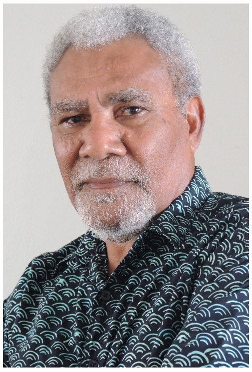
Public Statement by
Rt Hon Sir Mekere Morauta
Port Moresby, 24 May 2016

PNG's Economic and Financial Reality



The Prime Minister and his advisers must accept the incontrovertible evidence that Papua New Guinea is in the midst of an extensive and deepening economic and financial crisis, former Prime Minister Mekere Morauta said today.

"Only by the Prime Minister acknowledging the nature and scale of the problem, and sharing it with Papua New Guineans, can we find solutions to fight the problem, hand in hand.

"Everyone knows something is seriously wrong," he said. "Everyone is talking about it. Everyone is living with the growing effects. Families can see that the cost of food is skyrocketing. Students know that there are insufficient jobs when they leave school. Public servants know they aren't being paid on time and in full. Businesses know that they can't get foreign exchange to pay their suppliers, and that the economy is stagnating."

Sir Mekere said the problems were urgent and obvious:

2016 Budget failure

- The 2016 Budget has failed as a result of lower economic growth, lower than budgeted commodity prices, a failure to secure the $US1 billion sovereign bond and the $US300 million International Finance Corporation loan, and failure to adjust immediately to cushion the effect of these changes
- Revenue is likely to be about K800 million lower than expected, and the financing shortfall is heading towards K1.3 billion, so there is a K2.1 billion hole in the Budget
- Delivery of essential services such as health, education, transport and productive infrastructure continues to worsen
- Debt servicing costs in the 2016 Budget of K1.5 billion are now higher than spending on individual essential services such as health, education and transport

Government Debt

- The Government has stated that public debt is K18 billion
- Government debt is far higher than the Government is admitting, because it excludes all the off-balance-sheet liabilities, such as borrowings by State-Owned Enterprises, the UBS loan, unfunded superannuation and other contingent liabilities
- Taking into account all these other hidden liabilities, true debt is likely to be at least K28 billion, almost 50 percent of GDP and almost double the maximum 30 percent permitted by the Fiscal Responsibility Act
- The 2016 debt servicing cost of K1.5 billion is about 10 percent of expenditure

Cash Flow crisis

- Lack of cash is severely reducing the delivery of essential services such as health and education, preventing full and timely payment of wages and entitlements to public servants and causing businesses to close or sack staff because of non-payment of government bills. Continued foreign exchange rationing is adding to cash flow pressures

Foreign exchange crisis

- There is a shortage of foreign exchange, with the value of the kina collapsing and foreign reserves dwindling
- In early 2012 the kina was worth 47 US cents, but today it is worth only 30 US cents
- Over the same period foreign currency reserves have fallen from $US4.7 billion to $US1.7 billion, officially estimated to be 10 months import cover
- But talking about 10 months import cover is disingenuous: $1.7 billion reserves are overstated because the Central Bank is not meeting foreign exchange demand, and $170 million imports per month are understated because companies can't get foreign exchange
- Adjusting for those two factors and allowing demand to be met, and Papua New Guinea only has one to two months of import cover
- On top of this there is demand for foreign exchange to meet capital and financial commitments, including the forthcoming need for Kumul Petroleum to complete the refinancing of the K3 billion UBS Oil Search loan, in foreign currency

"It is no good pretending that these problems will magically disappear by themselves, or that flowery words and deceptive numbers are the answer," Sir Mekere said.

"Nor are expensive, ad-hoc temporary measures that have more to do with propping up the Government than saving the nation.

"What is needed is an agreed plan involving all of Papua New Guinea society and the nation's international friends and multi-lateral allies."

Sir Mekere said such a plan should have four essential elements:

A comprehensive economic and financial reform plan

- Well structured and well financed reform, based around balance of payments support and implemented over three or four years with international cooperation and assistance

A mini-budget

- The 2016 Budget is no longer workable, with revenue continuing to collapse, the GDP growth rate falling to 4.3 percent this year and even lower from then on, unplanned and unproductive debt continuing to rise and misallocation of scarce funds away from essential services and productive infrastructure spending. The deficit keeps rising and there are few prospects of financing it
- The Government should not wait any longer: it needs to bring a mini-budget to Parliament in the next session

A Sovereign Wealth Fund

- The Government has ignored the fact that the PNG economy is essentially commodity driven, and therefore cyclical. It needs permanent mechanisms to lessen the impact of price shocks such as the one the nation is now experiencing
- A proper Sovereign Wealth Fund, as originally envisaged in 2011, will help insulate PNG from commodity cycles and will have the additional benefit of protecting funds
- The House of Kumul, a shaky structure thrown together on weak foundations, is swaying. It should be rebuilt, with revenue flows channeled into a Sovereign Wealth Fund and insulated from misapplication

Preventive measures

- Faults and blockages in the systems and processes that have allowed waste, mismanagement and abuse to flourish must be identified and remedied. In particular economic and financial management tools must be sharpened, then applied
- Transparency and accountability need to be dramatically improved so that the country's real financial position is known with certainty
- For example the Central Bank recently announced that the National Statistical Office had calculated that GDP had risen from K51 billion in 2015 to K64 billion today. That increase, which has not been explained, included a rise in 2006 GDP by an extraordinary 48 percent, and 35% in 2013. As a result the economy is suddenly one-third bigger!

Sir Mekere said: "The need for economic and financial reform is urgent; there is no time to waste. The longer the Government delays, the greater the pain of adjustment will be.

"The need to act is highlighted by the poor standing of Papua New Guinea in international financial markets, demonstrated by the Government's lack of success in securing the $US1 billion sovereign bond issue or the IFC K1 billion loan, and the slashing of the nation's credit rating three times in the past 12 months.

"I am advised that an IMF mission will be visiting the country in June; I encourage the Prime Minister and his advisers to take advantage of this opportunity and seek its assistance with a full economic reform agenda. There is nowhere else but the IMF for the Government to go. Any other type of commercial borrowing will just add to the country's debt burden and not solve the underlying problems.

"The time for shallow, short-term thinking and expensive borrowing is over. We cannot borrow our way out of this quagmire. Comprehensive economic and financial reform, implemented with strict discipline over a period of 3 or 4 years, as will come with IMF balance of payments support, is the only answer."