



**BUSINESS COUNCIL BREAKFAST
SPEECH BY
HON. DON POLYE, MP
MINISTER FOR FINANCE & TREASURY**

**“SOVEREIGN WEALTH FUND AND SUSTAINABLE DEVELOPMENT”
30 SEPTEMBER 2011**

INTRODUCTION

Good morning distinguished guests, business executives, ladies and gentlemen; I would like to thank the Chairman/President of the Business Council for inviting me to this Breakfast to address this forum on the Sovereign Wealth Fund and Sustainable Development.

Let me from the outset, take this opportunity to acknowledge and thank the business community for the continuous investment in our economy. You are the key to generating jobs and opportunities for the people of PNG and our Government looks forward to working closely with you.

As the business community is well aware, PNG has a new Government with young and experienced leaders who will take the country forward to the next election.

Before going any further, allow me to briefly comment on the state of the PNG economy because economic conditions affect business and investments in the country.

PNG ECONOMIC PROGRESS

The PNG economy continues to grow despite the global financial predicaments faced by many developed countries and I am proud to say here today that PNG has recorded 8 years of consecutive economic growth representing the longest period of uninterrupted growth in PNG's history.

In 2011 the economy is expected to continue to grow by a very strong 9 per cent, significantly higher than the 8 per cent growth anticipated earlier. This is driven by higher levels of economic activity in the non-mining sector and the expected ramp up in the PNG LNG construction, investor and consumer confidence following continued macroeconomic stability as well as critical microeconomic reforms. This outcome is more than double the recently released estimates for average global growth from the IMF. The PNG economy is doing well. We need to ensure we manage this boom, and share the benefits of the boom in a sustainable way for all the people of PNG. And as a Government, we must ensure we continue to deliver the policies that deliver the environment in which businesses can thrive, job growth can be strong, and the quality of life of the people of PNG can increase.

PNG has benefitted greatly from increased competition in the key service sectors of the economy, particularly the telecommunications, aviation and tourism sectors. This Government will continue to build on these gains and closely monitor and evaluate these reforms to ensure they achieve their objectives and explore new opportunities for further reform, where necessary.

The Government will also continue working with the business community to identify impediments to business investment.

2011 SUPPLEMENTARY BUDGET

Last week, I handed down a K781.8 million, Supplementary Budget with the theme “**sharing the benefits of economic growth with our people**”.

Spending is being shifted to important policy-driven development priority areas to invest in the development of our nation, and to share the benefits and opportunities of economic growth with ordinary Papua New Guineans.

Unlike the previous Government, the O'Neill-Namah Government won't just talk about transforming the rural economy, it will deliver improvements in the rural economy by ensuring funding is allocated to the right areas, by being transparent and accountable in the expenditure of public funds, and by weeding out corruption in the system. Under the previous Government, the share of the Development Budget going to the key enablers for the Medium Term Development Program, including education, health, infrastructure and law and justice, fell from 73 per cent to just 53 per cent. In the just announced Supplementary Budget, we have started a process to reverse dramatically this decline.

MANAGING ECONOMIC AND FISCAL CHALLENGES

Now let me turn to the challenges that we may face. The economic and fiscal outlook for PNG in 2011 and the medium term is positive but there are risks. The last week has demonstrated how dramatic these risks are. PNG is part of the global economy, and the recent news from the IMF and global sharemarkets has not been good.

Economic overheating is also a concern in Papua New Guinea. Annual inflation is now forecast to be 9 per cent in 2011, an upward revision to 2011 Budget forecast of 8.2 per cent, and the most recent estimate is 9.6 per cent. This is largely due to the high level of economic growth, a continuing shortage of skilled labour and land which pushes up wages and rental prices, and higher food and fuel prices from high global demand.

The domestic economic outlook is positive but not without risks. The risks include volatile and falling commodity prices from the projected high levels, negative domestic factors like landowner issues, bad weather, mine disruptions and a heightened inflationary environment.

On the upside, there are a number of mining and gas projects which are currently under active consideration. Should these projects proceed, this would provide a significant boost to economic growth and a more positive revenue outlook over the longer term.

Considering these risks, the Government is mindful of the need to promote macroeconomic stability and to provide prudent fiscal management.

One of the significant policy decisions undertaken by the Government to reduce some of these challenges is the establishment of a Sovereign Wealth Fund.

THE PAPUA NEW GUINEA SOVEREIGN WEALTH FUND

The scale of PNG LNG project is a major development for PNG. Many people have described it as transformative. However, the expected level of gains from the PNG LNG must be placed in perspective. Estimated GDP is expected to jump up by as much as 25 per cent when the gas is turned on from 2014. However, most of the benefits from this massive new project are the increases in taxes and dividends from this project. Contrary to the impression created by the former Government, the new moneys available to the people of PNG as a whole are modest.

For example, the expected increase in tax revenues as a result of PNG LNG is only 5 per cent of total tax receipts over the expected life of the mine. Dividends may add another 2 per cent. In part, these will only offset the reduction in revenues from old mines such as Ok Tedi, where even if it is extended, the tax flow will be much more modest as costs will be higher.

Despite these modest revenue flows, the economic size of the project means that we must manage major macroeconomic pressures such as exchange rate appreciation (Dutch disease), increased liquidity and higher overall demand within the economy. This could undermine the competitiveness of the non-mineral sectors of the economy, such as agriculture, potentially having a severe impact on activity, employment and incomes in labour sensitive sectors of the economy.

Past experience from the emergence of new resource sectors and earlier commodity booms indicates that PNG has not successfully translated these revenues into improved socio-economic indicators and sustained development outcomes to the extent that might be expected – we cannot afford to squander this opportunity by dismissing the macroeconomic risks that need to be managed.

It is also important to recognise that over recent years, the shortage of funds has not been our problem in terms of effective development spending on infrastructure projects. It has been the poor ability of the public sector to establish and deliver credible project plans that has seen funds languish rather than being put to effective use. The availability of higher LNG funds will not see this problem disappear and it may intensify. This strongly argues against allocating excessive funds that cannot be effectively used. Our recent experience indicates a poor track record of successfully translating development funds into effective infrastructure programs.

In recognition of these implementation challenges, the O'Neill-Namah Government will commence a process that will involve policy, legislative, technological and administrative reforms to arrest problems of efficiency and programmes effectiveness. I am keen to see systems and processes for the delivery of goods and services strengthened and effectively managed. Impediments and useless or costly systems will be removed for better. I want to ensure projects design, costing and financing and implementation changed to programmes, planning and procurement. The monitoring, evaluation, auditing and programmes reporting components of management be improved. I am keen to bring immediate changes to the current procurement system to add value to efficiency. My intention is to bring financial legislative reforms to Parliament hopefully in the November session, but latest by early next year.

The misuse of public funds imposes a real cost on the economy and the people of PNG. The O'Neill-Namah Government will continue to pursue investigations, and prosecution of those involved in theft and misappropriation of public funds. I commend those involved in the current investigations into the alleged malfeasance of development budget funds.

I encourage those of us placed in responsible positions of trust, either in the public or private sector to be vigilant and prudent. Let me be blunt; if one steals or allows others to steal, one is robbing the future of PNG children, defying the trust of the people. It also undermines the capability of honesty and credibility of PNG as a Nation.

The mixture of much more modest revenue flows from PNG LNG, and the need to manage the impacts of the exports from the project, indicate the importance that this Government gives to the business sector in PNG. The real growth in jobs for PNG must be based on growth in the broader economy – the PNG LNG project is vital but it will create relatively few jobs. Our businesses have a vital role to play in this job growth. We know that we must create the environment in which well managed businesses will be profitable. And in this context, we must ensure that PNG's wage structure remains competitive.

I would like to inform the business community that the Government is now in its final stages of finalizing the legislation framework of the PNG Sovereign Wealth Fund to support the management of historic wild fluctuations in mineral and petroleum revenues to underpin the long-term social and economic development in PNG. It will be an Organic Law and not an ordinary Act of Parliament. The Government is aiming to table this legislation in the November sitting of Parliament this year.

The Sovereign Wealth Fund will provide an enhanced opportunity for the government to build capacity and capability in the country. We need to develop our intellectual capital, our technical expertise and skills, our entrepreneurial strengths and corporate abilities. We will develop ourselves to run and operate with a corporate or private sector mindset, but run the government on the democratic principles famously expressed by Abraham Lincoln: a "government of the people, by the people, for the people".

The O'Neill-Namah Government has just commenced by making Education a priority, and the trend shall continue.

We need more major Business Investments in PNG. We also need more Partnership between PNG companies and foreign investors. But in doing this we must also encourage

outcomes that are socially inclusive and in which our people can participate. So for instance, agriculture is important for the people of PNG and I am keen to see that major import substitute programme is launched where people can enjoy homegrown food stuff like kaukau, taro, veges etc. I am keen to encourage large scale rice farming, local food crop farming, and other industries development. Whilst we support large scale farming, O'Neill-Namah Government will ensure that small scale local farming is protected and promoted in co-existence to larger ones.

I am giving thought to some of the structural constraints to our people's aspirations for entrepreneurship. Perhaps, we need to do more to create local business support schemes like business investment guarantee schemes to boost our local businesses. For instance, at present it is too difficult for local firms from providing bond securities when competing for jobs. It is the duty of government to create that leverage to increase local or National content in the economy. I have directed Treasury to develop a policy on this very important business incentive for our people as soon as possible. A flourishing economy with strong growth is great; but it helps little if it is not shared by the people. As one of our senior leaders told me recently in our Ministerial Economic Committee meeting, "how good is GDP growth, however big it is, if our people do not realize the benefit of it?" The Sovereign Wealth Fund will allow an assured and steady stream of funds to the budget to support our people to owning, participate and benefitting from their endeavors and initiatives. When our people are appropriately equipped and empowered, it can't be that difficult for our people to lead into enabling the effective growth of industries like agriculture, manufacture, downstream processing, tourism and micro, small, medium scale enterprises. The Small to Medium Enterprises (SMEs) are the backbone of our economy, and need significant support by government. For example, building a food storage facility at the Port Moresby and Lae markets will promote growth of SMEs and provide opportunities for women in business.

We will craft innovative and creative strategies to mobilize resources to transform the infrastructure development process. I am of the view that a system/method creative to the usual Government budgeting process need to be found. We need to avoid the piece-meal-approach to addressing infrastructure development as Government cannot fulfill all

requirements using the mere K2 billion development budget component. This requires sharper prioritization and policy-driven budgets.

Be it the modalities of PPP, BOT, or creating a “front-end load of future funds facility”, some strategic financing package needs to be considered to transform the way the Government of PNG does its infrastructure and other development. I will work with my colleague Ministers for State Enterprises, Transport and Works to develop workable arrangements.

Building capacity will also require competition throughout the economy. The government has recently approved in principle the merging of the airlines but this will need to pass the test of efficiency, productivity and a thorough assessment that it will provide a net benefit to our people and the economy. The shipping industry is a monopoly today; hence freight costs are too high. I attempted to regulate competitive freight costs under the Merchant Shipping Act in my previous portfolio as Minister for Transport but my tenure ended before I could complete this reform. I ask that we work together to achieve competitive freight charges in that industry. We should also be mindful of the need to create a diverse economy that is vibrant and dynamic. The wealth of the Nation should not be polarized but shared; growth should be inclusive and progressive.

The current proposal is that the PNG Sovereign Wealth Fund will be an onshore managed, offshore invested and onshore spent. The key role is to manage the massive fluctuations in our minerals revenues. These have moved from only 3 per cent to 20 per cent of non-mineral GDP. These massive fluctuations in our past have led to instability, and this has hurt businesses. We understand that in the partnership between Government and business, we must aim for broad stability in the level of contracts that are available for businesses. A road contractor will not invest in equipment if they think road maintenance will be available one year, but not the next.

One of the key features of PNG Sovereign Wealth Fund is that the State will retain full ownership and control over its assets. Additionally, the SWF will be fully integrated into the Budget and Fiscal framework. This is to ensure that all revenues (including dividends) from the PNG LNG project as well as from other mineral and petroleum projects and the timing of

all expenditures can be most effectively used to advance PNG's social and economic development. These processes can also help ensure funds are accounted for and managed in a transparent and coordinated manner.

I would like to inform you all that the Sovereign Wealth Fund is a new concept to the people of Papua New Guinea and therefore as a responsible Government, we will undertake a public information, education and awareness program across the country to foster understanding on this matter of national importance. So this is an opportunity for the business community to provide views on the PNG Sovereign Wealth Fund.

CONCLUSION

Ladies and gentlemen, I would like to conclude by stating that it has been a great honor for me to address the business council today.

Although PNG has enjoyed 8 years of solid economic growth, we need to be mindful of the number of key risks that I have mentioned earlier that confronts us. Therefore, the Government is cautious about these risks and particularly inflation and will need to carefully design and implement policies that will address or reduce these challenges.

And Sovereign Wealth Fund is one of the key policies that the Government is driving to manage the substantial fluctuations in our mineral and petroleum revenues to help ensure that the potential adverse risks from the mineral boom (the so-called Dutch Disease) can be best managed in ways consistent with macro-economic stability and lower inflation.

In doing so, the Government remains optimistic that the economic future of this country can be secured and our development priorities met. And this Government recognizes that it must be done in partnership with our business sector.

Thank you.