L Wilson Kamit: Policy and regulatory environment for business

Address by Mr L Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea, to the 21st Australia Papua New Guinea Business Forum, Cairns, Australia, 1-3 May 2005.

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Introduction

Honourable ministers from the Governments of Papua New Guinea and Australia, Mr. Alan Walter, President of the Australia - Papua New Guinea Business Council, Mrs. Winifred Kamit, President of the Business Council of Papua New Guinea, members of both Councils, distinguished guests, ladies and gentlemen. I am honoured and pleased with your invitation to address this forum again.

The macroeconomic stability seen in Papua New Guinea during the last three years, for me as the Governor of the Central Bank, is like breathing of fresh unpolluted air. Steady continuous high foreign exchange inflows; fiscal discipline; balance of payments and fiscal surpluses; enabled the Bank of Papua New Guinea to pursue a stable exchange rate; which has led to low inflation and allowed for a reduction in domestic interest rates.

The recent reports of a net profit of K85 million by the Bank South Pacific and K120 million by the POSF from their 2004 operations, a K58 million net profit by NASFUND for the first quarter of 2005, announcements of expansion in business operations, and a pick-up in construction activity, are good indicators of improvements in economic activity. A large number of companies, including banks declaring dividends and paying them to both their domestic and overseas shareholders, are a further indication of an increase in economic activity and that there is renewed confidence and optimism in the business community.

I hope that we will continue to receive this type of news from the many other firms and industries in Papua New Guinea in the coming months. The stable macroeconomic climate experienced in Papua New Guinea over the last three years is expected to continue in 2005. Whilst this is obviously positive news, those of us tasked with ensuring a conducive environment for economic growth and management of the nation's economic affairs, are constantly challenged towards ensuring its sustainability.

The contribution of the Central Bank was, providing a stable interest rate and exchange rate regime through a conducive monetary policy as well as developing the necessary infrastructure for a sound financial system. This was implemented through the legislative changes introduced in 2000 and 2001. We constantly ask ourselves as to how else we can promote business activities in Papua New Guinea. In this same forum last year I alluded to the Bank's intentions to review the remaining controls on foreign exchange. Then at the Annual Mining Conference in Sydney in December 2004, I went on to announce our decision to affect these in 2005. I have been tasked to dwell on this aspect of reforms undertaken by the Central Bank in this morning's session.

Whilst there is this sense of the arrival of good times, it is only right that these good times be shared by as many stakeholders as possible in our community for a sense of accomplishment to be felt. I mentioned in my speech to this forum last year that significant strides have been made by the Bank to ensure the soundness and stability of the financial system. Coverage, in terms of accessibility to most of the population is lacking. This is an area very much outside of the Bank's direct influence and it is pleasing to note that the Government, through its District Treasury Rollout Program is attempting to address this issue at the moment through the provision of banking services via the postal service network and District Treasury offices. The Treasurer is the right person to give details on this program, but from what I have heard in the media there is much optimism where the services have been launched in the Morobe, Eastern Highlands and Central provinces.

Only recently the Bank of Papua New Guinea issued a licence to the Papua New Guinea Micro Finance Company Limited owned by Papua New Guinea Sustainable Development Program Limited (60%) and the Bank South Pacific Limited (40%), with a very strong indication that the International Finance Company (IFC) the investment arm of the World Bank will take a twenty percent (20%) ownership interest in this venture. It will be the first time that the IFC is directly involved in Papua New Guinea as an investor or lender. We hope this is a break-through and will see them involved in other projects in privately and publicly owned enterprises; a tacit vote of confidence.

Mr. Robert Igara the Chief Executive Officer of PNGSDP was invited to address the forum and provide some details on the operations of the company he is heading. The Government asked him to act as the liaison person with the IFC and I am sure he will be glad to answer any questions you might have.

The Bank has also embarked on addressing the issue of banking and financial service coverage in Papua New Guinea, by introducing the Micro-Finance & Employment Project in 2000, co-sponsored by the Asian Development Bank, AusAID and the Government of PNG. A pilot micro-bank in Wau, Morobe province, which the Bank of Papua New Guinea licensed in 2004, is showing strong signs of growth by expanding its micro-finance operations into the city of Lae after one year of commencement.

These initiatives are not in direct competition with the existing financial institutions, but are seen as complementary to the financial system.

Foreign exchange control liberalisation

Let me touch on the Bank's decision to remove the remaining controls on foreign exchange.

The first question many may ask is the obvious one: why liberalise the exchange controls? The rationale as I have stated is to allow for a smoother flow of capital into and out of the country. Under a floating exchange rate regime, exchange controls are not required because the market can adjust itself to meet the supply and demand of foreign currency and the exchange rate acts as an adjustor to adverse impacts from domestic or external shocks. Prior attempts and intentions to liberalise exchange controls did not eventuate. In 1994, after the kina was floated, the controls were retained to allow the severely depleted reserves to be rebuilt to comfortable levels. Again in 1997 and 1998, the timing was inappropriate with adverse economic shocks resulting from the El Nino drought, Sandline crisis and low confidence levels. One of the deciding factors not to pursue liberalisation was that, the Central Bank did not have the independence to rein in a monetary expansion, as a result of any expansionary fiscal policy, and to stop the pressure on the kina emanating from it.

In 2000, whilst the enactment of the Central Banking Act gave the Central Bank greater independence, the controls were kept to give the Bank time to develop appropriate monetary instruments and prudential standards to achieve the objective of price stability. The stable macroeconomic environment that emerged in 2003 and improved outlook for the country has enabled the Bank to revisit the liberalisation of the exchange controls. If ever there was a time to liberalise, this is it.

The next question many of you may have is: what form would this liberalisation process take? As explained in my address to the Annual Mining Conference in December 2004, the liberalisation involves imposing EXEMPTIONS on the exchange control regulations, without actually doing away with the legislation on Foreign Exchange and Gold Regulation itself. We are in a sense shelving the legislation with the possibility of re-introducing it as and when the need arises, the most probable being in the event of a severe balance of payments crisis.

Another question on the minds of many present here is: When will the liberalisation be implemented? As mentioned, the liberalisation means the Bank of Papua New Guinea will no longer be required to review, analyse and grant exchange control approvals. Whilst it will not be a delegated function, the authorised dealers, which at the moment are the four (4) commercial banks operating in the country would have to process all transactions, including reviewing applications for foreign exchange transactions and ensuring tax clearance is obtained from the Internal Revenue Commission (IRC). The Bank of Papua New Guinea's emphasis now will be on the reporting forms from the dealers and other transactors for Balance of Payments analysis purposes.

At the time the initial round of consultations took place with stakeholders, including the authorised dealers, many were not aware of the full impact of the liberalisation of the existing controls and their ability to handle it. The views expressed by the major stakeholders and business community, including the Minister for Finance and Treasury during the post-announcement discussions is that whilst they welcomed this major reform, a cautious approach to stagger the liberalisation process should be followed. Those were the reasons for the delay in implementing the proposed reform.

It is my pleasure however to announce at this forum that the first aspect of this reform in the remaining controls on current and capital account transactions will be effective o**n 01st June 2005, except for the following controls:**

- **Approval involving private capital account contracts between residents and non-residents;**
- **Approval to open and operate foreign currency accounts outside Papua New Guinea; and**
- **Licensing of authorised dealers and gold exporters.**

These controls are still subject to the approval of the Central Bank as required under the Foreign Exchange & Gold Regulation. For those transactions that will be liberalised, they will still require tax clearance, which will now be the responsibility of the authorised dealers and the IRC.

Prior to the effectiveness of the liberalisation of these controls, the Bank of Papua New Guinea will undertake public awareness campaigns around the major centers of Papua New Guinea and hold further consultations with the major stakeholders. Subsequent announcements on the liberalisation of the remaining controls will follow later on.

We would like to work together with everyone concerned to ensuring the reform is implemented successfully. The exchange controls are a hang-over from the days of the fixed exchange rate regime. Liberalising exchange controls would open up the economy, removing one of the administrative impediments to doing business in Papua New Guinea and assist in the Government's Export-led Growth Strategy.

Our supervision of the financial system in Papua New Guinea, covering the banks, licensed financial institutions, the saving and loans societies, superannuation funds, life insurance companies and others are to ensure that they comply with the legislation requirements, world's best practices and operational work ethics.

I want to assure you all that the Bank of Papua New Guinea will not shy away from implementing and fulfilling its mandated role of ensuring a sound and stable financial system for the people of Papua New Guinea and those who do business in the country. We now have the necessary legislations in place and strong independence to safeguard the institutions that we licensed in the various legislations under our jurisdiction. It would be tantamount to gross negligence on our part not to enforce these regulations to safeguard the soundness of our financial institutions, their shareholders and beneficiaries.

Thank you.