

## **L Wilson Kamit: Monetary policy, supervision and governance of the financial system in Papua New Guinea**

Speech delivered by Mr L Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea, at the workshop of the New Ireland Forum for Development on 'Partnership in development - understanding the issues', at the Institute of Public Administration, Port Moresby, 14 August 2004.

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Rt. Honourable Sir Julius Chan  
Ambassador Noel Levi  
Other distinguished guests and speakers  
Organisers of the New Ireland Forum for Development  
Ladies and Gentlemen

### **Introduction**

I am honoured to be here today to address the New Ireland Forum for Development. The overall theme, '*Partnership in Development - Understanding the Issues*' is an ideal one, given the current state of our socio-economic and political development, as well as the on-going changes within our nation and society. Thank you Mr. Stephen Mokis for the invitation.

The new Central Banking Act (CBA) of 2000 requires greater transparency and accountability in the Central Bank's activities. We are required to publicise economic information through the Quarterly Economic Bulletins (QEB), Annual Reports, Semiannual Monetary Policy Statements (the latest was dated 30 July) and the monthly Kina Facility Rate (KFR) announcements. This also requires giving talks and presentations to different sectors of the business and civic community on what we do, as opposed to the past where we shied away from such invitations to speak publicly. Over the years, I had had the opportunity to address graduation ceremonies of educational institutions, given talks to business grouping and have made presentations at various forums around the country. With the Central Bank Board, we have held Board meetings at Alotau, Lae, Wewak, Kavieng and Goroka. On other business, staff and I have visited Manus, Mount Hagen and Kokopo on different occasions to give public talks. There were also briefings to the National Executive Council (NEC) and the Economic Ministers. In July last year (2003), I was invited to address the Provincial Governors' Conference in Kavieng. It was the first time for the Central Bank to address a large number of politicians and public servants under one roof.

Today's invitation is one such meeting that we are happy to attend. The presentation is however slightly different, because whilst my talk on '*Monetary Policy, Supervision and Governance of the Financial System*' has a national emphasis, this forum has a provincial focus.

I have divided my talk into the three areas mentioned, namely, monetary policy, supervision and governance.

### **Managing and implementing monetary policy**

The Bank of Papua New Guinea deals with the monetary policy of the country, one of the major economic policies of the Government. The other policies include the fiscal or budget, wages, and employment policies. By October this year, Papua New Guinea will have had a floating currency for ten years. We floated in 1994.

The new CBA 2000 outlines the main objective of monetary policy as 'achieving and maintaining price stability'. Stable prices, which include stable exchange rates, and low interest rates and inflation, are important to promote economic efficiency and growth in the long run. Experiences show that countries with high inflation have poor economic performance, due to amongst other things, poor functioning of product and labour markets, distributional effects, and high cost of doing business.

Maintaining price stability in a small open economy such as PNG requires amongst other things, relative stability in the exchange rate. Downward pressure on the kina exchange rate can come about from domestic sources, mainly fiscal imbalances and too much private sector credit, and from external

sources, such as developments in international markets or natural disasters such as the El Nino drought and frost.

The appropriate monetary policy response to a depreciating currency and rising inflation is to tighten monetary conditions (increase interest rates). This would encourage domestic residents to keep their wealth in kina denominated assets, as well as discourage domestic consumption and import demand. However, increasing interest rates to tighten monetary conditions would also discourage domestic investment, resulting in a decline in private sector activity and employment. On the other hand, when the currency is stable or appreciating and with inflation falling, then monetary policy would be eased (reducing interest rates).

Monetary policy was tightened from mid-2002 up to mid-2003 due to inflationary pressures as the kina depreciated to an all time low. The recent fiscal discipline of the Government, improved international commodity prices and exports, and confidence in the macroeconomic management of the economy has seen a recovery in our economy. This has led to high international reserve levels at the Central Bank, stability in the exchange rate and declining inflation. The Central Bank therefore eased monetary policy in the second half of 2003 and has maintained this stance in 2004 to stimulate economic activity. Whilst there are favourable economic indicators, lending by the commercial banks remain flat.

International reserves at the Central Bank now totals around US\$612 million (almost K2 billion), the exchange rate has stabilised at around 0.3110 US dollar and inflation has declined to 2.9 percent over the year to March 2004. Economic activity as measured by the gross domestic product (GDP) is projected to increase by 2.8 percent this year, while employment in the formal private sector continues to grow.

These gains however should not allow us to become complacent. Rather, we have to continue to maintain vigilance in ensuring appropriate policies and actions are pursued so that we can continue to gain on these hard won achievements.

An effective monetary policy requires a sound financial system. The Central Bank ensures this through its supervisory function. I will now discuss this second major function of the Central Bank.

### **Supervision of the financial system**

At the Bank of PNG, following the passing of several legislations (CBA 2000, BFIA 2000, Life insurance and Superannuation Acts) our responsibility now covers the supervision of almost the whole financial system in the country. Besides the commercial banks, finance companies, and savings and loan societies, we now oversee the life insurance companies, superannuation funds, and the micro credit schemes. This is in addition to our other responsibility of managing monetary policy. We take seriously these responsibilities because we are mindful of the profound impact of our decisions and actions or inactions on the economy and society as a whole. We insist on the same standards we expect from those the Bank supervises.

The Central Bank also encourages the establishment of savings and loan societies to provide complementary financial services to those provided by the banks, finance companies and the existing Savings and Loan societies. There were two types of saving and loan societies until recently: employer-based societies such as Teachers and Elcom; and provincial-based societies like the Niu Ailan Savings and Loan society. Provincial-based societies are flavoured in a fashion that membership is open to those living in the province and those who are from the province but are living or working outside the province. There is now an addition to the type of societies available - only yesterday I launched the service centre for the Nasfund Savings and Loan Society. This society is open to membership from contributors of the Nasfund, which covers a cross-section of employees in the private sector.

As at the end of June 2004, there were twenty-one (21) active savings and loan societies, of which, the Niu Ailan Savings and Loan Society Limited is one. I will talk briefly on the Niu Ailan Savings and Loan Society.

I have to first of all express my condolences on the passing of the founding Chairman of the society, the Late Mr. Greg Luka. Under his stewardship, the Society has grown to become one of the success stories.

The New Ireland Provincial Government was the promoter of the establishment of the Niu Ailan Savings and Loan Society, with a cash donation of K50,000 when it was registered in March 1995. Annual grants of K50,000 from the provincial government were given in 1995 and 1996, and in kind up until April 2002. The success of the society is shown in its membership, which grew from 167 in March 1995 to 5,754 at the end of June 2004. As I've already mentioned, membership is open to all New Irelanders living in or outside the province. So Stephen, if you decide to migrate to Australia or Fiji, you can still be a member. The only hitch is your deposits must be paid in kina (not dollars). Oh, I also doubt if the society will accept deposits in *mis* either, but kina and toea, they will accept.

The society is also in a financially strong and viable position. As at the end of June 2004, total assets of the society were K6.5 million, while total deposits and liabilities were K5.3 million and K5.5 million, respectively. Total loans amounted to K2.8 million.

The success of the society is based on good management and sound business practice, and I have acknowledged the stewardship of the Late Greg Luka in this area. This prudent management and good corporate governance will have to continue for the society to maintain its satisfactory performance.

We have also created a microfinance unit in the Bank to deal with microfinance issues. Early this year, we launched the Wau Microbank in the Morobe province. Microfinance is an area of increased interest and we are considering appropriate legal framework to oversee this industry.

We are all familiar with the illegal money schemes or pyramid schemes. The Central Bank continues to work with the law enforcing agencies to stamp up these illegal schemes, which have created financial problems for many of our people. We have taken out advertisements listing the licensed financial institutions and warning the public on the illegal schemes. We need the public's support - your support - to help us stop and prosecute the operators of these schemes.

As part of the international community, we are not immune from financial threats and illegal activities from abroad. The Central Bank is working with other Government agencies in implementing appropriate mechanisms to deal with money laundering, terrorism financing and proceeds from crime. Not only must we safeguard our financial system from domestic threats, but also from external ones.

At this point, one may ask; who then supervises the supervisor? Who supervises the Governor? This is an important question given all that I have talked about on our increased responsibilities.

At the Central Bank, the recently passed legislations explicitly state that the Governor is solely responsible for managing monetary policy and supervision of the financial system. We have in place a Board of Directors drawn from a cross-section of the community - comprising representation from accountants, trade unions, churches, businesses, and prominent individuals. This Board is very vigilant and their statutory role is to ensure that the Governor performs his roles diligently and prudently in the conduct of monetary policy and supervision of the financial system. Performance can be gauged from the achievement of the objective of monetary policy, which is 'price stability', as well as the soundness of the financial system. The Central Bank can also be called up by the Parliamentary Public Accounts Committee.

### **Governance of the financial system**

The supervision of our financial system requires sound management of the institutions at all levels.

Governance, and in particular, good corporate governance has become an important part of our daily work and language. Together with the other buzz-words of transparency, independence and integrity, what do good governance and accountability entail?

One cannot stress enough the importance of good governance and accountability for an individual, an organisation and society as a whole. It has to become part of our work culture and ethics. Whilst we can spend all day talking about development and making plans, our best policies and strategies will not work if good governance is missing in their implementation. And in PNG, we have had a poor record - but it is improving.

The lack of corporate governance and accountability in many of our institutions has been an area of concern. Our past history and record of management in Papua New Guinea, especially in public institutions which are guardians of the nation's interests and wealth, has given rise to the need to re-establish proper procedures and order.

The on-going work of the Parliamentary Public Accounts Committee, which is an attempt to instill accountability on the use and management of public resources, is commendable. So are the efforts of the Ombudsman Commission, the Institute of Directors, Inc., Transparency International and other organisations that aim to promote good governance and accountability. These institutions not only advocate the use of proper rules and guidelines in conducting business, but also the use of one's good sense and due diligence.

Whilst it is one thing to have in place the best rules and regulations, it is another thing to practice them using common sense. The collapses of large companies abroad, some due to accounting fraud but others due to carelessness and neglect, highlight the need for continued diligence. Closer to home, the turn around of the former PNG Banking Corporation, prior to its sale, other financial institutions that the Bank supervises, such as superannuation funds (case of NPF) from loss-making institutions to profitable ones in a short space of time was based on one thing alone; the newly appointed Board and management of these institutions ensured that everyone was diligent and followed the established rules and guidelines re-sounding good governance. The important lesson here is, do not take short cuts.

It is important that we all remain a "Fit and Proper" person for purposes of directorships, management appointments and general community recognition and acceptance. This applies equally to a Managing Director of a company as it does to an Honorary Treasurer of a Church. This good reputation must come to us over time and we must work at it - we cannot buy an excellent reputation. We must earn it.

## **Conclusion**

The theme of this workshop is a very meaningful and timely one: *Partnership in Development - Understanding the Issues*. We all have a part, those in Government, the private sector, Non-Government organisations, and the in-formal sectors in ensuring that the real benefits of economic development is passed on down to our people.

The Central Bank realises that its policies and activities cannot be done in isolation from those of other organisations. Monetary policy on its own cannot deal with the problems of this country. It has its strengths, as well as its limitations.

However, working together, understanding the issues, abiding by established rules and procedures, as well as practising good governance would enable organisations and institutions to perform effectively. This would go a long way in ensuring our people receive tangible benefits, and achieving a harmonious and better society for all our people.

In conclusion, may I once again thank the Convenor of this Forum, Mr. Stephen Mokis, and his Committee, for your invitation and all of your contribution and participation at this event.

Thank you and God bless all.