

## **Loi M Bakani: Papua New Guinea's economy and comments on the planned Sovereign Wealth Fund**

Address by Mr Loi M Bakani, Governor of the Bank of Papua New Guinea, to the 2012 Papua New Guinea Advantage Summit, an International Investment Summit on Papua New Guinea, Port Moresby, 9 September 2013.

\* \* \*

### Acknowledgments

The organizers entitled my presentation as “economic briefing” and asked me to touch upon the “Sovereign Wealth Fund”. I will do my best in the time allotted to me, to cover both subjects and more.

I will commence with the subject of Inflation:

As you might know, the Bank of Papua New Guinea's (the Bank) main role and objective, as is the case with many Developed Countries Central Banks, is “Price Stability”. Only after this objective is achieved, and subjected to it “to promote macro-economic stability and economic growth in Papua New Guinea”. In the last four years 2009–2012, the Bank of Papua New Guinea achieved its primary and secondary objectives, far beyond expectations. Inflation was on the average 6.4% per annum. Given the very high economic growth, as measured by the real increase in Gross Domestic Product (GDP) of 9.5% in the same period, the inflation outcome is at the low end of our projections and expectations.

The outcome we are still trying to fully understand is the very low inflation in 2012, of 2.2%. This trend continues in 2013 with inflation of 1.6% in the March quarter and 0% in the June quarter, in spite of the devaluation of the Kina since the last quarter of 2012. In the past, our analysis showed that the devaluation was one of the main causes of inflation. It may seem that the effect of kina devaluation is offset by low imported inflation because of low inflation in our major trading partner countries and slow down in capital inflow, and could be a measurement issue.

At the present the Bank's projections show that inflation in 2013 will be around 5.5%. The Bank's assessment and analysis shows that the projection is on the high side. I state with confidence that, “Price Stability”, will be achieved.

The second subject of my presentation is on GDP growth:

As stated above, GDP growth in the last four years was 9.5%. Present projections are for a 5.2% growth in 2013. This projection which, in my view is on the low side, means that in the five years 2009 to 2013 average GDP growth will be 9%. There is no question that it is one of the highest growth rates in the world.

We can without hesitation define Papua New Guinea as a Very High Growth, Small Emerging Market Economy. With the commencement of the operation of the LNG project in 2014, Papua New Guinea has a huge potential to continue and grow at high rates in the future.

Why do I consider the projected GDP growth for 2013 to be on the low side? It will all depend on the implementation of the Government's Expenditure Plan (Appropriation Act) in the 2013 and future budgets. Based on the fact that the PNG LNG Project construction is scaling down in 2013, and will end in early 2014, the Government decided to present an expansionary budget with a substantial deficit of K2.5 billion or around 7.1% of GDP.

The guiding principles were:

1. Free education;
2. Free basic health services;

3. Infrastructure development;
4. Rural development projects; and
5. Law and order.

The overall policy stance of the Government of providing free education, free health that goes hand in hand with clean water and sewerage systems, law and order and infrastructure development is right and commendable. To turn Papua New Guinea from a low income developing economy, to a medium to high income developing one, we will need a healthy and better educated population, in which individual safety and security is granted. For the produce of our rural population to reach the markets, we will have to have usable transport infrastructure of roads, ports and jetties, airports, coastal shipping as well as power and telecommunication.

In this respect the utilization of the machinery and equipment and highly trained man power used to develop the LNG project, for national and rural infrastructure development is a top priority. The Government must take the lead role in the detailed planning, issue of the tenders and awarding of contracts, to ensure that the implementation of these developments are done in the most efficient and productive way.

The allocation of K10 million to each district has to be used to develop the rural infrastructures such as feeder roads, class rooms, health clinics, police stations, while the National Government takes responsibility for the national roads, communication, power, airfields, ports and jetties, coastal shipping and other infrastructure. A combined plan and effort will turn rural Papua New Guinea around, and improve the livelihoods for 80% of the population.

The Government has to plan in great detail and professionally the pace of implementation. The decisions it took are very wide ranging, complex and very costly. It has to ensure that the very large amounts of resources that were allocated to each of the above tasks are used efficiently, and under close scrutiny and control.

The Government is aware that its 2013 expenditure plan can be funded from domestic financial resources. This will result in all of it, excluding some minor import components of fuel, spare parts and some planning will be accounted for as contribution to domestic GDP. If things will materialize as planned, then GDP growth will be substantially higher from the 5.2% projected, and closer to the five year average growth of 9%.

The Government has to plan in great detail and professionally the pace of implementation. The decisions it took are very wide ranging, complex and costly. It has to ensure that the very large amounts of resources that will have to be allocated to each of the above tasks are used efficiently, and under close scrutiny and control.

I recommend that, only after all the plans and safe guards are in place, the resources should be released. Otherwise we will repeat the misallocations and misuse of funds of the recent years from the public funds.

Another policy I advocate from the day I was appointed the Governor of the Bank is the development of the agriculture sector.

Eighty percent of our population are subsisting and earning their living in the formal and informal agriculture sector. We have an abundance of very fertile land, no shortage of water resources, excellent climatic conditions, and many under employed people in the rural areas. Therefore, in the medium term, the industry that can provide a source of income and improve the standard of living, of the great majority of the population is the agriculture sector. The agriculture export industries like oil palm, cocoa, coffee, rubber, tea and coconut are just some of the commodities that, if the right structures will be put in place, they can serve the purpose of providing productive employment and income to the rural majority. Given the world shortage of food and the ever increasing prices of food products in recent years, Papua New Guinea can become the food basket of the Pacific and beyond. The Government

should develop an incentive framework that encourages investment in the agriculture sector, to replace imports, enhance and encourage exports of food products.

The most effective way of counter-acting the “Dutch Disease” phenomena is by developing the traditional industries. No question that in Papua New Guinea agriculture will be the preferred industry to concentrate our efforts and focus.

Given that the resources are available, and the production technologies are simple, the development is not hard to come by. Papua New Guineans are farming their land for many generation, and achieving results in agriculture can be realized relatively in a short time. Once the education system will progress and the population’s technical skills will improve, the development of more sophisticated industries can be encouraged and incentivized by the Government.

As requested by the organizers, I will make some short comments on the planned Sovereign Wealth Fund (SWF). Because of some legislative problems, a new Sovereign Wealth Fund Organic Law was drafted. I am very comfortable with the new Organic Law because it meets the internationally recommended Santiago Principles of Governance and Management.

The objectives as stated in the SWF Organic Law and Act are:

I quote from the new Act;

The objectives for which the SWF is established are that it:

- (a) supports the long-term social and economic development objectives of the State;
- (b) provides a means of saving for future generations; and
- (c) facilitates the macroeconomic stabilisation of the Papua New Guinea budget and economy.

These objectives may from time to time be further defined by a Constitutional Law or a Regulation.

I am in full agreement with the funds that will be established:

I quote from the new Act;

The SWF shall comprise:

- (a) a Sub-Fund to be known as the “Sovereign Wealth Fund Development Fund”;
- (b) a Sub-Fund to be known as the “Sovereign Wealth Fund Futures Fund”;
- (c) a Sub-Fund to be known as the “Sovereign Wealth Fund Stabilisation Fund”;
- (d) a Sub-Fund to be known as the “Sovereign Wealth Fund Management Fund; and
- (e) such other Sub-Funds as may be provided for by a Constitutional Law or by a Regulation.

The funds will be domestically managed and off shore invested. My assessment is that after several iterations we reached a state, in which it will be of great value in stabilizing the economy and preventing the “Dutch Disease” phenomena from occurring, and if it does, to counter act it.

I will touch on two very important initiatives by the Bank of Papua New Guinea. Those are in my domain and very dear to me.

The Bank, in collaboration with the Pacific Financial Inclusion Program, held a two day workshop on the 22nd and 23rd of August to discuss the Financial Service Sector Assessment report. The report identified gaps and issues as to why 85% of the population continues to be unbanked. We are currently formulating the “National Strategies on Financial Inclusion and Education”, with the aim to enable the great majority of the population to be financially literate and included in the formal financial sector. It was decided to establish a

Centre for Excellence in Financial Inclusion (CEFI) to be the national coordinating agent of all financial inclusion and education initiatives. The CEFI was launched in April 2013 and its mandate approved by the NEC in August 2013.

The Bank will also see to it that the payment system is low cost, efficient and provides all the necessary instruments that an advanced financial system needs. The new National Payment System is at an advanced testing stage and planned to go live toward the end of 2013. The objective is to achieve real time settlement of all payments and transfers carried out by and through the financial system in PNG.

Thank you.