



## **Speech**

### **Economic Growth: Lessons Learned from the Last Ten Years and Challenges and Opportunities Ahead**

***"Policy lessons from the PNG Economy in the Past 10 Years"***

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#### **Introduction**

Thank you for the opportunity to speak to you briefly today on the policy lessons from the performance of the PNG economy over the past decade.

The performance of the PNG economy over the past decade is a tale of two halves.

In the first half (from 1996 to 2001) of the past decade, we had little economic growth, GDP per capita fell, inflation rose to double digits, the exchange rate fell, and the Budget deficit and public debt rose to alarming levels.

We have seen a significant turnaround in our economic performance in the second half of the past decade (from 2002 to 2006), with the economy growing solidly, GDP per capita rising slightly, inflation at record lows, the exchange rate

stable, the Budget in balance and public debt falling (although still high as a share of GDP).

### **What is the reason for this different performance?**

The PNG Government is proud of this turnaround in our economic performance. From my perspective, there are three broad factors that explain much of this improved performance.

1. Structural economic reforms.
2. Disciplined fiscal policy.
3. A more favourable external environment (in particular, higher commodity prices).

I would now like to briefly expand a little on each of these topics.

#### *Structural economic reforms*

At the recent Australia-PNG Business Forum, I noted that PNG continues to benefit from the structural economic policy initiatives put in place by the previous Government, including:

- Improved governance arrangements for the superannuation industry.
- Progressive privatization of Government owned business enterprises.
- Central Bank Independence.

The structural reform initiatives of the previous Government took political courage – particularly as the political costs of such policies are usually borne up front while the benefits can take some time, say 3 to 5 years, to be realized.

#### *Disciplined Fiscal Policy*

Fundamental to the improved recent macroeconomic performance in PNG has been the maintenance of disciplined fiscal policy.

When I became Treasurer in mid-2002, the state of PNG's public finances was very poor – we were facing a large Budget deficit, causing inflation to jump sharply, the exchange rate to fall, and public debt was dangerously high.

We were in trouble, and tough action was needed if we were to stave off crisis. We put together a *Medium Term Fiscal Strategy* (MTFS) that mapped out an achievable plan to return the Budget to balance by 2008, and took action immediately through a supplementary budget to restrain the 2002 Budget deficit.

Importantly, political stability since 2002 has allowed the Government's Budgets to be set in a medium-term policy framework, adhering to the MTFS targets.

However, it has not been easy to achieve these targets. Indeed, contrary to what some believe, it is actually harder – but just as important - to maintain fiscal discipline when revenues improve and the immediate crisis passes.

Indeed, the reason why I am so hard on the various spending proposals is that I know we have critical needs that need more funding – rehabilitating our transport infrastructure and hospitals and improving service delivery in rural areas – which stay unfunded if we spend money on other things.

#### *A more favourable external environment*

Another factor behind the turnaround in our economic performance has been a more favourable external environment.

In particular, historically higher prices for key mineral commodities, such as oil, gold and copper have added to aggregate demand, indirectly stimulating economic activity.

In contrast, in the late 1990s the external environment was less benign, with the Asian financial crisis and consequent low commodity prices coinciding with a severe drought, which was then followed by a tsunami.

Clearly, we cannot expect the external environment to always be this favourable. To me, this means that now is the time to tackle those more difficult policy issues, including privatization, that will help our economy remain strong should the external environment weaken (e.g., commodity prices fall).

### **Challenges and Opportunities**

The PNG economy has made significant progress in recent years, but we still have a long way to go.

There are three things we must do if we are to achieve sustained economic growth in PNG:

- We must stick to the Medium Term Fiscal Strategy and not allow undisciplined and unrestrained spending from undermining the macroeconomic stability on which our recent economic recovery is based.
- We need to improve the implementation of the Medium Term Development Strategy with an improved focus on project implementation and avoid the temptation to divert resources in the Development Budget in order to attract political support.
- We need to show strong economy leadership on structural economic policy, including having the courage to open up state-owned enterprises to private investment.

Thank you.