, as we broadly concur with the staff’s appraisal and just want to add the following comments for emphasis.

We agree with the staff that additional fiscal consolidation is needed, and the authorities’ goals of a zero non-resource primary balance and a long-term debt-to-GDP ceiling of 30 percent are a positive signal.

We welcome the authorities’ strong commitment to strengthen domestic revenue mobilization through the implementation of the medium-term revenue strategy. However, as this will take time to deliver results, we agree with the staff that consolidation should focus on spending restraint. We encourage the authorities to urgently improve financial management controls over the personnel emoluments.

We also agree with the staff that cuts should fall most heavily on programs providing the least accountability.

We agree with the staff that the pace of an exchange rate adjustment should be stepped up, and the backlog of foreign exchange orders needs to be cleared. We agree also that achieving the government's development objectives will require addressing challenges in governance and corruption.

We are encouraged by the recent measures taken by the government, particularly the establishment of the Independent Commission Against Corruption. However, we join Mr. Virolainen in emphasizing the importance for the commission to have a high degree of autonomy and independence.

Finally, regarding data, we join Ms. Pollard and others in urging the authorities to strengthen governance, management, and performance at the National Statistical Office, as timely and accurate production, compilation, and the dissemination of macroeconomic statistics are essential to affect their fiscal and monetary policy formulation.

Mr. Benk made the following statement:

We did not issue a gray statement, as we share the staff's appraisal and concur with the policy recommendations. However, I would like to emphasize a few points.

Concerning fiscal policy, we fully support the staff's detailed policy advice on the consolidation measures outlined in paragraph 20 of the staff report. Further steps are required to strengthen the fiscal framework, and we see merit in adopting the expenditure overhaul. We also urge the authorities to strengthen the framework for managing their natural resource wealth to safeguard resources for future development and growth. In this regard, we welcome the establishment of a sovereign wealth fund. However, proper governance, operational independence, as well as clear and binding spending rules, are essential for its effectiveness.

We join other Directors in encouraging the central bank to increase the exchange rate flexibility. Clearing the large backlog of foreign exchange orders is a necessary first step, and the proceeds of the recently issued dollar bond should facilitate that.

Structural reforms are critical to support the efforts toward diversifying Papua New Guinea’s economy. Improving the backbone institutions, governance, and the business environment will be required to enable the necessary private investment. We encourage the authorities to consult with the Fund in the preparatory phase.

Mr. Saito made the following statement:

We thank the staff for the informative papers, and Mr. Ray, Mr. Johnston, and Mr. David, for their insightful buff statement.

We are pleased to see a positive macroeconomic outlook in 2019, following the external and natural disaster shocks. We also welcome the reform efforts taken by the authorities, including the introduction of the medium-term revenue strategy, which we believe will play a critical role in enhancing the authorities’ tax capacity.

As we issued a gray statement, we would like to focus our comments on the statistics issue.

Like many other Directors, we urge the authorities to take necessary measures to strengthen the governance, management, and performance of the National Statistical Office (NSO). We were surprised to see that the division of national accounts’ data caused a nearly 10 percent deviation of nominal GDP growth between the NSO and the Treasury. We note from the buff statement that this was also a surprise to the authorities, with no opportunity for a transition strategy and associated communications strategy. As national accounts are fundamental statistics for the authorities’ policymaking, timely, accurate, and transparent data is crucial. To this end, we urge the authorities to closely communicate and appropriately share necessary information among relevant parties.

Related to this point, the staff’s written responses to technical questions state, “Staff do not have detailed information on the reasons for these differences” related to the deflator and real growth.

However, the staff states in Box 1 of the staff report, “The NSO figures are likely to be revised.” Could the staff elaborate on the reason why staff envisages the revision of the NSO data, not Treasury data, even though the staff do not have the information on the reasons for these differences?

The staff representative from the Asia and Pacific Department (Mr. Roger), in response to questions and comments from Executive Directors made the following statement:[1]

Maybe I could step back from the meat of the staff report, which tends to focus on the conjunctural issues, and say that when it comes to the overall medium-term strategy, the staff and the authorities are pretty much in agreement, that the name of the game is to get the economy in a good position to take advantage of the next cyclical upswing.

There are several large projects in the offing. Negotiations are underway. Investment would probably begin on a substantial scale in 2021-22, so a few years away but not a long time away. We do not have enough information on those projects to be able to build them into our baseline scenario, but we know that they are coming down the pike. The aim is to get the economy in good shape, to get the fiscal position, the monetary position in good shape to be able to deal with the shocks that these big projects are going to represent.

The second key objective on which we agree with the authorities is that to achieve their Sustainable Development Goals, they need to have development of the non-resource sector—agriculture, small business, exports—because that is where the jobs are going to be for ordinary people, that is how inclusion will happen. Currently, 80 percent of the population is rural, and many of those are subsistence rural. To bring those people into the system, it will have to happen in the agricultural sector.

There is a danger with the resource sector, that a country like Papua New Guinea can have Dutch disease, which would destroy any potential for the agricultural sector. It is important to get structural measures in place before the next big upswing because that could lead to Dutch disease. We are on the same page with the authorities on this. The issue is really about how to get there.

On fiscal, we agree with the authorities on their medium-term objectives of getting the debt-to-GDP ratio down to a safe level, getting a

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

deficit target of close to zero, which is consistent with the permanent income hypothesis. However, our starting point is different.

This was a question raised by Mr. Saito. How do we evaluate the budget? That is probably the main issue where we have a difference with the authorities at the moment.

They see themselves as well on their way to achieving their debt-to-GDP target. Our estimate is that they are 6 percentage points of GDP higher than that. About two-thirds of the story, about four percentage points, is due to the difference in the nominal GDP estimates. Much of this discussion is about the denominator, rather than the numerator.

We also have a bit of a difference on the numerator. We evaluate the foreign currency debt at current exchange rates, and their numbers use the original exchange rates. Even if there is a complete reconciliation on the nominal GDP deflator, we would still be seeing their debt-to-GDP ratio 2 percentage points of GDP higher.

Our take on this is that when a reconciliation of the 2015 GDP numbers comes out, it will probably be somewhere in between the NSO figure and the Treasury's current figure. If it is split halfway, then that means that the debt-to-GDP ratio will be close to 35 percent. The authorities will need to go back and look at their fiscal stance, because it will look worse than it looks right now. It may look a bit better than we are saying. I believe that will be an issue in the next staff visit, which may be in March of next year.

There is a disappointment on our side, that the authorities have not gone quite as far as we would have liked on consolidation, but we understand where they are coming from. What they have done quite cleverly is that they are putting in place the tools to be able to bring the deficit under better control. This means, in particular, their steps to improve control over personnel emoluments. That scrutiny should allow for many fraudulent claims, wage claims to be eliminated. There are people on the payroll who are collecting two checks. There are people who do not really exist. There are people who are labeled as teachers who are not actually teachers; they are doing something else. They need to clean up that part of the payroll. There are also people who are not receiving the money that they ought to be receiving. There is much to be done, but they now have a tool which, on balance, will tend to reduce the growth of personnel emoluments.

On the grants, we understand that this is politically sensitive turf. We recommended cutting where there is poor documentation. They have taken a slightly different route, which is to bring the procurement related to those grants into the central government. I expect that that will probably lead to cuts in grant—in actual expenditures because various projects will not satisfy the procurement rules.

They now have the tools so that, in a few months' time, if they see different deflator numbers, with implications for the debt-to-GDP ratio, they will be in a better position to bring the deficit down into the right direction.

On the monetary and foreign exchange strategy, it has taken a little while, and it has taken good collaboration with the World Bank; but together, we have convinced the authorities to move toward a comprehensive strategy to restore exchange rate flexibility. That includes getting rid of the foreign exchange backlog. It requires developing the tools to implement monetary policy with interest rates. That means the monetary operations are being overhauled. They have to get into better liquidity management. There are many pieces that need to be set up and implemented as they start clearing the foreign exchange backlog. The Monetary and Capital Markets Department (MCM) is providing significant technical assistance (TA) in this area, and we are working closely with them.

The exchange rate is moving. It has moved about 4 percent this year. They have not been loud about making those movements, but it is going in the right direction. We believe the strategy is underway. They are going to need more TA, but it should put them in a good position to restore an interbank foreign exchange market within the next few years.

Mr. Ray made the following concluding statement:

We thank the staff for a good set of papers but, more importantly, for the mission team, which Mr. Roger has led, and for the relations that they have established with our Papua New Guinea authorities, including their three visits this year, one of which was an additional visit following the large earthquake.

I can be blunt and say that Papua New Guinea is not the easiest of operating environments and the staff has not always enjoyed the most productive relations with the authorities that currently exists. We have just witnessed that in Mr. Roger's balanced and constructive comments.

I thank Directors for a useful set of gray statements and for their comments this morning.

As the Managing Director remarked last Wednesday, following her recent visit, Papua New Guinea faces considerable challenges, with GNI per capita officially at about US$2,500, although this is likely an overestimate, given the widely recognized undercounting in the census and, as we have been discussing, there are also some issues with the numerator.

On that measure, Papua New Guinea has come a long way in a short time. Per capita GNI was languishing around US$500 at the turn of the century, about the same level it had been at independence in 1975, and lower than at any point in between. The lift over the past decade and a half has been off the back of the resources boom, mainly in oil and gas. Capturing a fair share of that income and using it to benefit the population has been a challenge.

On other indicators, especially social indicators, the story is less rosy. Life expectancy at birth has been rising slowly and is now at around 65. Only about 40 percent of the population have access to safe water and fewer than 20 percent to sanitation. Papua New Guinea's Human Development Index rank is 154. Papua New Guinea's complex, if stunning, geography and complex, if fascinating, society makes challenging service delivery.

Our Papua New Guinea authorities concur with the thrust of the staff report, the need to redouble efforts to restore government finances, gradually address foreign exchange shortages through more exchange rate flexibility, and strengthen the longer-term development framework. As a number of Directors have commented on this morning, the authorities have reaffirmed their commitment to some medium-term targets, including a debt target of 30 to 35 percent of GDP.

Because of misuse with their measurement of GDP, it is not clear what the current trajectory is. Obviously, this is an issue, and our authorities are attempting to address it. As Mr. Roger noted, much of the difference between the staff's recommendations and our authorities' views rests on the differences within Papua New Guinea about what the level of nominal GDP actually is. Obviously, this makes fiscal strategy difficult to design and implement.

The authorities are working to improve their domestic revenue mobilization through the medium-term revenue strategy. As the staff notes, this is a complex undertaking, and progress has been a little slow, partly because of APEC. But compliance does seem to be improving. The imminent appointment of a resident Fund technical adviser should assist greatly.

A steering committee was established, and it plans to meet early in 2019, now that both APEC and the 2019 budget are out of the way.

On the expenditure side, the authorities are introducing better control, with the help of the EU. A new integrated financial management information system has been implemented. There are plans to audit payroll at the district level.

I did want to say a few words on the district and provincial service improvement grants. Our authorities understand the longstanding concerns with these programs, but they are an established and important part of Papua New Guinea's political process. Again, I want to be blunt. Many other countries, including my own, have similar programs from time to time. They are magnets for auditors general, as they should be.

Transparency is key to ensure that the grants actually flow to worthwhile projects. In Papua New Guinea, their history has been mixed. Our authorities are attempting to improve transparency and accountability, including through their new National Procurement Act.

Just to say something on a personal front: I believe it is important that we and staff support these efforts.

On monetary and foreign exchange policies, the authorities broadly agree with the staff. Fund TA has been particularly helpful here, and the authorities are likely to request more on an as-needed basis.

The Bank of Papua New Guinea has used some of the recent foreign exchange inflows from various sources, including the recent sovereign bond issue, to clear some of the back orders. The backlog, as a percentage of total orders, has declined from 50 to 60 percent at the beginning of 2018 to 30 to 40 percent this month.

I should say something about the difference between the Treasury and the NSO on the measurement of GDP. As the staff and many Directors have said, this needs to be addressed as a matter of priority, and there needs to be an improvement in communication. Our authorities are fully onboard with that. The Australian Bureau of Statistics has been re-engaged and will meet with both the NSO and Treasury officials in February/March to provide assistance on how to resolve this matter.

Lastly, Papua New Guinea's inaugural foreign sovereign bond issue in September was oversubscribed. It provides assistance to the authorities in their efforts to drive reforms within Papua New Guinea. It also necessitates greater transparency and should assist and improve governance over the management of the economy.

I thank Directors for their comments. I also thank the staff for the way that things with Papua New Guinea seem to be improving.

The Acting Chair (Mr. Zhang) noted that Papua New Guinea is an Article VIII member and maintains exchange restrictions and multiple currency practices subject to Article VIII, Sections 2(a) and 3. No decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They observed that growth in 2018 has continued to be sluggish, reflecting low commodity prices and the effects of a large earthquake that disrupted oil, gas, and mineral exports. They took positive note that economic growth is expected to be stronger in 2019. In this context, Directors agreed that strengthening macroeconomic policies and implementing structural reforms would help reduce risks and support inclusive longer-term economic growth.

Directors welcomed the confirmation of the government's long-term debt/GDP target of 30 percent and the adoption of a zero non-resource primary balance as a medium-term objective. The adoption of an expenditure rule consistent with the revenue target would help reconcile the fiscal targets and guide budget policy. Directors noted that the recent issuance of a debut sovereign bond is a positive development, and welcomed the authorities' intention to use the funds to improve the domestic public debt profile and help resolve foreign exchange shortages. Directors also welcomed the progress in strengthening public financial management.

Directors encouraged the government to continue to strengthen its fiscal framework, and noted that in the near term, additional fiscal consolidation is needed to reduce the risk of debt distress. This could be achieved through a combination of increases in revenue and reduction in spending, particularly on the government wage bill and grants. In this connection, Directors welcomed the government's strong commitment to strengthen domestic revenue mobilization through implementation of its Medium-Term Revenue Strategy, the significant increase in tax revenue through efforts to strengthen compliance, and tighter government payroll controls.

Directors agreed that the greater exchange rate flexibility that has been pursued in recent months should be continued in order to support growth in the non-resource sector. Eliminating the backlog of foreign exchange orders and strengthening liquidity management and foreign exchange operations would support the re-establishment of an interbank foreign exchange market. Carefully monitoring the impact of foreign exchange measures on the financial sector will be important.

Directors encouraged the authorities to seek better terms in negotiations for new resource projects and to develop a framework for managing resource revenues. The development of the non-resource sector should be fostered through provision of public services and infrastructure and be taken into account in revenue mobilization. Directors also supported the elimination of corruption and strengthening of governance as an important part of Papua New Guinea's development strategy, and commended recent progress in this area.

Directors welcomed improvements in macroeconomic statistics, but noted that further progress is needed to improve data completeness, timeliness, and accuracy, and supported provision of additional technical assistance in this area.

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

APPROVAL: March 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

1. ***We would like to hear staff's assessment on the recently submitted 2019 budget. Do staff think the 2019 budget appropriately incorporate staff's policy advice?***

- Staff will respond to this question during the Board meeting.

2. ***We would welcome staff comments on the progress of implementing MTRS with the support of resident TA from the Fund.***

- The government launched the MTRS in November 2017, starting implementation with the 2018 budget. IMF provided technical support for the design of the MTRS and, with funding from the Revenue Mobilization Thematic Fund, has supported implementation since July 2018. A revenue administration advisor has been recruited on a peripatetic basis pending completion of formalities. The Deputy Prime Minister and Secretary for Treasury are strong advocates for the MTRS. The Internal Revenue Commission's (IRC) acting Commissioner General is also supportive.

- Progress is steady. A large taxpayer office (LT0) has been opened with staff and taxpayers selected and account manager relationships established. LTO operations will begin before the end of 2018. Under the sequenced program of tax policy reforms, initial policy measures were implemented in the 2018 budget and further measures announced in the 2019 budget. The recent tax policy mission advised on the next phase of reforms and provided capacity building on petroleum fiscal modeling. Program governance frameworks are being developed. Several events including retirement of the Commissioner General and APEC preparations have impacted MTRS timelines. Establishing good program governance and management mechanisms at the MTRS Implementation Steering Committee and IRC levels will help ensure MTRS deliverables progress as planned.

3. ***Can staff provide more details on the uncertainty about the size of the gap* [debt/GDP or deficit] *to be closed and indicate the next steps for addressing the issue going forward?***

- The staff report includes (i) the official 2015 GDP numbers published by National Statistical Office (NSO) and (ii) revaluation of exchange rate when calculating public external debt. As a result, compared to the recently published 2019 Budget which does not include these factors, the public debt-to-GDP ratio is higher in the staff report by 6 percentage point (2018 debt/GDP is 36.8 percent in the staff report; 30.9 percent in the 2019 Budget). Of the 6 percentage point difference, exchange rate revaluation accounts for about 2 percentage point, while the rest of 4 percentage point comes from nominal GDP estimates. Going forward, this gap between the staff report and the budget is expected to widen by additional 2 percentage points (33.6 percent in the staff report versus 25.9 percent in the 2019 Budget) because the budget includes future resource projects which generates a construction boom, further boosting nominal GDP in the budget. The difference in nominal GDP levels between the staff report and the budget increases sharply from 16 percent in 2018 to 34 percent in 2023.

- The PNG Treasury is consulting with the NSO to reconcile the GDP data by the end of this year. If the PNG government agrees and uses the new GDP numbers made by NSO, the difference of nominal GDP between the IMF and the government will be resolved. This could shrink the debt-to-GDP gap, but not fully as we have different estimates onwards. In terms of medium-term forecast, the widening gap will remain as the IMF does not have good information on how to include future resource projects in our macro framework. Regarding the revaluation effects of exchange rate, the authorities are aware of it. Currently, the central bank of PNG is publishing the public external debt numbers similar to the IMF' and the World Bank' numbers, by including the revaluation effects. We are encouraging the Treasury to reflect our advice.

4. ***We wonder whether the proposed expenditure rule would provide enough value added, especially if the authorities also go along with the proposal to establish a sovereign wealth fund. What type of expenditure rule does staff have in mind?***

- The expenditure rules were proposed by the IMF staff during the Article IV mission, and discussed with the authorities, but more discussions will be needed in the coming year. Detailed expenditure rules customized for PNG and applicable for other Pacific Island countries are drafted in a forthcoming IMF working paper. The essence of this expenditure rule is to make the country more robust to natural disasters, climate changes, terms-of-trade shocks, and uncertain donor grant revenues from foreign governments. An important role for the Expenditure rule is to provide operational guidance in budget setting that is consistent with achieving the debt/GDP and medium-term revenue targets.

- The stabilization fund for disasters, the need for which is implied the fiscal rule, is different from a sovereign wealth fund because its aim is to conduct countercyclical fiscal policy in the face of various shocks (natural disasters / climate change / commodity price / foreign grants) and not for intergenerational equity aimed at in the sovereign wealth fund. The source of funding for the two funds would differ, as would disbursement rules.

5. ***Could staff comment on the proposal to develop a framework to manage natural resource revenues, including the operationalization of Sovereign Wealth Fund?***

- The PNG authorities have received TA for operationalization of a sovereign wealth fund (SWF) from the World Bank. At this point, governance arrangements have been established, and the authorities are in the process of establishing a governing Board for the SWF, which will be housed within the Bank of Papua New Guinea. The IMF has not been involved in development of the sovereign wealth fund. However, going forward, it will become important to engage on SWF operational issues in formulating Fund staff policy advice.

6. ***Could staff comment on efforts to obtain relevant data on SOE creditors, and the terms and conditions of public and publicly guaranteed borrowing?***

- The government is trying to collect government guaranteed SOE debts. Since some of the guarantees are outdated, the authorities are now cleaning up the data to obtain up-to-date information. Kumul Consolidated Holdings holds the government share in all SOEs and collaborating with the government to provide data on publicly-guaranteed debt. The staff is encouraging them to capture the SOE debt data.

Monetary and Exchange Rate Policy

7. ***However, we would welcome staff comments on the pace of exchange rate flexibility that would not put overall macroeconomic position at risk. Moreover, we note the BPNG's concerns on the possible pass-through effects of exchange rate depreciation on domestic prices. Could staff comment?***

- Both Fund and BPNG Staff estimate PNG's exchange rate pass-through at 0.3-0.4. This implies that a depreciation of 6 percent per year (about twice the current rate) would raise the inflation rate by about 2 percentage points. This would keep the level of inflation under 6.5 percent, which is roughly the upper limit of what the BPNG would be willing to tolerate.

8. ***Could staff comment on the adequate speed of the adjustment of exchange range.***

- The appropriate speed of adjustment in the exchange rate needs to take into account a number of factors including the impact on inflation, the responsiveness of supply and demand for FX, and the magnitude of adjustment required. As indicated in response to Question 7, our assessment is that a depreciation rate of about 6 percent is consistent with keeping CPI inflation within the authorities' tolerance range. With adjustment at this pace, we estimate that the over-valuation of the Kina could be eliminated over a two year period (if the EBA-lite estimate is correct) or three years if the market estimates are correct.

9. ***Since the Kina is overvalued by 10,7 percent according to staff's assessment and as the exchange rate overvaluation needs to be addressed, we may have doubt on staff's recommendation to step up the pace of adjustment to avoid persistent FX shortages. Could staff elaborate on the reason of this advice?***

- Please see responses to Questions 7 and 8. An important concern is that the

10. ***Will staff be providing TA for the transition to a more market-driven exchange rate regime?***

- Three strands of TA are being provided that are related to the restoration of exchange rate flexibility:

- MCM TA on monetary operations, liquidity management, and foreign exchange management. A mission was conducted just before the Article IV, and follow up TA is being planned;
- PFTAC TA on macroeconomic forecasting and monetary policy with exchange rate flexibility. TA has been provided at a workshop prior to the Article IV mission and a country visit by the PFTAC advisor during the Article IV mission.
- PFTAC TA on risk-based supervision. TA has recently been provided on supervision of liquidity risk.

Financial Supervision and Financial Stability

11. ***We would appreciate staff's detailed comments on how to mitigate financial stability risks arising from the capacity constraints.***

- Good management of risks will require careful sequencing and coordination of reforms in monetary management, together with building of relevant capacity within BPNG Supervision Department:

- With regard to sequencing and coordination of monetary management, MCM has already provided TA to strengthen liquidity management, beginning with liquidity forecasting and market operations. Together these should allow BPNG to minimize the net liquidity impact of FX and domestic public debt management operations. Likewise, ensuring a smooth transition from current exchange rate framework will require first clearing much of the FX orders backlog, gradually moving the exchange rate towards a less overvalued level.

- With regard to TA, PFTAC is providing a series of missions aimed at strengthening risk-based supervision. MCM is also considering a workshop in the pacific on financial stability, and BPNG staff would of course participate.

Policies for Inclusive Development

12. ***Further information is sought on the Fund's plan for cooperation with the other development partners in PNG.***

- The Fund PNG team is in regular contact with major development partners including World Bank, ADB, JICA, the EU, and the Australian authorities. With all of these, we aim to coordinate efforts and, if feasible, collaborate. PFTAC also coordinates its TA carefully with other TA providers.

- Development partners share the Fund's views on priorities for both macroeconomic reforms and development policies, many of which are included in the World Banks latest program for budget support which was approved by the World Bank Board in October.

13. ***Can staff comment on the authorities' strategy to build resilience to natural disasters?***

- PNG is exposed to a wide range of natural disasters, including droughts, earthquakes, tsunamis, and volcanic eruptions. In many cases, it is difficult or very expensive to build resilient infrastructure, so most efforts focus on strengthening post-disaster responses.

- The Authorities have highlighted adverse weather conditions as a macroeconomic risk in the 2019 National Budget. The Authorities have also made grant allocations (2019 Budget) for different sections of Government for disaster risk management and resilience. For example, a PNG Disaster Risk Management Program under the Department of National Planning and Monitoring; Environment, Climate Change & Disaster Risk Management under the Conservation and Environment Protection Authority; and Building Resilience to Climate Change under the Office of Climate Change and Development.

- Over the longer term, PNG's Vision 2050 plan which encompasses the countries long term development strategy, recognizes the need for disaster planning and climate change adaptation, and the government has a "Disaster Management Plan" which offers an appropriate framework within which to address natural disaster risk.

According to development partners, the main challenge is in the implementation, especially coordination between government agencies and non-government partners, donors and development partners, and the need to strengthen governance arrangements for disaster risk management.

14. ***Could staff elaborate further on the BPNG's latest efforts to promote financial inclusion?***

- PNG faces considerable challenges for financial inclusion: 85 percent of the population do not have bank accounts, and only 18 percent live in urban areas, while only 20 percent have access to electricity. This population also lacks proper identification which makes it difficult to access credit and many other public services. BPNG has partnered with tech companies to solve the problem of identification and access using a device called an IDBox and blockchain technology. Taking advantage of the fact that 80 percent of Papua New Guineans have an SMS-capable mobile phone, the IDBox runs on solar power, and creates a unique ID based on fingerprints and mobile phone numbers, which is stored in a blockchain distributed ledger. Once the identity is established, it can be used to access financial services, voting systems, health care services and remittances, among other services. IDBox could also reduce customary land disputes as it could provide a traceable ledger of property ownership. This initiative was launched in August 2017 and is ongoing.

15. ***In staff's view, what incentives could be provided by the government to encourage further private sector activity and investment?***

- Improving the environment for business activity and investment is a key pre-condition. This includes macroeconomic reforms to improve the tax regime, developing the monetary framework and avoiding chronic exchange rate overvaluation (which will improve relative prices for investment in the non-resource sector), investing in infrastructure and improving education and health services, and addressing challenges in governance. All these will provide a more stable environment for private sector activity, likely attracting foreign investment and technology transfer to improve productivity and exports.

- More specifically, some of the more important constraints to private sector activity include the lack of enforcement of contracts and property rights, challenges in security, and transportation and trading across borders.

Statistics

16. ***We invite staff to elaborate on what factors, apart from methodological changes, mainly accounted for these differences.***

- Our understanding is that methodological changes are not the main factor behind the differences between NSO and Treasury estimates of 2015 GDP. As indicated in Box 1, NSO has a much lower estimate for the deflator, reflecting sharp differences in estimates for the deflator in the mining and energy sector. NSO also has a lower estimate for real growth, especially in the construction sector. Staff do not have detailed information on the reasons for these differences. They will be discussed in meetings between NSO, Treasury, and BPNG, as recommended by Staff.

17. ***Could staff elaborate more on the accuracy and adequacy of information obtained by NSO? Does staff envisage upward revision of NSO data once necessary data become available?***

- Inefficient use of NSO's limited resources means that access to data and the quality of both source data and compiled are lower than they should be in a country of PNG's size. To help improve access to better quality data, and lower its cost, Staff explicitly recommended that the NSO establish memorandums of understanding with government departments to obtain relevant administrative data.

18. ***Could staff comment on whether Fund-provided TA on statistics is also being held up pending improvements at the National Statistics Office?***

- Currently, the PFTAC national accounts advisor has a mission penciled in for March 2019. However, that still needs confirmation from the authorities, which may be held up until they have sorted out various management and staffing issues and work priorities. Additionally, we will continue to coordinate closely with colleagues from the Australian Bureau of Statistics, who are also providing TA to NSO. Their TA program was suspended a few months ago, pending resolution of the management problems at NSO, but we believe is now being restored.

19. ***Could staff elaborate on what those differences [between the current BOP statistics and those proposed by the IMF TA report] could be and how it would change their assessment?***

- The main change in the BOP figures concerns the disposition of earnings in the LNG sector. A large part of the earnings in the sector are kept offshore and information on their use has been difficult to obtain. In such circumstances, a substantial portion of the earnings has been treated as a financial account outflow. The TA report recommended that a significant part of this outflow be reclassified as dividend or debt service payments. This has the effect of significantly reducing the estimated current account balance (as services payments increase), as well as cutting unidentified financial outflows. Although the TA report indicated that there is still much work to be done, this change helps to clarify that the main counterpart of the trade surplus is not large capital flight, but debt-related flows.