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Papua New Guinea: Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by the Executive Director for Papua New Guinea

In the context of the Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **July 31, 2001,** with the officials of Papua New Guinea on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 7, 2001**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **September 26, 2001,** updating information on recent developments.

- a News Brief summarizing the **views of the Executive Board as expressed during its September 24, 2001 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Papua New Guinea.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Papua New Guinea*
Memorandum of Economic and Financial Policies by the authorities of Papua New Guinea*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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PAPUA NEW GUINEA

Fourth Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria

Prepared by the Asia and Pacific Department

(In consultation with other departments)

Approved by R. Anthony Elson and Leslie Lipschitz

September 7, 2001

- Discussions were held in Port Moresby during July 17–31, 2001. The team met with Prime Minister Morauta, Chief Secretary Igara, Treasury Secretary Tarata, Bank of Papua New Guinea Governor Kamit, and other senior government officials.[1]

- The 14-month Stand-By Arrangement in an amount of SDR 85.5 million (65 percent of quota) approved on March 29, 2000, was extended by the Executive Board by four months through September 28, 2001, at the conclusion of the second and third reviews on April 23, 2001.

- Performance under the program has been affected by difficult economic and political conditions. Most quantitative performance criteria for end-June were not observed largely because of shortfalls in tax revenue and external financing. Notwithstanding an excess over the ceiling on net domestic financing, the government finances were in broad balance in the first half of 2001, compared with a deficit of about 1 percent of GDP in the program. Also, the performance criterion on the central bank's net domestic assets was observed reflecting a restrained credit policy.

- The authorities have taken action to limit the fiscal deficit to 2.6 percent of GDP in 2001, compared with 2.3 percent in the program. To help offset a sharp fall in tax revenue associated with a weakening economy, they cut expenditure by about 0.5 percent of GDP in July, and agreed to additional cuts of about 0.3 percent of GDP as a prior action for the review. The price and international reserve objectives for 2001 remain broadly unchanged.

[1]The team comprised Mr. Rosales (Head), Mr. Heenan, Ms. de Bolle (all APD), Ms. Dieterich, Ms. Roehler (both FAD), and Mr. Mlachila (PDR), and was assisted by Mr. Tareen (Resident Representative). Ms. Davidson (OED) also participated in the discussions.

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EXECUTIVE SUMMARY

- **Under difficult economic and political conditions, the government has stayed on course in pursuit of macroeconomic stabilization and structural reform**, under a program supported by the Fund, other multilateral agencies, and bilateral donors.

- **Performance under the Stand-By Arrangement that expires at end-September has been affected by difficult circumstances**. Most indicative targets for end-March and quantitative performance criteria for end-June were not observed largely because of shortfalls in tax revenue and external financing relative to the program. The staff supports the authorities' request for waivers.

- **The economy is in recession with real GDP projected to contract by 2 percent in 2001, compared with a slight increase in the program**. While mineral output is expected to fall by somewhat less than previously estimated, key nonmineral activities are contracting sharply, particularly construction. Exports are projected to be weaker than in the program, but the impact on the external current account is expected to be more than offset by lower import demand.

- **Various factors contributed to shifting market sentiment and exchange rate volatility in the first half of 2001**. The government faced military unrest in March, anti-reform protests and the related death of four demonstrators in June, and sporadic strikes in recent months. Uncertainties also arose as the government experienced cash flow difficulties, which were in part related to delays in meeting conditionality for the release of the floating tranche under the World Bank's Governance Promotion Adjustment Loan. The kina depreciated by 10 percent in the seven months ending July 2001.

- **The authorities have taken action to limit the fiscal deficit to 2.6 percent of GDP in 2001, compared with 2.3 percent in the program**. To help offset a sharp fall in tax revenue associated with a weakening economy, they cut expenditure by about 0.5 percent of GDP in July, and agreed to additional cuts of about 0.3 percent of GDP as a prior action for the review.

- **The revised financial program for the remainder of 2001 is consistent with the original program objectives**. It aims at lowering inflation to 8 percent and achieving an increase in the net international reserves of the central bank of $33 million, or $10 million less than previously targeted.

- **The government remains committed to structural reform, including privatization**. Preparations for the sale of the Papua New Guinea Banking Corporation are continuing despite opposition. The sale is expected to take place late this year.

I. Background

1. **The government has continued to implement a program aimed at stabilizing the economy and creating the conditions for private sector-led growth.** To these ends, it has maintained fiscal and monetary restraint and is moving forward with reforms to improve the governance, transparency, and efficiency of the public sector.

2. **The government's program has been supported by a 14-month Stand-By Arrangement (SBA) in an amount equivalent to SDR 85.5 million (65 percent of quota) that was approved on March 29, 2000.** The SBA was extended by the Executive Board by four months through September 28, 2001 at the time of the completion of the second and third reviews last April. A $90 million World Bank Governance Promotion Adjustment Loan (GPAL) was approved in June 2000, and financial packages from Australia, Japan, and other donors were also mobilized in support of the government's reform program.

3. **At the conclusion of the second and third reviews under the SBA, the Executive Board welcomed recent progress in stabilization and reform**. Directors emphasized, however, that perseverance in program implementation was needed to strengthen confidence and facilitate timely and adequate external assistance. While noting the emphasis on continued fiscal and monetary restraint in the macroeconomic framework for 2001, Directors welcomed the authorities' commitment to take compensatory measures if revenues turned out to be less than projected. Directors considered that continued Fund involvement in Papua New Guinea was desirable and could help catalyze the external resources that will be needed to support economic diversification and growth.

4. **The government has maintained course in the implementation of its stabilization and reform program**. Action was taken recently to secure removal of an injunction against the privatization of a large bank (Box 1), which facilitated the release in mid-July of the floating tranche ($20 million) under the World Bank's GPAL, albeit with some delay relative to program expectations. Also, in line with understandings specified in the Letter of Intent (LOI) dated April 9, 2001 the authorities agreed to compensate in part for a tax revenue shortfall and to make expenditure cuts a prior action for the completion of the fourth review under the arrangement. Upon completion of this last review, the equivalent of SDR 18.9 million would be made available to Papua New Guinea, which would raise total Fund credit outstanding to 65 percent of quota. Financial relations with Papua New Guinea are presented in Annex I.

II. Recent Developments and Performance Under the Stand-By Arrangement

5. **Macroeconomic policy implementation has been generally satisfactory, and inflation has declined** (Table 1). The tight fiscal and monetary policies maintained since 2000 have contributed to successive reductions in inflation, with the 12-month rate declining to 9 percent at end-March 2001, and to 8 percent at end-June 2001. In addition, net official international reserves (NIR) have strengthened since the start of the SBA (Figure 1), despite shortfalls in external financing relative to program expectations.

Box 1. Papua New Guinea: Preparations to Privatize a Financial Conglomerate

Bringing the Finance Pacific Group (FPG) to the point of sale was a key structural condition under the program supported by the Fund and the World Bank. The major assets of FPG were a large bank (PNGBC), an insurance company (MVIL), and the Rural Development Bank (RDB). Preparing these assets for divestment was a condition for the release of the floating tranche ($20 million) under the World Bank's Governance Promotion Adjustment Loan. As preparations took longer than expected, the related structural performance criterion for end-December 2000 was not observed, and the floating tranche was not released.

The authorities managed to bring PNGBC, the largest asset of FPG, to the point of sale in early April 2001 (prior action for the second and third reviews). At that time, the authorities issued an Information Memorandum, advertised the sale in the international press, and invited expressions of interest with the assistance of international financial advisors. On April 23, 2001, the Executive Board took this into account in granting a waiver on the nonobservance of the structural performance criterion on bringing FPG to the point of sale by end-2000. Also in April, the authorities resolved a dispute over ownership of assets between PNGBC and MVIL, which was considered a potential impediment for the divestment of these two companies. On this basis, the financial program for the second quarter of 2001 envisaged release of the World Bank's second tranche before end-June 2001.

On May 10, 2001 a court issued an injunction against the sale of PNGBC. The injunction, which was upheld by a Supreme Court ruling on June 21, was issued in the context of a suit against the Privatization Commission brought by a former executive of FPG for alleged nonpayment of severance following his dismissal in September 2000. At that time, the central bank, exercising its supervisory powers, secured the replacement of PNGBC's management, citing improper banking practices. The legal team representing the former executive argued that the authorities had transferred the assets, but not the liabilities, of FPG to the Privatization Commission owing to a deficiency in the Privatization Act passed in 1999. They persuaded the courts that until pending creditor claims could be settled, their client as well as other FPG creditors, needed to be safeguarded from possible nonpayment of preexisting claims in the event of the sale of PNGBC. While noting their concern that this legal action was aided by political opponents, the authorities maintained that the privatization law was adequate, and that PNGBC creditors were not exposed to any risk.

On June 28, the injunction was lifted after the government deposited with the court the disputed amount ($0.5 million) and provided a guarantee to creditors of FPG. On this basis, the World Bank determined that PNGBC had been brought back to the point of sale, and released the floating tranche in mid-July. More recently, the authorities have decided to review the Privatization Act, and to make amendments, if necessary.

6. **However, the economy is in recession with real GDP projected to contract by 2 percent in 2001, compared with a slight increase in the program.** While mineral output is expected to fall by somewhat less than previously estimated, key nonmineral activities are contracting sharply, particularly in the construction, and retail and wholesale trade sectors. Slow implementation of the budget during the first half of 2001 and persistent difficulties in the coffee industry have been contributing factors. Coffee exports, the main cash activity for the highlands (where 40 percent of the population lives), have been acutely affected by low international prices, deteriorating infrastructure, and the lack of bank credit owing to debt servicing difficulties (Box 2). Total exports are projected to be somewhat weaker than in the program, but the impact on the trade balance is expected to be more than offset by lower imports, with the external current account remaining in surplus at 3.8 percent of GDP.

7. **Notwithstanding sharply lower revenue, the government finances were in broad balance in the first half of 2001, compared with a programmed deficit of about 1 percent of GDP.** Nonmineral tax collections were substantially lower than targeted by the authorities, because of the weakening economy and optimistic goals for the recovery of tax arrears. The shortfall was particularly acute with respect to income taxes and the value-added tax, for which refunds due to mining companies had been underestimated. Mineral tax and nontax collections, in contrast, exceeded programmed levels mainly due to larger payments by oil operators, dividends from mining companies, and central bank profits. The authorities more than offset underperformance in tax revenue by underexecuting expenditure. This result reflected restraint in the issue of expenditure warrants, as well as problems in implementing certain programs, most notably the large Rural Development Program (RDP).

8. **Despite the lower fiscal deficit, delays in external financing required larger-than-planned domestic borrowing in the first half of 2001.** Capacity constraints in managing domestic debt operations in a coordinated and timely fashion also played a role in a breach in the central bank's lending limit to the government in March. To remedy this situation, the authorities secured early release of the second tranche ($10 million) of the budgetary support loan from Australia that was tied to the completion of the second review under the SBA. Even though the third tranche of the loan from Australia ($10 million) was received following the last Board meeting, placement of a substantial amount of government securities in the domestic market was necessary in view of delays in satisfying conditions for the release of the World Bank's floating tranche.

9. **Program performance through end-June was affected by difficult economic and political circumstances.** Most indicative targets for end-March and quantitative performance criteria for end-June were not observed largely because of the shortfalls in tax revenue and external financing relative to the program (Tables 2–5). While the end-June performance criterion on the central bank's NIR was not observed,[2] the performance criterion on the

[2]The adjusted floor for NIR at end-June was $237.6 million, compared with an unadjusted target of $232 million. The floor was adjusted upward by the full $15.6 million excess of

(continued)

Box 2. Papua New Guinea: The Condition of the Coffee Industry

The coffee industry in Papua New Guinea comprises about 280,000 smallholder growers, 660 larger farmers (1–30 hectares), 65 large plantations, 18 registered exporters, 51 registered processors, and over 6,000 roadside buyers. The smallholders are the industry's backbone, accounting for 70 percent of annual production.

Unlike other major agricultural export industries (palm oil and timber), the coffee sector is dominated by domestic producers. It is estimated that directly and indirectly coffee production is the main source of income for nearly half of the population. It is the main cash crop in the highlands region, where around 40 percent of the population lives.

Coffee exports reached a peak in 1998, when export earnings amounted to 38 percent of nonmineral exports, and 13 percent of total exports. Since then, the industry has experienced a significant decline, with production falling by 23 percent in 2000 and remaining stagnant in 2001. The main problems affecting the industry are:

- **Depressed world coffee prices**, with prices for Papua New Guinea falling by 60 percent since 1998.
- **The high level of indebtedness** to commercial banks, defaults, and delays in repayment, have led to stricter standards for lending to the sector. The buoyant coffee season of 1998/99 stimulated an upsurge of commercial bank credit to the coffee sector from around K 12 million in 1997 to over K 50 million in 1998 and K 45 million in 1999. The collapse in production in 2000 rendered many of these loans nonperforming, and resulted in unwillingness by commercial banks to extend further credit to the sector.
- **Deterioration in rural infrastructure** due to lack of maintenance of major highways as well as feeder roads. The majority of smallholders, who sell their production directly to roadside buyers, depends on the road network to get their coffee to market.
- **Lawlessness** has been rampant and is worsening at an alarming rate. It is estimated that the larger operations lose about 50 percent of their annual production to theft. Furthermore, roadside buyers are frequently robbed at gunpoint. Security expenditures amount to around 1 percent of total plantation costs of production and currency to pay wages is frequently transported by helicopter, adding to costs.

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mineral tax revenue above the agreed benchmark. In contrast, the shortfall in external financing of $24.6 million resulted in a downward adjustment that was capped at $10 million. In all, there was a net increase in the floor of $5.6 million.

central bank's net domestic assets (NDA) was observed with a significant margin. The end-June performance criterion on the government's net domestic financing (NDF) was not observed[3] and performance with regard to quantitative fiscal benchmarks for end-June was mixed. There was a small deviation from the limit on the government wage bill, but the limit on noninterest current spending was observed mainly as a result of underexecution of outlays on goods and services.

10. **Adverse financial and political conditions complicated policy implementation and contributed to shifting market sentiment and exchange rate volatility**. In addition to persistent cash flow difficulties, the government faced military unrest in March, anti-reform protests in June (which resulted in the death of four demonstrators), and sporadic strikes by employees of the Papua New Guinea Banking Corporation (PNGBC) in recent months. During the first quarter, the kina weakened, in part reflecting market skepticism about the government's ability to bring the program supported by the Fund and the World Bank back on track and uncertainties associated with the military unrest. As the unrest subsided and the Fund completed the second and third reviews, the kina rebounded from US$0.30 per kina at end-March to US$0.34 per kina at end-April. Subsequently, however, the kina weakened again in the midst of renewed uncertainty about external financing prospects, leads and lags in trade settlements to take advantage of a further depreciation of the Australian dollar against the U.S. dollar, and the difficult political environment.

11. **Notwithstanding the delay in external financing and other uncertainties affecting market sentiment, the central bank managed to bring about a recovery of NIR in the second quarter**. Thus, NIR stood at $240 million at end-June 2001 and rose to about $275 million by mid-August, following the release of the floating tranche of the World Bank GPAL in mid-July.

12. **The central bank lowered its benchmark interest rate several times during the first half of 2001**. Reductions of the kina facility rate followed the decline in inflation in March and several rounds of cuts in interest rates in key partner countries. Following the central bank's lead, commercial banks reduced lending and deposit rates, and interest rates on treasury bills declined across all maturities. However, real lending rates have remained high, and monetary aggregates have grown at a relatively slow rate, with base and broad money increasing by about 4 percent and 6 percent, respectively, during the 12-month period ending in June 2001. Bank credit to the private sector has remained stagnant, growing by only 3 percent during the same period.

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[3]The adjusted ceiling for NDF at end-June was K 118.3 million, compared with an unadjusted target of K 133 million. The ceiling was adjusted downward by the full K 41.05 million ($15.6 million valued at the program exchange rate of US$0.38 per kina) excess of mineral tax revenue above the agreed benchmark. In contrast, the shortfall in external financing of $24.6 million resulted in an upward adjustment that was capped at K 26.32 million ($10 million). In all, there was a net decrease in the ceiling of K 14.7 million.

13. **Progress has continued in structural reform.** As regards privatization, PNGBC was brought to the point of sale in early April 2001 and international consultants are developing the regulatory framework for the electricity, water, telecommunications, and port industries. Following the postponement of the sale of Air Niugini, the authorities are considering ways to secure private sector involvement in the company. Public sector administrative reform has also been advanced, with functional reviews completed for the Departments of Finance and Treasury, Prime Minister and National Executive Council, Personnel Management, and Foreign Affairs, as well as for the National Fisheries Authority. Three overseas missions were closed in July 2001, and a contract for a new integrated human resources management system was awarded in August to replace the outdated payroll and personnel records systems.

III. POLICY DISCUSSIONS

14. **The authorities reiterated their commitment to stabilization and reform despite intense opposition by special interests, and made strong public statements in defense of their reform program.** At the opening of the new parliamentary session during July 24–25, Prime Minister Morauta robustly defended his government's program, providing a comprehensive explanation of the benefits of privatization and other reforms. He also presented strong arguments for maintaining a close relationship with the Fund and other multilateral agencies and donors. The authorities emphasized that they continue to view the reduction of inflation, the rebuilding of the official international reserves, and the improvement of governance and efficiency in the public sector as the paramount objectives of their program. In the attached LOI, the authorities request waivers for the nonobservance of end-June performance criteria on NIR and NDF.

Fiscal policy

15. **The mission estimated that, without corrective action, the fiscal deficit would reach about 3½ percent of GDP in 2001, compared with 2.3 percent in the program** (Tables 6–8). A large tax revenue shortfall would also lead to a net domestic borrowing requirement of 2 percent of GDP (compared with 0.4 percent of GDP in the program) that would be inconsistent with program objectives. Consequently, the authorities decided to take measures to limit the fiscal deficit to 2.6 percent of GDP in 2001. To this end, they agreed to make expenditure cuts of about 0.3 percent of GDP by early September (prior action for the completion of the fourth review) to supplement cuts amounting to 0.5 percent of GDP implemented in July.

16. **The authorities intend to minimize the impact of the expenditure cuts on the delivery of essential services.** This will be done in the context of a mid-term budget review initiated in August, involving consultations with departments. The distribution of the cuts in goods and services will then be communicated to departments through the circulation of a

revised warrant issue plan in September.[4] The expenditure cuts involve mainly outlays for goods and services (0.3 percent of GDP), the domestically funded development programs (0.1 percent of GDP), as well as reductions in provisions to settle disputed obligations under consideration by the courts (0.2 percent of GDP) and to fund retrenchments (0.2 percent of GDP). Both the court resolution of the disputed obligations and the retrenchment program are proceeding at a slower pace than envisaged in the budget.

17. **Notwithstanding the expenditure cuts, the revised fiscal plan for the second half of 2001 would provide stimulus to the economy**. The fiscal deficit during this period would reach about 2½ percent of GDP, or about 1 percentage point of GDP more than previously envisaged. Virtually the entire deficit for the second half of 2001 would reflect a substantial increase in development expenditure fully funded by concessional loans and a rise in spending on rural development.[5] With the expected increase in external financing in the second half of the year and the current recessionary conditions, such a fiscal stance should not spark inflationary pressures. The revised fiscal plan envisages net repayments to domestic creditors in the last quarter of 2001, excluding any net proceeds that might arise from privatization, which would be used to further reduce net government debt. Excluding any such proceeds, government debt in relation to GDP is projected to rise considerably in 2001, as a result of substantial exceptional financing, the continued depreciation of the kina, and the contraction in real GDP. In net present value terms, however, the government's external debt in relation to GDP is projected to increase only moderately from 45.2 percent in 2000 to 48.7 percent in 2001, reflecting the rising share of concessional debt.

18. **The revised government revenue projections for the second half of 2001 reflect recent trends and a rephasing of grant receipts**. While nonmineral tax collections have been revised downward substantially, the authorities are counting on larger mineral tax and nontax collections than in the program. The higher mineral tax revenue would be associated mainly with somewhat firmer oil prices than assumed in the budget, while the larger nontax payments would arise principally from greater dividend transfers to the Treasury. Some of the additional transfers will be based on an upward revision of profits obtained by public and semi-public entities in 2000, while others reflect a government decision (as the largest shareholder) to distribute a larger share of accumulated profits, based on ability to pay. External grant receipts are expected to be lower than originally budgeted, with most

[4]Under the Public Finance Management Act, parliamentary approval is only needed to *increase* expenditure, while the finance minister has discretionary power to cut expenditure from budgeted levels.

[5]The deficit could be lower, and the fiscal stimulus more diffuse, however, if the pace of execution of the development programs remains slow. In addition, due to lags in reporting the implementation of the externally funded development programs, spending in the first half of the year may have been underreported and consequently projected spending for the remainder of 2001 may be overstated.

materializing in the second half of the year. The considerably larger project grants expected in the second half of the year are largely from Australia and will be fully mirrored by donor-funded expenditure with no cash flow implications.

19. **The authorities viewed prospects for continued slow execution of the RDP with concern**. They noted that, while slow execution of this program helped restrain government expenditure in the first half of the year, continuation of this trend would delay needed spending to repair feeder roads and mitigate poverty in the rural areas (Box 3). In addition, as resources under this program are channeled through parliamentarians, further delays in execution could lead to political complications in the months ahead, as campaigning intensifies in the run up to the general elections scheduled for July 2002. The authorities saw scope for improving the guidelines established last year with the assistance of the World Bank to ensure good governance and the high quality of expenditure under the RDP. Tight requirements and inadequate resources devoted to program administration may be slowing project formulation and approval. While committed to the guidelines, the authorities were of the view that the revised fiscal plan for the remainder of 2001 should provide for a sharp increase in the pace of execution of this program, indicating that they will seek ways to facilitate such an increase in consultation with the World Bank. The staff urged continued adherence to agreed guidelines, and expressed reservations about the prospects for full spending of the remaining RDP resources, even if the execution rate increases.

20. **The authorities noted that the release of $85 million in external financing programmed for the last quarter of the year was subject to some risk**. This risk arises mainly from limited technical capacity to implement a broad range of agreed measures in many policy areas. However, the authorities indicated that they would work closely with multilateral agencies to ensure compliance with conditionality and the timely release of assistance. Conditionality for resources expected from the Asian Development Bank ($25 million) relates to improvements in government administration to be completed by early November (Box 4). The second tranche under the World Bank's GPAL ($35 million) and the associated assistance from Japan ($25 million) are contingent on progress in several structural areas, including forestry policy (Box 5).

21. **To help improve cash flow management particularly in light of the risks regarding external financing, the government intends to increase the scope for domestic borrowing**. Virtually all domestic borrowing has taken place through short-term treasury bills, for which there is a statutory limit that has already been reached. As there is no legal limit on the placement of longer-term government securities, the government intends to issue up to K 105 million in one-year notes, in three tranches of K 35 million each, over the coming months. This would allow the retirement of treasury bills, which so far are being rolled over, and provide greater flexibility in debt management. While this plan is broadly consistent with the recommendations of the recent MAE technical assistance report, the mission cautioned that, if the outlook for external financing weakens, expenditure restraint would need to be intensified as there may not be enough demand to allow the placement of the full K 105 million, and that there would likely be macroeconomic and institutional

Box 3. Papua New Guinea: Special Programs for Rural Development

In 1999, the government created three programs to support rural development: the District Support Grant (DSG), the Rural Action Program (RAP), and the Rural Development Program (RDP). The annual budget allocation for these programs amounts to K 143 million, equivalent to 1.4 percent of GDP, K 28 million each for the DSG and RAP, and K 89 million for the RDP. Under the DSG and the RAP, each of the 109 MPs (89 from districts and 20 from provinces) can decide on the use of available resources amounting to K 0.5 million per year. In contrast, under the RDP only the 89 MPs representing districts are additionally assigned K 1 million to spend in their constituencies. In contrast to the discretion that applies to the DSG and the RAP, use of resources under the RDP must conform to guidelines introduced in 2000 and designed in consultation with the World Bank to ensure good governance and efficiency. To oversee adherence to these guidelines, the government established the Office of Rural Development (ORD).

The RDP guidelines govern project identification, approval, control, and evaluation based on the Public Finance Management Act. In the context of often limited technical capacity in the MPs' constituencies as well as in supporting committees, meeting requirements for project approval and execution has proved difficult. At the beginning of 2001, possible spending under the RDP included K 83 million in unspent allocations from 2000 and the K 89 million budgeted for 2001. The authorities agreed to defer K 30 million of the budgeted amount for 2001 as part of the understandings that permitted the completion of the second and third reviews. In the first half of 2001, only K 5.1 million of RDP monies were spent due to delays in project implementation and changes in the timing of disbursements. In contrast, allocations for the DSG and the RAP were fully spent in 2000, and spending in the first half of 2001 was on track.

Prospects for increasing the pace of RDP implementation are uncertain. While improvements in the operation of the ORD are expected, it has not yet been able to meet all of its obligations, including reporting on project implementation.

Management of the RDP adversely affected the cash flow situation of the Treasury. Part of the unspent balances in 2000 (K 60 million) was placed in trust accounts in commercial banks. This has tied down liquidity, which could otherwise be available to fund other development programs. The rationale for this practice is to safeguard the eventual use of resources by MPs from potential cash flow problems.

Box 4. Papua New Guinea: Public Sector Reform Program Supported by the Asian Development Bank

To support its Public Sector Reform Program, the government is requesting a loan from the Asian Development Bank (AsDB) amounting to $60 million. The loan is expected to be approved by the AsDB Board in early December 2001. It would be disbursed in two tranches: in December 2001 ($25 million) and May 2002 ($35 million). The terms of the loan are commercial:

- Maturity of 15 years.
- Grace period of 3 years.
- Interest rate linked to LIBOR.
- A commitment charge of 0.75 percent per year and a front-end fee of 1 percent.

The implementation of the program will be coordinated by the Central Agencies Coordinating Committee (CACC). The Treasury will be the executing agency while day-to-day management will be in charge of the Public Sector Reform Management Unit.

The government and the AsDB have tentatively agreed on a policy matrix for the release of the tranches. Formal loan negotiations are expected to continue in mid-October 2001. However, a significant number of the policy actions have been undertaken or are advancing satisfactorily, after a slow start during the past year. The actions already undertaken for release of the first tranche include:

- Establishment of a Public Sector Reform Management Unit.
- Timely issuance of a budget preparation circular by CACC specifying targets and outputs.
- Completion of functional reviews of several departments, including Personnel Management, Prime Minister and National Executive Council, Treasury and Finance, Health, and Transport and Works.

At present, key actions remaining for the release of the first tranche include:

- Establishment by cabinet of performance-oriented management, notably giving department heads responsibility to prepare performance plans and reports, and adopting procedures for recruiting and terminating department heads.
- Staff census for central agencies (departments).
- CACC approval of terms of reference for an independent audit of the Department of Education and action plans for strengthening the oversight institutions (Office of the Auditor-General, and the Ombudsman Commission).
- Budget submission for 2002 would need to take into consideration the recommendations of the functional and expenditure reviews of the Departments of Personnel Management, Prime Minister and National Executive Council, Treasury and Finance, Health, and Transport and Works.

Box 5. Papua New Guinea: Key Conditions for the Release of the Second Tranche Under the World Bank's Governance Promotion Adjustment Loan

The World Bank approved a Governance Promotion Adjustment Loan (GPAL) on June 13, 2000 in support of the reform program initiated by the government in mid-1999. The main objectives of the loan are to:

- Improve fiscal and debt management.
- Address shortcomings in governance and civil service effectiveness.
- Enhance the quality and efficiency of public services, including through privatization.
- Implement more efficient delivery of health services.
- Strengthen forestry management.

The loan amounts to $90 million with a maturity of twenty years, including a five-year grace period at the Bank's standard variable interest rate and commitment fee for fixed-spread loans. It carries an expected disbursement period of up to three years in the form of two tranches of $35 million each and one floating tranche of $20 million.

The first tranche was disbursed on June 22, 2000 upon approval of the GPAL. The floating tranche was released on July 19, 2001 after key conditions were met, most notably bringing the Papua New Guinea Banking Corporation to the point of sale. The second tranche ($35 million) is expected to be released in the fourth quarter of 2001 provided a number of conditions are met. The major conditions are:

- Establishment of a management information system for integrated payroll and human resources records.
- Amendment of the Forestry Act to: (a) strengthen the regulatory framework for the harvesting of forested land; (b) provide for disclosure by the Forestry Board of noncommercial deliberations; (c) disallow delegation of the powers of the Board to an individual; and (d) broaden composition of the Forestry Board to improve its independence.
- Completion of audits of major state enterprises to be privatized, formulation of a policy on modalities for privatization, and commencement of due diligence exercises.
- Formulation of policies to maintain services supplied by the entities to be privatized to the remote/uneconomic areas of the country ("community service obligations").
- Implementation of recommendations of the Commission of Inquiry into the National Provident Fund to improve governance and efficiency of the its operations.
- Establishment of a domestic debt recording and reporting system, and development of a comprehensive debt management strategy.

constraints on borrowing (particularly sovereign exposure limits for subsidiaries of foreign banks).

Monetary and exchange rate policies

22. **Central bank officials affirmed that monetary policy will be focused on a further reduction of inflation.** However, they indicated that they will monitor macroeconomic conditions and that if inflation continues to decline, they will consider gradually and cautiously easing monetary policy. Officials indicated that operations with repurchase agreements will be introduced shortly for liquidity management purposes. However, the main monetary policy instruments will continue to be the weekly treasury bill auction for banks and direct sales of treasury bills to the public through the Tap Facility, at interest rates set at 100 basis points below those obtained at the auction. They viewed the operation of this facility in a very positive light, noting that it enhanced competition for funds, thereby leading to more attractive yields for depositors.

23. **The mission cautioned against any easing of monetary policy before inflation is firmly on a declining trend.** It underscored the need to set interest rates with a view to the achievement of the key inflation and NIR targets. Credibility of monetary policy could be at risk if further actions to lower interest rates were abruptly reversed by the end of the year in the event that the large external financing envisaged to materialize during the fourth quarter of 2001 were delayed. The mission also urged early implementation of the recommendations of the recent MAE mission to improve monetary operations (Box 6). In particular, the mission stressed the urgent need for introducing an electronic system for the registry of securities and the transfer of funds. Such a system would help improve the recording of debt operations, thereby improving the quality and timeliness of information essential for formulating monetary and fiscal policies.

24. **The revised financial program for 2001 aims for an increase in NIR of $50 million during the second half of the year to a level of $290 million by end-2001, compared with $300 million originally envisaged** (Tables 9–12). This result would be made possible by the substantial official capital inflows expected during the period. The central bank is to conduct open market operations to ensure adherence to the indicative quarterly path of NDA, with reserve money expected to grow in 2001 by somewhat less than in the program.

25. **The central bank intends to maintain a flexible exchange rate policy.** Under this policy, intervention in the foreign exchange market will be limited to the smoothing of short-term volatility and the achievement of the NIR target. The mission and the authorities agreed that the level of the exchange rate remained broadly adequate, particularly as competitiveness had been enhanced by the depreciation of the kina in real effective terms (Figure 2).

26. **In its capacity as bank supervisor, the central bank is monitoring closely the condition of the banking system.** While the ratio of nonperforming loans has remained high at 12 percent during the first half of 2001, provisioning has also been broadly unchanged at about 50 percent. Bank profitability has been affected adversely by the weak economic

Box 6. Papua New Guinea: The Recent MAE Technical Assistance Report on Monetary Management

The report provides an assessment of the monetary policy framework, including policy instruments and the adequacy of available data to inform policy formulation. It notes that in order to develop a medium-term monetary framework, price and output measures need to be improved, and more research is needed on the transmission mechanism.

On the operation of monetary policy, the report describes progress in developing new instruments for liquidity management as well as for clearly signaling (in conjunction with the monetary policy statements) the intended monetary stance. It notes, however, that significant problems remain in policy implementation. Institutional arrangements may be exacerbating the short-run volatility of the exchange rate. Liquidity forecasting is hampered by poor coordination between the central bank and the Department of Finance and the unpredictability of treasury bill sales under the Tap Facility, which allows direct central bank sales of government securities to the public. In addition, there is a need to improve liquidity forecasts.

To improve the operational aspects of monetary policy as well as to develop a coherent medium-term monetary policy framework, the MAE mission recommended actions to:

- Reestablish an electronic registry for securities transactions as soon as possible.
- Introduce the capacity to oversubscribe individual security maturities offered in treasury securities auctions.
- Implement a Master Repurchase Agreement to allow the use of overnight repos for liquidity management purposes.
- Replace some treasury bills with longer maturity securities.
- Improve coordination between the Department of Finance and the central bank on liquidity forecasting, debt, and cash management.
- Make institutional changes to reduce the short-term volatility of the foreign exchange market.
- Establish and begin work on an agenda of focused and prioritized research on the desirable medium-term evolution of the monetary framework.

The central bank is considering implementation of these recommendations.

environment, but remains high for most banks. The situation of PNGBC has continued to improve through cost reductions and the writing-off of bad loans, including to the coffee industry. Following large losses in 2000, PNGBC is set to attain significant profits in 2001.

Structural reform policies

27. **Privatization plans are largely on course and the agenda has been expanded**. The authorities intend to sell a controlling stake in PNGBC in November–December 2001. To this end, the Privatization Commission is working to provide interested parties with materials necessary to conduct due diligence, including through a recent road show in Australia and New Zealand. To ensure the adequacy of the privatization framework, the authorities agreed to review the Privatization Act, and to amend it, if necessary. As part of a new initiative, the authorities plan to establish a People's Unit Trust (PUT), which will permit widespread public participation in the equity of privatized enterprises. In early 2002, the public would be able to purchase through the PUT some of the remaining shares of PNGBC, as well as shares in another 11 smaller enterprises which are being prepared for sale. In addition, to facilitate eventual privatization of public utilities, the authorities are working to establish a single independent regulatory authority, which would have licensing power and set rates as well as service standards. The authorities expect the establishment of this authority to strengthen consumer protection and permit the repeal of the Price Regulation Act.

28. **The public sector reform program will continue**. Functional reviews of the Departments of Health, Works and Transportation, Lands and Physical Planning, National Planning and Monitoring, and the Attorney General are to be completed by December 2001. Recommendations from reviews completed by October 2001 will be incorporated in the budget for 2002, including the closure of four additional diplomatic posts abroad. A revenue review of the forestry sector will be initiated shortly, and will be aimed at designing an equitable system for revenue sharing among companies, the government, provinces, and landowners. The system should also ensure sustainable forestry management, adequate taxation, and good governance. As regards pension reform, the Superannuation and Life Insurance Acts enacted in December 2000 will become effective by end-2001, and pension funds are preparing to adhere to the new requirements. These requirements include the appointment of qualified trustees and the adoption of professional investment management. The National Provident Fund (NPF) has now repaid its debts and improved its financial condition.

IV. Policies for 2002 and the Medium Term and Capacity to Repay the Fund

29. **The mission proposed a broad outline for the budget for 2002, recommending that the net domestic borrowing requirement be limited to no more than 1½ percent of GDP**. The authorities agreed that the budget for 2002 should support the objectives of further reduction in inflation and strengthening of the official reserve position, which would require constraining domestic government indebtedness. Noting that preparations for the formulation of the budget had not yet commenced, the authorities acknowledged that the economic outlook for 2002 appeared difficult, particularly because of the continued decline in oil

output and deferrals of expenditure in 2001. In addition, they recognized that, on current prospects, net external financing for the government is likely to shift to net repayments.[6] Against this background, the mission estimated that the overall fiscal deficit would need to be brought down to about 1 percent of GDP in 2002, unless larger external financing could be secured. It was recognized that such a target would require adjustment measures, most likely a further substantial reduction in expenditure relative to the size of the economy, which would need to be addressed in the preparations of the government's budget proposal for next year.

30. **The proposed framework for 2002 takes into account the medium-term outlook.** The staff prepared a medium-term scenario assuming continued sound fiscal and monetary policies and further efforts at structural reform.[7] The structural reforms would continue to focus on improving efficiency in government operations, including through public sector reform and privatization, and fostering the development of private sector activity. The scenario also takes into account the projected decline in oil output related to the depletion of reserves, with existing wells running dry by 2015. In the absence of major new investments in the gas and nickel industries, projected increases in the output of gold and other minerals are not expected to offset the fall in oil production, with mineral GDP continuing to decline over the medium term. The external current account balance would register small surpluses aided by a projected recovery in export prices for agricultural commodities, and as imports by the mineral sector contract with declining activity. In this scenario, Papua New Guinea's capacity to repay the Fund would remain strong, with obligations to the Fund over the medium term projected generally not to exceed 2 percent of exports of goods and nonfactor services (Table 15).

31. **The projected decline in oil output will eventually erode government revenue and put pressure on the public finances.** Limiting the fiscal deficit to less than 1½ percent of GDP during 2002–06 would permit a steady reduction in government debt relative to GDP (Table 18). In this scenario, Papua New Guinea's debt burden would remain sustainable, with a reduction in the interest bill in relation to GDP helping to offset declining oil tax revenue and buttressing government saving. In the context of robust nonmineral real GDP growth and a decline in inflation to partner country levels by the end of the period, monetary aggregates would be expected to rise at a somewhat faster pace than GDP, while the flexible exchange rate regime would ensure that external competitiveness remains adequate and the net official international reserves would remain at a comfortable level.

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[6]External financing for 2002 and the medium term is still highly tentative. Identified external disbursements for 2002 are low as little additional exceptional financing is expected to materialize before the elections scheduled for midyear.

[7]Technical preparations on the authorities' side were not sufficiently advanced to permit understandings on medium-term targets.

32. **Medium-term prospects would improve if a major investment in gas (Box 7), presently being contemplated by foreign investors, takes place in the years ahead.** This very large investment (about $1.7 billion over the projection period (2002–06) and about $3 billion through 2011) would result in relatively large external current account deficits during the construction phase (particularly during 2002–05), which would be covered mostly by foreign direct investment. Output could commence around 2005, with tax revenue from project-related activities increasing thereafter as corporate tax payments accrue.

33. **There are risks to the near- and medium-term outlook.** Any slackening in the government's determination to pursue sound policies would complicate economic conditions in the near term and prospects for obtaining the envisaged external assistance over the medium term. Such a weakening in financial policies could hinder private investment, thereby magnifying the effects of the secular decline in oil exports. The resulting deterioration in public finances could lead to the return of high inflation and exchange rate instability. Even with solid policy implementation, Papua New Guinea remains vulnerable to large terms-of-trade shocks over the medium term.

V. Safeguards Assessment

34. Under its current arrangement with the Fund, Papua New Guinea is subject to the transitional procedures governing safeguards assessments. These procedures require the Bank of Papua New Guinea (BPNG) to demonstrate, by providing certain documentation to Fund staff, that it publishes annual financial statements that are independently audited in accordance with internationally accepted standards. The BPNG has cooperated fully in providing Fund staff with the required documentation.

35. The staff has reviewed the documentation provided and noted that the financial statements of the BPNG are prepared in accordance with International Accounting Standards and are audited by the Office of the Auditor General in accordance with standards applied by the International Organization of Supreme Audit Institutions, which are materially consistent with the International Standards on Auditing. The staff noted that the audited financial statements are made available with considerable delay, and certain weaknesses may exist. Based on the assessment, the staff has proposed that the BPNG speed up publication of its financial statements. The BPNG provided its 1999 audited annual financial statements to the Fund in July 2001 and expects to be able to provide its 2000 annual report in the near future.

VI. Statistical Issues

36. **There is an urgent need to further improve macroeconomic statistics.** In particular, the compilation procedures and the timeliness of the national accounts need to be substantially improved, and the National Statistical Office strengthened. In addition, balance of payments and price statistics should be compiled on a more frequent basis. With the assistance of an FAD expert, the authorities plan to improve the consistency between fiscal and monetary financing data. In support of this effort, the central bank is preparing a revised manual of accounts for the financial system, with improved sectorization.

Box 7. Papua New Guinea: Pending Requirements and Macroeconomic Effects of the Gas Project

Pending requirements to initiate the gas project are:

(i) Securing gas sales contracts in Queensland, Australia; and

(ii) Funding the equity participation by landowner groups, and central and local governments in the downstream component of the project, involving the construction of a pipeline and offshore processing facilities. The modality of government participation is still being negotiated.

On the first requirement, there have been two recent setbacks. On May 18, 2001 the Queensland government announced its intention to withdraw as the principal prospective wholesaler of Papua New Guinea gas. It had previously agreed to underwrite the wholesale contracts of the two Queensland state-owned energy companies, and major Papua New Guinea gas buyers, Ergon Energy and Energex. As a result, the Papua New Guinea gas project developers will now need to negotiate directly with potential final customers in Queensland the terms of the sales agreements. This greater decentralization in the negotiation process could translate into delays in securing sales contracts, hindering prospects for first gas to be delivered in 2005.

The second setback was the announcement on May 28, 2001 by Woodside Energy and Shell Development (Australia), the Timor Sea gas developers, that a letter of intent specifying key commercial terms for the supply of gas to a major consumer of gas in Queensland had been signed. The Timor Sea gas project is the major competitor of the Papua New Guinea gas project in the Queensland energy market. Although the letter of intent is not a binding sales agreement and is further conditional on a number of factors, it does signal a more aggressive bidding strategy by the Timor Sea for the Queensland market than originally envisaged by the Papua New Guinea developers. More recently, disputes about revenue sharing between the Australian and East Timor governments have cast doubt on the pace of implementation of this project.

The following table summarizes the **macroeconomic impact** of the implementation of the gas project over the medium term, in comparison with the baseline scenario shown in Table 18.

	2002	2003	2004	2005	2006
Growth and prices (change in percent)					
Real GDP	3.1	3.4	2.6	4.7	4.7
Mineral	-4.1	-1.8	-2.7	11.7	8.5
Nonmineral	5.0	4.7	3.8	3.2	3.8
CPI (average)	7.0	4.0	3.1	1.9	1.7
Savings and investment (in percent of GDP)					
Foreign savings	-1.0	5.6	7.4	-2.0	-3.7
Public saving-investment balance [1]	-1.1	-1.3	-1.4	-0.7	0.0
Private saving-investment balance [2]	2.1	-4.3	-6.0	2.7	3.7

Sources: Department of Treasury; Bank of Papua New Guinea; and Fund staff estimates and projections.
[1]Central government operations only.
[2]Derived as the difference between foreign saving and the public saving-investment balance.

VII. Staff Appraisal

37. **The authorities have demonstrated a commitment to press forward with stabilization and reform under difficult economic and political conditions.** In the first half of 2001, the authorities continued to make progress under the program supported by the SBA, most notably in reducing inflation and furthering preparations for privatization. The authorities have maintained course in spite of significant obstacles, including growing opposition to reform and implementation problems related to limited technical capacity. While performance under the program has been weaker than originally envisaged, the staff is encouraged by the strong commitment recently expressed by the Prime Minister in parliament to press ahead with the government's structural reform program.

38. **The staff believes that the revised macroeconomic framework for the remainder of 2001 is consistent with the objectives of the program, in the context of less favorable conditions.** Perseverance in the pursuit of its objectives should help solidify confidence and create the conditions for economic recovery. In particular, adherence to the agreed fiscal and monetary policies and progress in privatization would send a clear signal to donors and investors that present policies will be maintained even as the elections approach.

39. **It will be important to remain vigilant over financial developments and implement additional corrective actions, if needed.** In light of the weak state of the economy, closer monitoring of revenue collections and the execution of the expenditure program will be necessary to permit the early prevention of deviations from the fiscal target. Under the agreed fiscal plan there is only limited scope to access the domestic credit market for bridge financing in the event of a delay in external assistance.

40. **The government budgets for 2002 and the years ahead should be based on a realistic assessment of external financing possibilities and prospects for the mineral sector.** As oil production is projected to decline, the economy will need to adjust to lower oil revenue. Ensuring fiscal sustainability will require constraining government expenditure in line with the availability of resources. Fiscal policy, therefore, would need to remain focused on reducing the size of the government and increasing efficiency in the delivery of priority services. It will be essential to arrest the growth of spending on goods and services and transfers, as well as to maintain wage moderation. Over the medium term, it will be important to limit fiscal deficits to achieve steady reductions in nonconcessional government debt relative to GDP, which would help reduce the interest bill in relation to GDP. In this connection, the staff advises minimizing the government's contracting or guaranteeing of debt to finance equity participation in the gas project, and to fund any such participation with concessional financing to the largest extent possible.

41. **Monetary policy should be focused on attaining program objectives.** The authorities should resist pressures to lower interest rates significantly until further evidence becomes available that inflation continues to be on a declining trend. While the support of fiscal policy is necessary for the consistent achievement of the NDA and NIR targets, the central bank should stand ready to conduct open market sales to help ensure adherence to

these targets. In 2002, monetary policy will have to guard against a resurgence in inflation and losses in NIR as the nonmineral sector recovers. This risk calls for caution as regards the advisability and timing of further reductions in interest rates.

42. **The staff urges early implementation of the recent MAE recommendations to improve monetary management.** Also, greater coordination between the Treasury and the central bank as regards short-term cash flow, debt, and liquidity management will be essential. Limits on central bank lending to the government should be observed.

43. **The staff supports the authorities' flexible exchange rate policy.** Intervention in the foreign exchange market should continue to be limited to minimizing short-term volatility of the kina and facilitating achievement of the international reserve target.

44. **Close surveillance over the banking system should remain a priority.** The current recessionary conditions have put stress on borrowers, which could lead to a further deterioration in loan quality. However, improvements in the condition of the largest bank (PNGBC) achieved by the interim management that was installed by the central bank late last year have mitigated this risk to some extent. Periodic visits by an MAE supervision expert will continue to help improve supervisory capacity.

45. **The staff welcomes the authorities' determination to press ahead with privatization and deregulation.** In particular, plans to sell a controlling interest in PNGBC by end-2001 and facilitate acquisition by the public of shares in a range of public enterprises commencing in early 2002 should be pursued vigorously. To promote good governance in privatized entities, involvement of at least one large strategic investor should be sought. The staff endorses the government's policy of separating commercial activities and regulatory functions in the state enterprise sector. In this respect, the establishment of a regulatory framework for utilities will facilitate privatization and improvements in service delivery. The planned elimination of price controls, following the establishment of a single regulatory authority, will also promote efficiency and business confidence.

46. **Public sector reform should continue to focus on improving efficiency, governance, and service delivery.** It will be important to observe agreed guidelines for the implementation of the RDP, and to improve the administration of this program in consultation with the World Bank. The staff supports plans to continue with functional reviews of government departments, which should point to ways to improve efficiency in the government sector, including through continued shedding of redundant staff. The staff welcomes the recent improvement in the operations and finances of the NPF, and encourages the authorities to work toward similar improvements in other public sector pension programs.

47. **Working closely with multilateral agencies and donors remains an essential requirement for adequate and timely external assistance.** To overcome the constraints arising from limited implementation capacity, it would be advisable to seek additional technical assistance to help implement actions that will trigger the release of financial assistance on a timely basis. It will be essential to sustain a strong and coordinated effort to

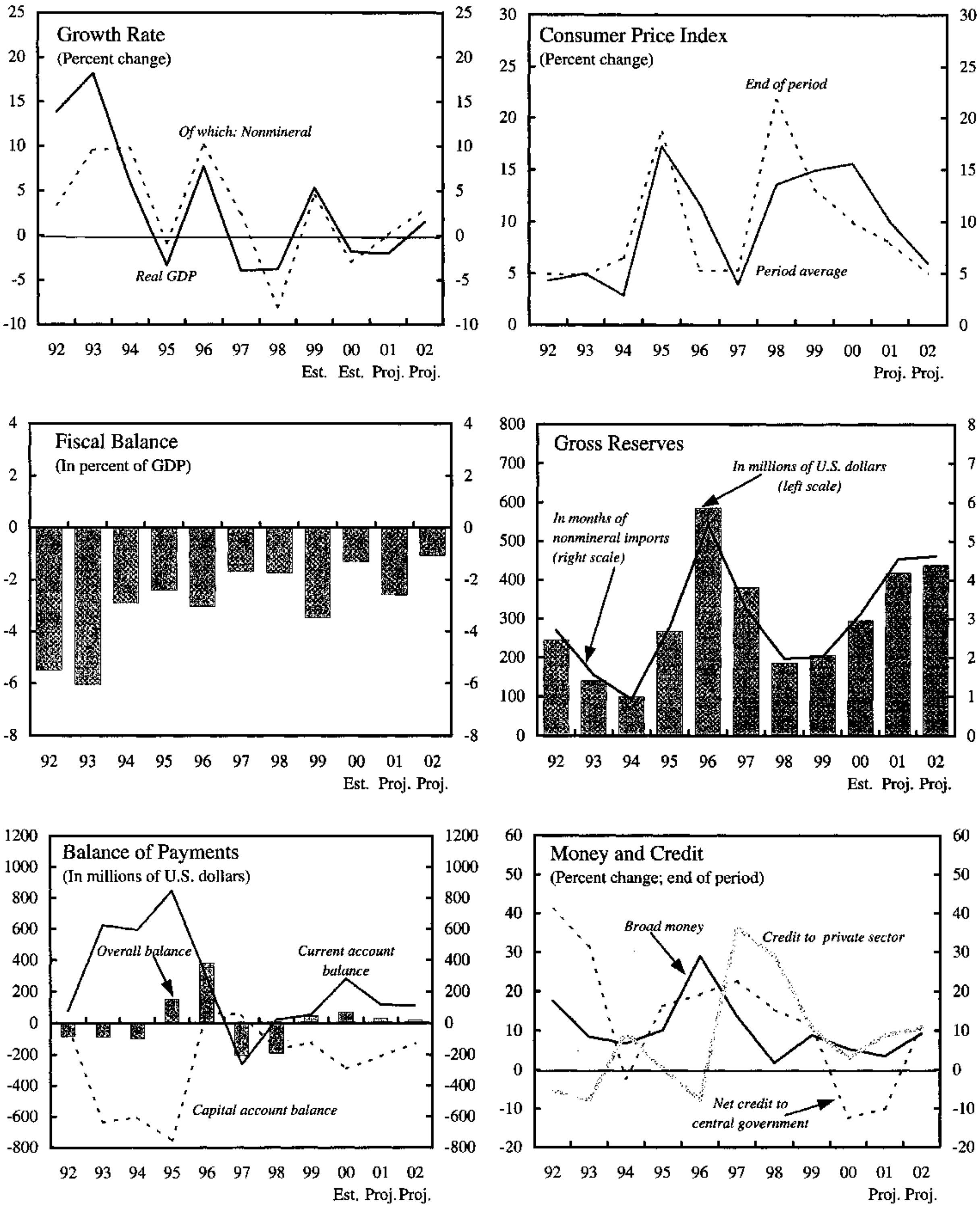
ensure the timely disbursement of the sizable assistance programmed for the last quarter of this year, including through continuous communication and close collaboration with multilateral agencies and donors. In this connection, a successor arrangement from the Fund could facilitate continued high-level support from the international community, while fostering policies that promote growth and reduce Papua New Guinea's vulnerability to external shocks.

48. **The staff supports the authorities' request for waivers for the nonobservance of the performance criteria on NIR and NDF for end-June 2001**. In the case of the performance criterion on NIR, the magnitude of the deviation was less than the shortfall in external financing, which was disbursed in July. The nonobservance of the performance criterion on NDF was also due to a shortfall in nonmineral tax revenue related to weaker-than-expected domestic demand. The staff believes that, with the agreed revision of the fiscal plan for the remainder of 2001, the thrust of the program objectives remains intact.

49. **The quality, coverage, and timeliness of economic statistics continue to hamper the government's ability to conduct macroeconomic policy**. Further progress in developing indicators of domestic activity and trade is needed, and priority should be attached to improving the compilation of the national accounts. To this end, the recommendations of the recent Pacific Financial Technical Assistance Centre mission should be implemented without delay. It will also be essential to improve the monitoring and recording of externally financed expenditure to permit more reliable estimates and projections of the government finances. The staff welcomes the authorities' commitment to eliminate discrepancies between the fiscal and monetary accounts, including by developing an electronic treasury bill registry. Additional technical assistance should be requested if needed, as improved reconciliation of fiscal and monetary accounts are essential to prevent instances of misreporting.

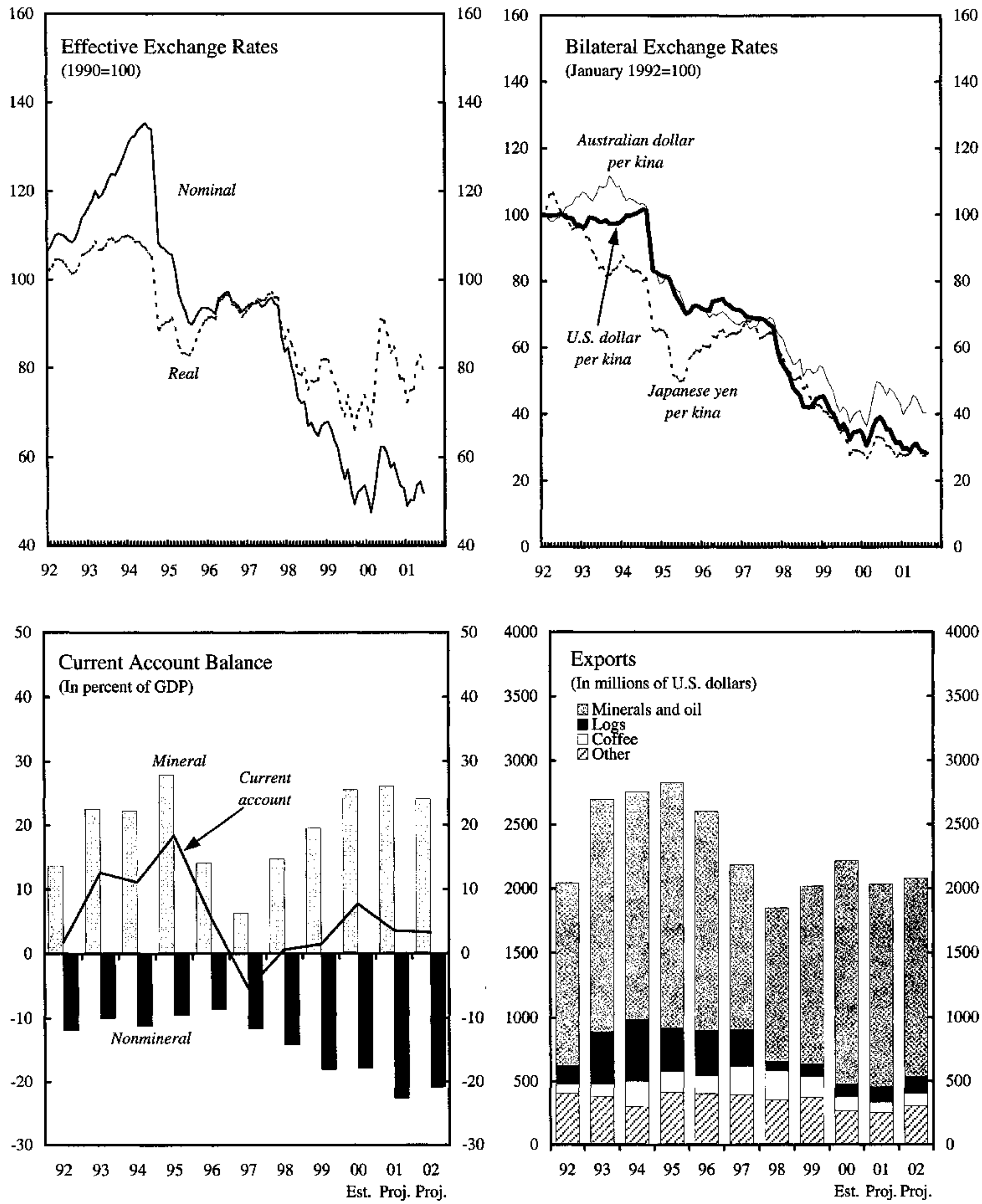
51. **The authorities have made significant progress in the implementation of the economic program supported by the current SBA**. With perseverance in the implementation of appropriate policies, Papua New Guinea's economic and financial position will continue to strengthen. On this basis, the staff supports the authorities' request for waivers and recommends completion of the fourth review under the SBA.

Figure 1. Papua New Guinea: Economic and Financial Indicators, 1992-2002



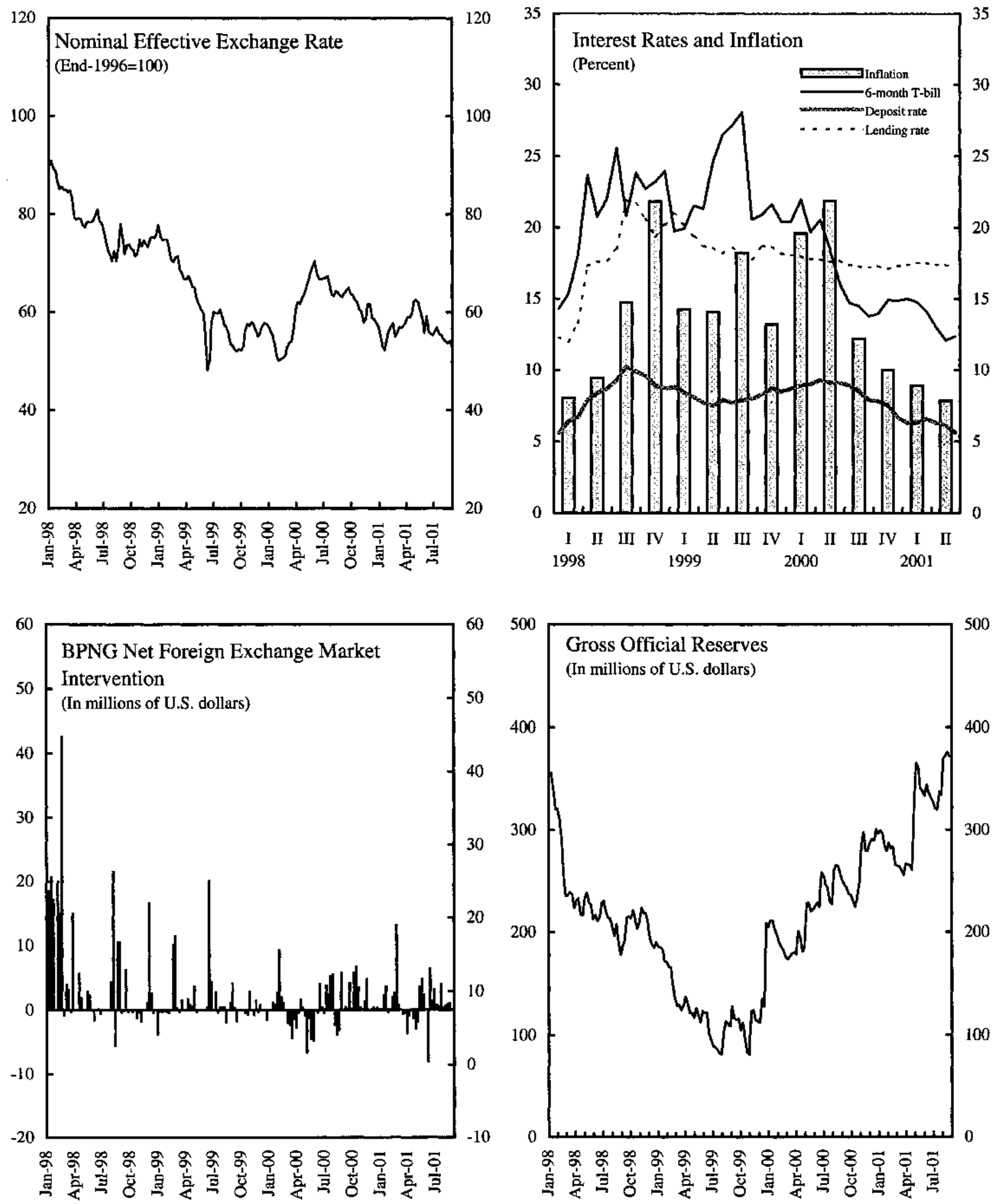
Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

Figure 2. Papua New Guinea: Selected External Indicators, 1992-2002



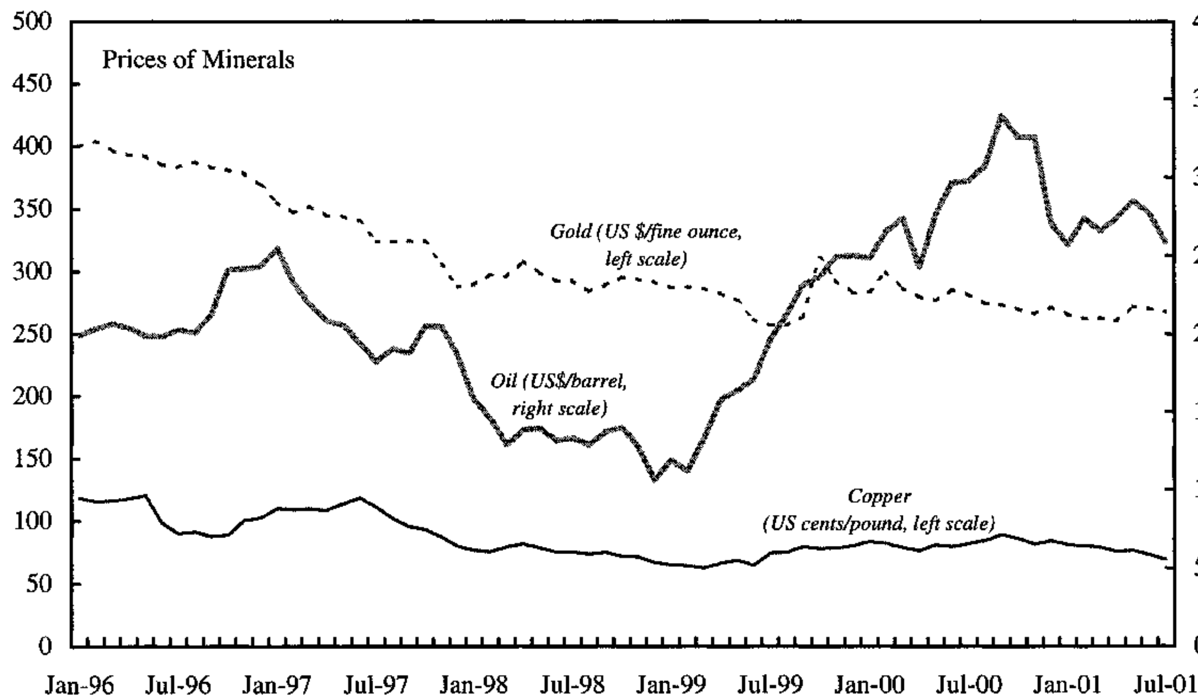
Sources: Data provided by the Papua New Guinea authorities; IMF, Information Notice System; and Fund staff estimates.

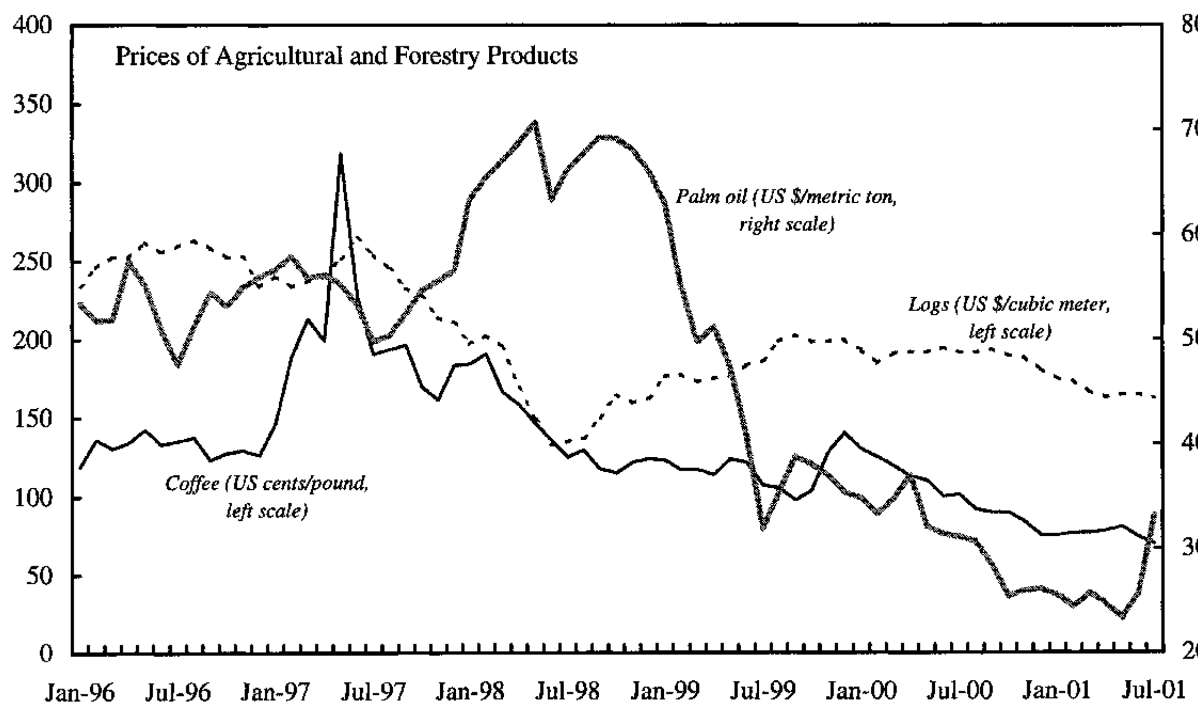
Figure 3. Papua New Guinea: Short-Term Financial Indicators, 1998-2001



Source: Data provided by the Bank of Papua New Guinea.

Figure 4. Papua New Guinea: Key Export Prices, 1996-2001





Sources: Data provided by the Papua New Guinea authorities; and IMF, Commodity Price System.

Table 1. Papua New Guinea: Selected Economic Indicators, 1997–2002

Nominal GDP (2000): US$3.6 billion
Population (2000): 5.1 million
GDP per capita (2000): US$716
Quota: SDR 131.6 million

	1997	1998	1999	2000	Prog. 2001	Proj. 2001	Proj. 2002
Real sector (percent change)							
Real GDP growth 1/	-3.9	-3.8	5.4	-1.8	0.3	-2.0	1.5
Mineral	-26.0	16.8	8.7	2.4	-14.2	-9.2	-4.1
Nonmineral	2.5	-8.1	4.5	-3.0	4.6	0.1	3.0
CPI (annual average)	3.9	13.6	14.9	15.6	10.0	10.0	6.0
CPI (12 months)	5.3	21.8	13.2	10.0	8.0	8.0	5.0
Terms of trade (percent change)	2.0	-8.2	8.0	14.5	-0.9	-0.9	-2.0
Central government budget (percent of GDP)							
Revenue and grants	31.2	29.2	27.7	29.5	29.8	30.1	29.6
Expenditure and net lending 2/	31.0	31.6	30.0	30.9	32.1	32.6	30.6
Of which:							
Clearance of pre-2000 arrears and obligations	...	...	1.6	1.9	0.6	0.5	0.1
Structural adjustment expenditures 3/	...	...	...	1.0	0.6	0.4	0.6
Overall balance, cash basis (excluding grants) 4/	-6.1	-7.7	-8.6	-6.6	-7.5	-7.7	-5.9
Overall balance, cash basis (including grants) 4/	-1.7	-1.7	-3.5	-1.3	-2.3	-2.6	-1.1
Domestic financing, net 5/	1.1	3.4	0.1	0.9	-0.1	0.5	1.4
Of which: Banking system 6/	2.2	1.6	0.6	-1.3	0.4	-0.9	0.9
External financing, net	-1.2	-1.2	1.9	0.6	2.3	2.0	-0.4
Privatization, net	0.0	0.2	0.3	-0.1	0.0	0.0	0.0
Money and credit (year-on-year percentage change)							
Domestic credit	22.7	17.1	4.0	-4.5	8.9	-0.5	10.5
Net credit to government	22.7	15.4	11.2	-12.5	4.5	-10.0	11.2
Credit to the private sector	36.3	29.0	10.5	3.0	12.8	8.8	10.6
Broad money	6.8	1.8	8.9	5.4	10.0	3.5	9.3
Balance of payments (US$ million)							
Exports, f.o.b.	2,186	1,849	2,019	2,214	2,054	2,033	2,080
Imports, c.i.f.	-1,972	-1,425	-1,525	-1,502	-1,583	-1,466	-1,487
Current account (including grants)	-263	23	53	282	-27	118	112
(In percent of GDP)	-5.3	0.6	1.4	7.7	-0.8	3.8	3.5
Exceptional financing (net)	25	0	80	70	125	125	35
Overall balance	-204	-189	44	70	28	32	20
Reserves and external debt (end-of-year, US$ million)							
Net international reserves	328	139	183	256	300	290	310
(In months of nonmining imports, c.i.f.)	2.8	1.5	1.8	2.7	3.0	3.1	3.3
Gross international reserves	380	187	206	296	418	398	418
(In months of nonmining imports, c.i.f.)	3.3	2.0	2.0	3.1	4.2	4.3	4.4
Public debt-to-GDP ratio (in percent)	26.6	35.2	37.3	39.3	44.1	50.4	49.2
Public debt-service ratio (percent of GNFS exports)	8.6	7.3	7.5	6.7	6.9	6.8	6.8
Exchange and interest rates							
US$/kina (period average)	0.6975	0.4859	0.3939	0.3724	0.3300	...	...
US$/kina (end-period)	0.5710	0.4770	0.3700	0.3255	0.3300	...	...
Interest rate (182-day T-bills)	14.5	23.9	20.4	14.9	...	...	...
Nominal GDP (millions of kina) 1/	7,063.7	7,863.4	9,341.3	10,103.1	10,758.0	10,146.9	10,750.0

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ GDP figures for 1999 and 2000 are preliminary.
2/ Assuming that the gap for 2002 will be closed by expenditure cuts.
3/ Expenditures in 2000-01 to support structural reforms under World Bank and Asian Development Bank loans.
4/ Includes statistical discrepancy, which reflects inconsistencies between fiscal and monetary statistics.
5/ Includes changes in float.
6/ Includes a K 52 million write-down of the commodity stabilization fund in 1999.

Table 2. Papua New Guinea: Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2000

	Dec. 31, 1999	Mar. 31, 2000			Jun. 30, 2000			Sep. 30, 2000			Dec. 31, 2000			
		Original Program Indicative Targets			Original Program Performance Criteria			Original Program Performance Criteria			Original Program Indicative Targets	Second and Third Reviews Performance Criteria		
	Actual Stock	Unadjusted	Adjusted	Actual	Unadjusted	Adjusted	Actual	Unadjusted	Adjusted	Actual		Unadjusted	Adjusted	Actual
	(In millions of kina)													
Ceiling on net domestic assets of the central bank 1/, 2/, 3/	194	251	244	91	226	199	-102	83	158	-16	-144	-267	-131	-112
Ceiling on net domestic financing of the government 1/, 3/, 4/, 5/	1,548	59	45	-76	133	34	16	101	176	-30	-123	-156	-20	22
	(In millions of U.S. dollars)													
Floor on net international reserves of the central bank 1/, 6/, 7/, 8/	182	130	133	164	150	160	230	214	186	218	307	339	287	256
Ceiling on the contracting or guaranteeing by the public sector of new nonconcessional external debt with a maturity of over one year 4/, 8/, 9/	14	0	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the stock of public sector and publicly guaranteed nonconcessional short-term external debt with initial maturity of up to one year 4/, 8/, 10/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of external payment arrears by the public sector		Continuing												

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ Figures in the "actual" column for December 1999, March 2000, and June 2000 have been revised slightly from those presented in EBS/00/201.
2/ Defined as reserve money less net foreign assets of the central bank.
3/ The ceiling on net domestic assets of the central bank and net domestic financing of the government will be adjusted downward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the Bank of Papua New Guinea (BPNG) foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) total net receipts from asset sales. Upward adjustments will be made by the amounts that the values of the following items fall short of the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow (to a maximum adjustment of K 20 million); (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow (to a maximum upward adjustment of $70 million); and (iii) total net receipts from asset sales. With respect to the adjuster in (iii), if net receipts from asset sales are negative, the value of net receipts from asset sales shall be set at zero for the purposes of comparison with the benchmark values in Table 4.
4/ Cumulative flow since the beginning of the year.
5/ For adjustments to the ceiling on net domestic financing of the government prior to September 2000 refer to IMF Staff Report EBS/00/53. From September 2000 onward the ceiling on net domestic financing of the government will be adjusted downward by the full amount of the excess of the sum of nontax revenue (excluding grants) and non-mineral tax revenue, less domestic interest payments over the program levels shown in Table 4.
6/ The floor on net international reserves of the central bank will be adjusted upward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) foreign currency-denominated net receipts from asset sales. Downward adjustment will be made by the amounts that the values of the following items fall short of the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow (to a maximum downward adjustment of $7.6 million); (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow (to a maximum downward adjustment of $70 million); and (iii) foreign currency-denominated net receipts from asset sales. With respect to the adjuster in (iii), if net receipts from asset sales are negative, the value of net receipts from asset sales shall be set at zero for the purposes of comparison with the benchmark values in Table 4.
7/ Valued at the program exchange rates.
8/ The public sector is defined to include the national and provincial governments, and statutory authorities. Excluded from the limits on external borrowing are the use of Fund resources, loans from the World Bank, the Asian Development Bank, and other multilateral and official bilateral donors; loans contracted for debt rescheduling or refinancing (provided the terms of the new loans are at least as concessionary as the terms of the debt being rescheduled or refinanced); and credits that are regarded as concessionary.
9/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines con Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are leases.
10/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Excluded from this performance criterion are normal import-related trade credit and leases. Included in this performance criterion are off-balance sheet assets and liabilities (e.g., swaps and forwards).

Table 3. Papua New Guinea: Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2001

	Dec. 31, 2000	Mar. 31, 2001			Jun. 30, 2001				Sep. 30, 2001		Dec. 31, 2001	
									Indicative Targets		Indicative Targets	
	Actual	Indicative Targets			Performance Criteria				Second	Fourth	Second	Fourth
	Stock	Unadjusted	Adjusted	Actual 1/	Unadjusted	Adjusted	Actual 1/	Actual 2/	and Third Reviews 1/	Review 2/	and Third Reviews 1/	Review 2/
					(In millions of kina)							
Ceiling on net domestic assets of the central bank 3/, 4/	-112	-11	-42	-41	-40	-55	-96	-253	-183	-196	-174	-361
Ceiling on net domestic financing of the government 5/, 6/, 7/	1,569	187	156	172	133	118	186	186	-12	229	47	106
					(In millions of U.S. dollars)							
Floor on net international reserves of the central bank 7/	256	217	229	227	232	238	235	240	292	230	300	290
Ceiling on the contracting or guaranteeing by the public sector of new nonconcessional external debt with a maturity of over one year 5/, 8/, 9/	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the stock of public sector and publicly guaranteed nonconcessional short-term external debt with initial maturity of up to one year 5/, 8/, 10/	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of external payments arrears by the public sector	Continuing											

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ Net international reserves and net domestic assets of the central bank are valued at the original program exchange rates, which were US$1.3713/SDR and US$0.38/kina.

2/ Net international reserves and net domestic assets of the central bank are valued at the revised program exchange rates for September and December 2001, which are US$1.2457/SDR and US$0.31/kina.

3/ Defined as reserve money less net foreign assets of the central bank.

4/ The ceiling on net domestic assets of the central bank will be adjusted downward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; and (iii) foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate. Upward adjustment will be made by the amount that mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out in Table 4 (to a maximum adjustment of K 20 million). Upward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out Table 4 (to a maximum adjustment of K 26.4 million). Upward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate.

5/ Cumulative flow since the beginning of the year.

6/ The ceiling on net domestic financing of the government will be adjusted downward by the full amount of the excess of the sum of nontax revenue (excluding grants) and nonmineral tax revenue, less domestic interest payments over the program levels shown in Table 4. Downward adjustment will be made by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; and (iii) total net receipts from asset sales. Upward adjustment will be made by the amount that mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out in Table 4 (to a maximum adjustment of K 20 million). Upward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out Table 4 (to a maximum adjustment of K 26.4 million). Upward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate.

7/ The floor on net international reserves of the central bank will be adjusted upward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) foreign currency-denominated net receipts from asset sales. Downward adjustment will be made by the amount that the value of mineral tax receipts, as recorded in the BPNG foreign exchange cash flow, is less than the amount indicated in Table 4 (to a maximum downward adjustment of $7.6 million). Downward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow are less than the amount indicated in Table 4 (to a maximum downward adjustment of $10 million). Downward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales.

8/ The public sector is defined to include the national and provincial governments, and statutory authorities. Excluded from the limits on external borrowing are the use of Fund resources, loans from the World Bank, the Asian Development Bank, and other multilateral and official bilateral donors; loans contracted for debt rescheduling or refinancing (provided the terms of the new loans are at least as concessionary as the terms of the debt being rescheduled or refinanced); and credits that are regarded as concessionary.

9/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are leases.

10/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Excluded from this performance criterion are normal import-related trade credit and leases. Included in this performance criterion are off-balance sheet assets and liabilities (e.g., swaps and forwards).

Table 4. Papua New Guinea: Quantitative Benchmarks Under the Stand-By Arrangement, 2000-01

	Actual							Indicative Targets							
								Original Program			First Review	Second and Third Reviews		Fourth Review	
	Dec. 31	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Sep 30.	Dec. 31
	1999	2000				2001		2000				2001			
	(In millions of kina, cumulative from the beginning of each year)														
Ceiling on central government wages and salaries 1/	777	149	364	567	813	185	419	144	377	570	814	185	414	622	859
Ceiling on central government recurrent expenditures 2/, 3/, 4/	2,015	470	1,016	1,520	2,219	485	1,012	436	1,006	1,515	...	...	...	...	...
Ceiling on central government noninterest recurrent expenditures 2/, 3/, 5/	1,628	364	790	1,192	1,790	367	793	372	815	1,236	1,705	410	835	1,254	1,801
Floor on pre-1999 domestic arrears reduction 6/	149	40	64	75	193	11	14	37	77	99	109	...	...	...	...
Floor on nonmineral tax revenue 7/	1,662	402	935	1,391	1,888	420	870	393	842	1,318	1,931	476	1,022	1,391	1,950
	(In millions of U.S. dollars, cumulative from the beginning of each year)														
Floor on mineral tax receipts 8/	131	8	54	92	147	9	49	5	43	74	129	8	33	77	116
Memorandum items:															
Exceptional external financing (in millions of U.S. dollars) 1/, 8/	80	0	35	35	70	14	24	0	36	81	180	4	49	49	138
Privatization receipts, net of cost of sales (in millions of kina) 9/, 10/	26	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Of which: Foreign currency denominated															
In millions of kina 9/	...	...	...	0	0	0	0	0	0	0	0	0	0	0	0
In millions of U.S. dollars 9/, 11/	...	...	...	0	0	0	0	0	0	0	0	0	0	0	0
Nontax revenue	166	26	56	102	145	19	73	19	92	148	169	20	47	150	209
Domestic interest payments	261	79	159	226	284	87	143	42	123	175	317	88	143	207	268

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ Defined as sum of national department and provincial expenditures on wages and salaries including wages and salaries for teachers of provincial governments (items 111, 112, 113, 141) but excluding retrenchment allowances, contributions to superannuation funds, and some other benefits (leave benefits (item 114) and education benefits (item 116)).
2/ Refers to gross expenditure, including spending on services provided by the Department of Works to the rest of the government. A corresponding amount is recorded as nontax revenue.
3/ The benchmark on total recurrent expenditure in the original program was modified to noninterest recurrent expenditure at the time of the first review.
4/ Includes net lending.
5/ Excludes net lending.
6/ Amount for December 31, 2000 includes K 68 million in identified pre-1999 arrears, and the remainder may also include the clearance of arrears incurred in 1999. There are no floors set for 2001, as remaining pre-1999 claims are under dispute subject to court decision.
7/ In 1999 excludes VAT revenue collected in trust accounts.
8/ As recorded in the foreign exchange cash flow of the Bank of Papua New Guinea. Prior to 2001 these figures refer to MRSF receipts.
9/ Net revenues from the privatization of the Halla Cement Company in the third quarter of 2000 are set at zero because the cost of sale was greater than the receipts.
10/ As reported by the Department of Treasury.
11/ As recorded in the balance of payments of the Bank of Papua New Guinea.

Table 5. Papua New Guinea: Prior Actions, Structural Performance Criteria, and Benchmarks Under the Stand-By Arrangement, 2000-01

	Program Target Date	Status
I. Prior actions for first review.		
Endorsement by cabinet of a plan and timetable for the Public Sector Reform Program (PSRP).		Observed.
II. Prior actions for the second and third reviews.		
Bringing the Papua New Guinea Banking Corporation (PNGBC) to the point of sale.		Observed.
Rescission of central bank guarantee to PNGBC.		Observed.
II. Prior actions for the fourth review.		
Implementation of central government expenditure cuts totalling K 33 million.		
III. Structural performance criteria.		
Completion of financial and managerial audits of the two major pension funds: the Public Officers' Superannuation Fund (POSF) and the National Provident Fund (NPF).	By end-March 2000.	Observed.
Passage by parliament of the Central Bank Act.	By end-April 2000.	Observed.
Passage by parliament of the Bank and Financial Institutions Act.	By end-April 2000.	Observed.
Completion and submission to cabinet of the design and timetable for the public sector reform program.	By end-June 2000.	Not observed by target date. Waiver requested based on subsequent completion as a prior action for the first review.
Finance Pacific brought to the point of sale.	By end-December 2000.	Not observed. Waiver requested based on bringing PNGBC to the point of sale as a prior action for completing the second and third reviews.
IV. Structural benchmarks.		
The self-assessment questionnaire on good fiscal practices will be completed and submitted to the Fund.	By end-March 2000.	Observed.
The Privatization Commission will have identified candidates for privatization and will have formulated a detailed schedule and methodology to be employed.	By end-March 2000.	Observed.
Actuarial reviews of the NPF and POSF will have begun.	By end-April 2000.	Superseded by plans for a comprehensive industry reform, which was begun in late 2000.
Endorsement by cabinet of the recommendations on the PSRP.	By end-August 2000.	Observed, also a prior action for the first review (see above).
Endorsement by cabinet of the recommendations of the Public Expenditure Review.	By end-August 2000.	Replaced by ongoing departmental reviews.
Cabinet approval of the tax system review.	By end-September 2000.	Not observed by the target date. However, the tax review was presented to cabinet in October 2000 and recommendations incorporated into the 2001 budget enacted by parliament.
Ongoing effort to close down remaining pyramid schemes.	Continuing.	

Table 6. Papua New Guinea: Central Government Budget, 1996-2002

(In millions of kina)

	1996	1997	1998	1999	2000	Prog. 2001	Proj. 2001	Proj. 2002
Revenue and grants	1,837.5	2,201.5	2,299.8	2,583.3	2,975.8	3,202.6	3,050.5	3,178.7
Tax revenue 1/	1,526.4	1,674.4	1,595.4	1,940.7	2,314.9	2,463.9	2,320.7	2,453.6
Nonmineral	1,121.0	1,284.4	1,354.8	1,682.0	1,888.0	2,147.2	1,949.7	2,095.1
Mineral	405.4	390.0	240.6	258.7	426.9	316.7	371.1	358.5
Nontax revenue 2/	141.0	215.1	234.1	165.5	144.5	175.0	209.2	208.2
Of which: Mineral	18.8	60.8	65.8	37.3	0.0	20.0	39.2	37.9
Grants 3/	170.1	312.0	470.3	477.1	516.4	563.8	520.6	516.9
Budget grants	164.5	133.0	113.5	125.8	25.4	38.5	46.8	0.0
Project grants	5.6	179.0	356.8	351.3	491.0	525.3	473.8	516.9
Expenditure	1,861.0	2,192.4	2,486.5	2,801.2	3,123.3	3,451.7	3,311.3	3,485.2
Recurrent	1,528.8	1,767.9	1,895.4	2,020.2	2,218.6	2,290.0	2,237.9	2,348.3
Noninterest	1,271.5	1,470.3	1,560.0	1,627.5	1,790.0	1,843.4	1,801.1	1,918.1
Salaries and wages 4/	604.2	655.4	690.2	776.9	836.3	859.2	859.2	919.0
Arrears, court cases	...	...	...	148.8	193.3	61.5	46.5	15.0
Goods and services, and transfers 5/	667.3	814.9	869.8	701.9	760.4	922.7	895.4	984.1
Interest	257.3	297.6	335.4	392.7	428.6	446.6	436.8	430.2
Domestic	174.5	206.3	228.0	260.5	284.2	284.8	267.8	249.5
Foreign	82.8	91.3	107.4	132.2	144.4	161.8	169.0	180.7
Development budget, other capital expenditures and net lending	332.2	424.5	591.1	781.0	904.7	1,161.7	1,073.4	1,136.9
Development budget	338.6	427.6	595.7	786.1	806.2	1,104.1	1,040.8	1,074.5
Project grants	...	...	...	351.3	491.0	525.3	473.8	516.9
Concessional loans 6/	...	...	...	121.3	106.5	135.0	135.0	174.7
Domestic funds 5/	...	...	...	313.4	208.7	443.8	432.0	383.0
Structural adjustment expenditures	...	...	...	...	101.0	65.8	40.8	65.2
Net lending	-6.4	-3.1	-4.6	-5.0	-2.5	-8.2	-8.2	-2.8
Measures (revenue increase/expenditure cut)	...	...	...	...	...	...	...	192.5
Overall balance (from above the line)	-23.5	9.1	-186.7	-217.9	-147.5	-249.1	-260.7	-114.0
Discrepancy - Residual revenue (+) / expenditure (-) (net) 7/	-185.4	-128.6	50.4	-107.6	16.3	0.0	-0.3	0.0
Overall balance (from below the line)	-208.9	-119.5	-136.3	-325.6	-131.2	-249.1	-261.1	-114.0
Financing	208.9	119.5	136.3	325.6	131.2	249.1	261.1	114.0
Foreign (net)	10.1	-87.5	-94.1	178.2	58.4	252.2	206.7	-41.6
New borrowing 6/	118.5	85.6	108.1	196.5	119.7	135.0	135.0	174.7
Amortization	-125.7	-206.8	-202.2	-233.2	-252.1	-307.0	-332.8	-334.3
Exceptional financing	17.3	33.7	0.0	214.8	190.8	424.2	404.5	118.1
Domestic (net)	138.5	207.0	216.5	101.0	21.5	46.9	104.3	155.6
Banking system 8/	110.9	155.3	129.1	56.1	-134.4	...	...	...
Other	27.7	51.7	87.4	44.9	155.9	...	...	...
Float	...	...	...	20.0	58.0	-50.0	-50.0	0.0
Privatization (net) 9/	60.3	0.0	13.9	26.4	-6.6	0.0	0.0	0.0
Memorandum items:								
Underlying balance (excluding arrears and structural adjustment expenditures)	-23.5	9.1	-186.7	-69.2	146.8	-121.8	-173.4	-33.8
Overall balance, excluding grants	-379.0	-431.5	-606.6	-802.7	-647.6	-812.8	-781.7	-630.9
Military expenditures	...	...	87.1	91.7	...	90.4	...	...

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

1/ In 1999 includes estimated K 20 million in value-added tax revenue received into accrual trust account.
2/ In 1999 includes estimated K 11 million in license fees received into accrual trust account.
3/ From 2000 onward all Australian grants are project grants.
4/ Includes leave benefits and education subsidies.
5/ While some conditional grants to provinces (District Support Grants, Mining Agreements, and Social Safety Grant) were shifted from recurrent to development budget in 2000, they are shown consistently in the development budget.
6/ Figure for 2000 is preliminary.
7/ The residual deficit is the difference between identified revenues and expenditures, and financing.
8/ In 1999 adjusted by estimated K 52 million write-off of government collateral deposit for net lending activity.
9/ Figure for 2000 refers to the net cost of selling Halla Cement (net).

Table 7. Papua New Guinea: Central Government Budget, 1996-2002

(In percent of GDP)

	1996	1997	1998	1999	2000	Prog. 2001	Proj. 2001	Proj. 2002
Revenue and grants	26.7	31.2	29.2	27.7	29.5	29.8	30.1	29.6
Tax revenue 1/	22.2	23.7	20.3	20.8	22.9	22.9	22.9	22.8
Nonmineral	16.3	18.2	17.2	18.0	18.7	20.0	19.2	19.5
Mineral	5.9	5.5	3.1	2.8	4.2	2.9	3.7	3.3
Nontax revenue 2/	2.0	3.0	3.0	1.8	1.4	1.6	2.1	1.9
Of which: Mineral	0.3	0.9	0.8	0.4	0.0	0.2	0.4	0.4
Grants 3/	2.5	4.4	6.0	5.1	5.1	5.2	5.1	4.8
Budget grants	2.4	1.9	1.4	1.3	0.3	0.4	0.5	0.0
Project grants	0.1	2.5	4.5	3.8	4.9	4.9	4.7	4.8
Expenditure	27.0	31.0	31.6	30.0	30.9	32.1	32.6	32.4
Recurrent	22.2	25.0	24.1	21.6	22.0	21.3	22.1	21.8
Noninterest	18.5	20.8	19.8	17.4	17.7	17.1	17.8	17.8
Salaries and wages 4/	8.8	9.3	8.8	8.3	8.3	8.0	8.5	8.5
Arrears, court cases	...	...	...	1.6	1.9	0.6	0.5	0.1
Goods and services, and transfers 5/	9.7	11.5	11.1	7.5	7.5	8.6	8.8	9.2
Interest	3.7	4.2	4.3	4.2	4.2	4.2	4.3	4.0
Domestic	2.5	2.9	2.9	2.8	2.8	2.6	2.6	2.3
Foreign	1.2	1.3	1.4	1.4	1.4	1.5	1.7	1.7
Development budget, other capital expenditures and net lending	4.8	6.0	7.5	8.4	9.0	10.8	10.6	10.6
Development budget	4.9	6.1	7.6	8.4	8.0	10.3	10.3	10.0
Project grants	...	...	...	3.8	4.9	4.9	4.7	4.8
Concessional loans 6/	...	...	...	1.3	1.1	1.3	1.3	1.6
Domestic funds 5/	...	...	...	3.4	2.1	4.1	4.3	3.6
Structural adjustment expenditures	...	...	...	...	1.0	0.6	0.4	0.6
Net lending	-0.1	0.0	-0.1	-0.1	0.0	-0.1	-0.1	0.0
Measures (revenue increase/expenditure cut)	...	...	...	...	...	...	...	1.8
Discrepancy - Residual revenue (+) / expenditure (-) (net) 7/	-2.7	-1.8	0.6	-1.2	0.2	0.0	0.0	0.0
Overall balance (from below the line)	-3.0	-1.7	-1.7	-3.5	-1.3	-2.3	-2.6	-1.1
Financing	3.0	1.7	1.7	3.5	1.3	2.3	2.6	1.1
Foreign (net)	0.1	-1.2	-1.2	1.9	0.6	2.3	2.0	-0.4
New borrowing 6/	1.7	1.2	1.4	2.1	1.2	1.3	1.3	1.6
Amortization	-1.8	-2.9	-2.6	-2.5	-2.5	-2.9	-3.3	-3.1
Exceptional financing	0.3	0.5	0.0	2.3	1.9	3.9	4.0	1.1
Of which: Financing gap	...	...	...	...	...	0.4	0.0	0.0
Domestic (net)	2.0	2.9	2.8	1.1	0.2	0.4	1.0	1.4
Banking system 8/	1.6	2.2	1.6	0.6	-1.3	...	...	...
Other	0.4	0.7	1.1	0.5	1.5	...	...	...
Float	...	...	...	0.2	0.6	-0.5	-0.5	0.0
Privatization (net) 9/	0.9	0.0	0.2	0.3	-0.1	0.0	0.0	0.0
Memorandum items:								
Underlying balance (excluding arrears and structural adjustment expenditures)	-0.3	0.1	-2.4	-0.7	1.5	-1.1	-1.7	-0.3
Overall balance, excluding grants	-5.5	-6.1	-7.7	-8.6	-6.4	-7.6	-7.7	-5.9
Military expenditures	...	...	1.1	1.0	...	0.8	...	...
Nominal GDP (millions of kina)	6,881.3	7,063.7	7,863.4	9,341.4	10,103.1	10,758.0	10,146.9	10,750.0

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

1/ In 1999 includes estimated K 20 million in value-added tax revenue received into accrual trust account.
2/ In 1999 includes estimated K 11 million in license fees received into accrual trust account.
3/ From 2000 onward all Australian grants are project grants.
4/ Includes leave benefits and education subsidies.
5/ While some conditional grants to provinces (District Support Grants, Mining Agreements, and Social Safety Grant) were shifted from recurrent to development budget in 2000, they are shown consistently in the development budget.
6/ Figure for 2000 is preliminary.
7/ The residual deficit is the difference between identified revenues and expenditures, and financing.
8/ In 1999 adjusted by estimated K 52 million write-off of government collateral deposit for net lending activity.
9/ Figure for 2000 refers to the net cost of selling Halla Cement.

Table 8. Papua New Guinea: Central Government Operations, 2000-2001, Quarterly Profile

(In millions of kina)

	2000					Program 2001					Actual 2001		Projection 2001		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Revenue and grants	464.2	781.6	821.8	908.2	2,975.8	574.4	785.6	885.3	957.3	3202.6	482.2	634.4	836.4	1097.5	3050.5
Tax revenue	422.7	653.5	572.8	665.8	2,314.9	503.7	623.5	663.4	673.3	2463.9	449.8	569.9	615.0	686.0	2320.7
Nonmineral	401.8	532.9	456.7	496.5	1,888.0	476.0	545.7	557.8	567.8	2147.2	419.9	449.9	521.4	558.4	1949.7
Mineral	20.9	120.6	116.1	169.3	426.9	27.7	77.8	105.6	105.6	316.7	29.9	120.0	93.6	127.5	371.1
Nontax revenue	25.9	29.8	46.1	42.7	144.5	19.8	26.9	64.4	63.9	175.0	19.1	54.3	76.6	59.2	209.2
Of which: Mineral	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	20.0	20.0	0.0	25.7	4.0	9.5	39.2
Foreign grants	15.6	98.3	202.9	199.7	516.4	50.8	135.3	157.6	220.1	563.8	13.3	10.2	144.8	352.3	520.6
Budget grants	15.6	0.0	0.0	9.8	25.4	13.3	15.2	0.0	10.0	38.5	13.3	0.0	2.7	30.8	46.8
Project grants	0.0	98.3	202.9	189.9	491.0	37.5	120.1	157.6	210.1	525.3	0.0	10.2	142.1	321.5	473.8
Expenditure	507.1	752.1	805.1	1,059.0	3,123.3	658.8	797.6	894.3	1101.0	3451.7	525.0	591.3	899.5	1295.5	3311.3
Recurrent	469.8	545.9	504.3	698.5	2,218.6	539.5	537.1	548.0	665.4	2290.0	486.2	526.4	578.8	646.5	2237.9
Noninterest	363.9	425.8	402.2	598.1	1,790.0	419.2	426.1	442.4	555.7	1843.4	367.0	426.2	461.0	546.9	1801.1
Salaries and wages	150.0	213.7	203.2	269.4	836.3	185.0	228.7	195.3	250.2	859.2	184.7	234.5	203.1	236.9	859.2
Goods and services, and transfers 1/	174.1	188.2	187.7	210.4	760.4	222.9	177.2	217.2	305.4	922.7	170.9	189.1	247.9	287.5	895.4
Arrears, court cases	39.8	23.9	11.3	118.3	193.3	11.4	20.2	29.9	0.0	61.5	11.4	2.6	10.0	22.5	46.5
Interest	105.9	120.2	102.1	100.4	428.6	120.3	111.0	105.6	109.7	446.6	119.2	100.2	117.8	99.6	436.8
Domestic	79.3	79.3	67.4	58.3	284.2	87.6	55.2	73.2	68.8	284.8	86.7	56.7	63.2	61.2	267.8
Foreign	26.6	40.9	34.7	42.2	144.4	32.7	55.8	32.4	40.9	161.8	32.5	43.5	54.6	38.4	169.0
Development, other capital expenditure and net lending	37.2	206.2	300.9	360.5	904.7	119.2	260.4	346.4	435.7	1,161.7	38.8	64.8	320.7	649.0	1,073.4
Development budget	33.7	194.0	278.5	300.0	806.2	119.3	256.4	324.4	404.0	1104.1	39.9	63.8	308.9	628.1	1040.8
Project grants	0.0	98.3	202.9	189.9	491.0	37.5	120.1	157.6	210.1	525.3	0.0	10.2	142.1	321.5	473.8
Concessional loans 2/	1.1	32.7	8.6	64.2	106.5	10.8	32.4	37.8	54.0	135.0	0.2	3.2	37.8	93.8	135.0
Domestic funds 1/	32.6	63.0	67.1	46.0	208.7	71.0	103.9	129.0	139.9	443.8	39.7	50.4	129.0	212.9	432.0
Structural adjustment	4.3	12.6	23.4	60.7	101.0	1.6	5.3	23.2	35.7	65.8	0.0	1.0	13.0	26.8	40.8
Net lending	-0.8	-0.4	-1.0	-0.3	-2.5	-1.7	-1.2	-1.2	-4.0	-8.2	-1.0	0.0	-1.2	-6.0	-8.2
Overall balance (from above the line)	-42.8	29.5	16.6	-150.8	-147.5	-84.4	-12.0	-9.0	-143.7	-249.1	-42.8	43.2	-63.1	-198.0	-260.7
Discrepancy - Residual revenue (+) / expenditure (-) (net) 3/	139.9	-120.7	65.6	-68.5	16.3	0.0	0.0	0.0	0.0	0.0	-63.9	63.5	0.0	0.0	-0.3
Overall balance	97.1	-91.2	82.3	-219.3	-131.2	-84.4	-12.0	-9.0	-143.7	-249.1	-106.7	106.7	-63.1	-198.0	-261.1
Financing	-97.1	91.2	-82.3	219.3	131.2	84.4	12.0	9.0	143.7	249.1	106.7	-106.7	63.1	198.0	261.1
Foreign (net)	-21.4	-0.7	-29.8	110.3	58.4	-51.9	65.4	153.5	85.2	252.2	-46.2	-47.8	19.8	280.9	206.7
Borrowing	1.1	32.7	21.7	64.2	119.7	10.8	32.4	37.8	54.0	135.0	0.2	3.2	37.8	93.8	135.0
Amortization	-48.4	-74.2	-51.5	-58.9	-233.0	-62.7	-88.2	-66.1	-90.0	-307.0	-79.7	-81.4	-84.6	-87.1	-332.8
Australian swap	25.9	-45.0	0.0	0.0	-19.1	...	...	...	...	...	...	...	...	...	...
Exceptional financing (loans)	0.0	85.8	0.0	105.0	190.8	0.0	121.2	181.8	121.2	424.2	33.3	30.4	66.6	274.2	404.5
Of which: Financing gap						0.0	0.0	0.0	45.0	45.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	-75.6	91.9	-45.9	51.1	21.5	186.3	-53.5	-144.5	58.5	46.8	171.6	14.5	43.2	-125.0	104.3
Banking system	-200.9	109.9	-36.8	-6.7	-134.4	...	...	...	...	...	113.4	...	...	...	...
Other	125.3	-18.0	-9.1	57.7	155.9	...	...	...	...	...	58.2	...	...	...	...
Float	...	...	...	58.0	58.0	-50.0	0.0	0.0	0.0	-50.0	-18.7	-73.4	0.0	42.1	-50.0
Privatization (net) 4/	0.0	0.0	-6.6	0.0	-6.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:															
Cash expenditures	506.0	621.1	593.7	805.0	2,525.8	610.4	645.1	698.9	836.9	2,791.4	524.8	577.9	719.5	880.2	2,702.4

Sources: Department of Treasury; Bank of Papua New Guinea; and Fund staff estimates.

1/ While some conditional grants to provinces (District Support Grants, Mining Agreements, and Social Safety Grant) were shifted from recurrent to development budget in 2000; they are shown consistently in the development budget.

2/ Figure for 2000 is preliminary.

3/ The residual deficit is the difference between identified revenues and expenditures, and financing.

4/ Figure for 2000 refers to the net cost of selling Halla Cement.

Table 9. Papua New Guinea: Monetary Survey, 1997-2002

	Actual									Projection			Program			
	1997	1998	1999	2000				2001		2001		2002	2001			
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.		Mar.	Jun.	Sep.	Dec.
	(In millions of kina unless otherwise indicated; end of period)															
Net foreign assets	767	463	678	587	733	829	1,028	1,063	1,113	...	...	...	...	...	...	...
Bank of Papua New Guinea (BPNG)	575	291	491	430	565	603	787	750	800	...	...	...	...	...	...	...
Foreign assets	666	391	553	459	626	651	909	877	1,084	...	...	...	...	...	...	...
Less: Foreign liabilities	91	100	62	29	61	49	122	127	284	...	...	...	...	...	...	...
Commercial banks	192	171	187	156	168	226	241	313	313	...	...	...	...	...	...	...
Net foreign assets 1/	1,152	581	662	589	786	790	880	848	879	1,055	1,256	1,350	781	826	988	1,015
Bank of Papua New Guinea 1/	864	366	479	432	606	574	674	598	632	742	936	1,000	571	611	768	790
Foreign assets 1/	1,001	491	540	461	671	620	779	699	856	1,093	1,286	1,350	681	856	1,081	1,101
Less: Foreign liabilities 1/	136	125	61	29	65	46	105	102	224	351	350	350	110	245	312	311
Commercial banks 1/	288	215	182	157	180	216	206	250	247	313	320	350	210	215	220	225
Net domestic assets	1,831	2,183	2,202	2,191	2,128	2,090	2,007	1,929	1,925	...	...	...	...	...	...	...
Net domestic assets 1/	1,446	2,065	2,214	2,189	2,088	2,121	2,125	2,089	2,101	2,026	1,886	2,083	2,283	771	687	787
Domestic credit	2,320	2,716	2,825	2,669	2,828	2,727	2,699	2,808	2,694	2,811	2,686	2,963	2,903	1,406	1,337	1,452
Net credit to central government	840	969	1,077	876	986	950	943	1,056	912	1,009	849	944	1,154	-403	-552	-502
BPNG	-97	368	498	266	212	224	133	327	144	232	74	111	311	288	152	167
Commercial banks	937	601	580	611	774	725	810	730	768	777	774	832	844	812	801	837
Claims on other sectors	1,480	1,747	1,747	1,793	1,842	1,777	1,756	1,751	1,782	1,802	1,837	2,019	1,749	1,809	1,889	1,954
Private sector	1,064	1,372	1,517	1,563	1,596	1,555	1,562	1,600	1,646	1,665	1,700	1,880	1,560	1,620	1,700	1,765
Official entities	299	208	159	141	161	147	124	124	117	117	117	117	124	124	124	124
Nonmonetary financial institutions	117	167	72	89	85	76	70	27	20	20	20	22	65	65	65	65
Other items, net	-489	-533	-622	-478	-700	-636	-692	-879	-769	...	...	...	...	...	...	...
Other items, net 1/	-874	-651	-610	-480	-740	-606	-574	-718	-593	-785	-800	-880	-620	-635	-650	-665
Broad money	2,598	2,646	2,880	2,778	2,861	2,919	3,035	2,992	3,038	3,081	3,141	3,433	3,064	3,100	3,181	3,308
Narrow money	919	1,021	1,234	1,138	1,115	1,129	1,272	1,157	1,188	1,201	1,248	1,364	1,289	1,303	1,337	1,391
Currency outside banks	225	277	342	266	263	250	285	246	280	267	295	322	293	296	304	316
Demand deposits	695	744	891	871	852	880	987	911	908	934	953	1,042	996	1,007	1,034	1,075
Quasi money	1,679	1,624	1,646	1,640	1,746	1,790	1,763	1,835	1,850	1,880	1,893	2,069	1,776	1,796	1,843	1,917
Memorandum items:																
Narrow money growth rate 2/	7.0	11.1	20.8	8.8	-9.0	-10.0	3.1	1.7	6.6	6.4	-1.9	9.3	13.2	16.9	18.4	8.9
Broad money growth rate 2/	6.8	1.8	8.9	0.6	0.2	0.0	5.4	7.7	6.2	5.6	3.5	9.3	10.3	7.8	9.3	10.0
Net credit to central government growth rate 2/	22.7	15.4	11.2	-30.8	-13.2	-23.8	-12.5	20.5	-7.6	6.3	-10.0	11.2	31.7	11.5	0.4	4.5
Private sector credit growth rate 2/	36.3	29.0	10.5	16.6	8.0	6.3	3.0	2.4	3.1	7.1	8.8	10.6	-0.2	1.5	9.3	12.8
Narrow money multiplier	2.86	2.63	1.83	2.18	2.22	2.02	2.26	2.08	2.28	2.20	2.17	2.19	...	...	...	...
Broad money multiplier	8.08	6.82	4.28	5.33	5.71	5.23	5.40	5.39	5.83	5.64	5.46	5.52	...	...	...	...
Broad money velocity	2.72	2.97	3.24	3.43	3.40	3.40	3.33	3.38	3.33	3.29	3.23	3.13	...	...	...	...
Government securities held by nonbanks	...	...	374	595	577	568	626	684	843	789.0	826.7	886.5	626.1	626.6	629.1	636.6
Total net credit to central government	...	1,394.3	1,547.5	1,471.9	1,563.8	1,518.0	1,569.1	1,740.7	1755.2	1798.4	1675.2	1830.2	186.3	132.8	-11.7	46.8
Change since beginning of year	...	...	153.2	-75.6	16.3	-29.6	21.5	171.6	186.2	229.4	106.2	155.0	186.3	132.8	-11.7	46.8
Of which: From banking system	...	...	108.1	-200.9	-91.0	-127.7	-134.4	113.4	-31.2	66.4	-94.5	95.2	193.1	139.2	-7.8	43.1

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

1/ Valued at program exchange rates. Prior to September 2001 the rates used were US$0.38/kina and US$1.3713/SDR. From September 2001 onward rates of US$0.31/kina and US$1.2457/SDR apply.
2/ Percent change from corresponding period of previous year.

Table 10. Papua New Guinea: Balance Sheet of the Central Bank, 1997-2002

	Actual									Projection			Program			
	1997	1998	1999	2000				2001		2001		2002	2001			
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.		Mar.	Jun.	Sep.	Dec.
(In millions of kina unless otherwise indicated; end of period)																
Net foreign assets	575	291	491	430	565	603	787	750	800	...	...	...	...	...	...	...
Foreign assets	666	391	553	459	626	651	909	877	1,084	...	...	...	...	...	...	...
Less: Foreign liabilities	91	100	62	29	61	49	122	127	284	...	...	...	...	...	...	...
Net foreign assets 1/	847	361	479	430	603	574	674	597	617	742	936	1,000	571	611	768	790
Foreign assets 1/	986	483	540	460	669	623	784	707	864	1,093	1,286	1,350	681	856	1,081	1,101
Less: Foreign liabilities 1/	139	122	61	30	66	49	110	110	246	351	350	350	110	245	312	311
Net domestic assets	-254	97	182	91	-64	-45	-225	-194	-279	...	...	...	...	...	...	...
Net domestic assets 1/	-525	27	194	91	-102	-16	-112	-41	-96	-196	-361	-378	-11	-40	-183	-174
Domestic credit	120	490	554	323	269	281	192	386	199	287	129	167	370	347	211	226
Net credit to government	-97	368	498	266	212	224	133	327	144	232	74	111	311	288	152	167
Securities	881	1,285	599	398	338	278	164	321	171	251	170	211	304	336	245	260
Treasury bills	771	1,178	438	243	185	140	25	191	40	138	63	118	175	207	127	154
Inscribed stock	110	107	162	156	153	138	138	131	131	113	107	93	129	129	118	106
Advances	0	0	0	0	0	0	0	107	68	77	0	0	100	45	0	0
Less: Central government deposits	978	917	102	133	125	54	31	101	96	96	96	100	93	93	93	93
Drawing accounts	7	17	-1	37	-49	-37	-64	0	0	0	0	5	0	0	0	0
Waigani public account	0	3	-1	161	-25	17	-68	0	0	0	0	5	0	0	0	0
Others	7	13	0	-123	-24	-53	4	0	0	0	0	0	0	0	0	0
Trust accounts	966	891	100	92	174	90	94	100	94	94	94	94	93	93	93	93
Counterpart fund accounts	5	9	3	3	1	1	1	1	1	1	1	1	0	0	0	0
Credit to other sectors	217	122	57	57	57	57	59	59	55	55	55	55	59	59	59	59
Other items, net	-374	-393	-372	-232	-333	-326	-417	-580	-478	...	...	...	...	...	...	...
Other items, net 1/	-645	-463	-361	-232	-371	-297	-304	-427	-295	-483	-490	-545	-380	-387	-394	-400
Reserve money	322	388	673	521	501	558	562	555	521	547	575	622	561	571	585	616
Currency in circulation	276	324	421	344	343	347	364	333	346	350	374	404	351	381	389	404
Deposits of commercial banks	26	60	247	173	149	190	194	214	171	193	197	214	210	190	197	211
ESA deposits	26	60	110	37	9	49	46	65	23	37	39	42	48	24	27	37
CRR deposits	0	0	137	136	139	141	148	149	148	152	154	168	152	156	160	164
Other deposits	20	4	5	5	9	21	4	8	4	4	4	4	10	10	10	10
Memorandum items:																
Reserve money growth 2/	-34.3	20.6	73.4	7.9	-11.4	-7.2	-16.5	6.6	4.1	-2.0	2.3	8.1	7.6	13.9	4.9	9.2
Nominal GDP growth rate 2/	2.7	11.3	18.8	15.8	13.0	10.5	8.2	6.1	4.1	2.3	0.4	5.9	...	...	...	...
Nominal nonmineral GDP growth rate 2/	9.6	8.2	12.4	8.6	4.9	1.5	-1.7	-0.4	0.8	2.1	3.4	9.9	...	...	...	...
Net international reserves (in millions of U.S. dollars)	328	139	182	164	230	218	256	227	240	230	290	310	...	...	...	...
Net international reserves (in millions of U.S. dollars) 1/	322	137	182	164	229	218	256	227	235	...	...	310	217	232	292	300
Period change in NIR (in millions of U.S. dollars)	...	...	...	-18	66	-12	38	-29	13	-10	60	20	-40	15	60	8
Gross international reserves (in millions of U.S. dollars)	380	187	205	175	255	236	296	266	325	339	399	419	259	325	411	418
Exchange rate (US$/kina)	0.5710	0.4770	0.3710	0.3815	0.4075	0.3620	0.3255	0.3030	0.3000	0.3100	0.3100	0.3100	0.3800	0.3800	0.3800	0.3800

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

1/ Valued at program exchange rates. Prior to September 2001 the rates used were US$0.38/kina and US$1.3713/SDR. From September 2001 onwards rates of US$0.31/kina and US$1.2457/SDR apply.

2/ Percent change from corresponding period of previous year.

Table 11. Papua New Guinea: Consolidated Balance Sheet of Commercial Banks, 1997-2002

	Actual									Projection		
	1997	1998	1999	2000				2001		2001		2002
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	
	(In millions of kina unless otherwise indicated; end of period)											
Net foreign assets	192	171	187	156	168	226	241	313	313	313	320	350
Foreign assets	206	286	286	260	247	282	296	396	406	406	420	460
Less: Foreign liabilities	14	114	99	103	79	56	56	83	93	93	100	110
Reserves	9	42	232	158	134	185	169	204	161	189	193	210
CRR accounts	0	0	137	136	139	141	148	149	148	152	154	168
ESA accounts	9	42	95	22	-6	44	21	55	13	37	39	42
Currency	51	47	79	77	80	97	79	88	66	83	79	82
Domestic credit	2,412	2,321	2,267	2,313	2,526	2,425	2,487	2,415	2,482	2,576	2,608	2,848
Net credit to central government	937	601	580	611	774	725	810	730	768	777	774	832
Claims on central government	1,108	889	792	841	988	937	1,065	997	1,020	1,004	996	1,012
Securities	1,033	806	768	817	960	920	1,053	990	1,014	998	990	1,006
Treasury bills	942	744	763	813	960	920	1,053	990	991	952	940	906
Inscribed stock	91	62	4	4	0	0	0	0	23	46	50	100
Loans	75	83	24	24	28	17	12	7	6	6	6	6
Less: Central government deposits	171	287	212	230	214	212	255	268	252	227	222	180
Claims on other sectors	1,474	1,720	1,688	1,703	1,751	1,699	1,677	1,685	1,714	1,799	1,834	2,016
Private sector	1,063	1,371	1,473	1,489	1,515	1,486	1,492	1,537	1,578	1,662	1,697	1,877
Official entities	299	208	159	141	161	147	124	124	117	117	117	117
Nonmonetary financial institutions	113	141	56	73	75	66	61	24	19	20	20	22
Other items, net	-84	-54	53	13	-131	-45	-8	-24	-55	-109	-113	-121
Deposits	2,354	2,365	2,532	2,506	2,589	2,649	2,745	2,739	2,754	2,810	2,842	3,106
Demand	1,058	1,142	1,276	1,245	1,252	1,299	1,437	1,379	1,369	...	...	...
Term	1,296	1,223	1,257	1,261	1,337	1,350	1,308	1,360	1,385	...	...	...
Central bank credit	216	121	54	54	54	55	53	53	52	52	52	52
Memorandum items:												
Deposits subject to reserve requirements	2,507	2,545	2,698	2,679	2,740	2,801	2,956	2,968	2,979	3,040	3,074	3,360
Implied cash reserve ratio (percent)	0.00	0.00	5.06	5.06	5.09	5.04	5.00	5.01	4.96	5.00	5.01	5.00
Kina facility borrowings (-deposits)	-20	0	-15	-15	-15	-5	-25	-10	-10	-10	-10	-10
Liquid assets	1,075	894	931	904	1,016	1,034	1,131	1,111	1,082	1,106	1,096	1,118
Liquid asset ratio (percent)	42.88	35.11	34.52	33.74	37.07	36.91	38.26	37.42	36.32	36.37	35.67	33.26
Excess ESA balances	6	60	95	22	-6	44	21	55	13	37	39	42
Total commercial bank assets	3,063	3,364	3,455	3,534	3,584	3,551	3,672	3,721	3,784	...	...	...
Claims on central government/total assets (percent)	36.2	26.4	22.9	23.8	27.6	26.4	29.0	26.8	27.0	...	...	...

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

Table 12. Papua New Guinea: Selected Monthly and Quarterly Financial Indicators, 1998-2001

	Interest Rates								Consumer Price Index (Percent Change) 2/		Ex-post Real 182-day Treasury Bill Yield	Ex-post Real Weighted Average Lending Rate	US$/kina Exchange Rate (e.o.p.)	Nominal Effective Exchange Rate Index: 1990=100
	Kina Deposit Rate 1/	Treasury Bills Weighted Average Auction Yield				Commercial Banks								
		28-day	63-day	91-day	182-day	Weighted Average Deposit Rate	Weighted Average Lending Rate	Overdraft (Indicative) Rate	12-month Ended	Year-on-Year				
1998														
January	11.00	14.08	14.08	14.28	14.30	5.6	12.3	9.75					0.5565	84.6
February	12.00	13.81	14.12	14.89	15.31	6.4	12.0	9.75					0.5540	80.6
March	17.98	18.30	16.16	15.50	18.07	6.7	13.3	12.00	8.0	5.2	10.0	5.3	0.5080	78.0
April	19.68	21.92	22.01	22.26	23.65	7.9	17.3	12.75					0.4890	73.1
May	17.73	19.11	19.51	19.09	20.77	8.4	17.6	12.75					0.4840	72.2
June	18.05	20.18	20.60	20.18	22.03	8.7	17.7	12.75	9.4	6.7	12.6	8.3	0.4675	72.4
July	19.50	23.68	25.07	25.16	25.55	9.3	18.5	12.75					0.4140	67.0
August	17.58	19.30	21.41	20.75	20.82	10.2	21.9	12.75					0.4450	67.7
September	17.85	20.50	22.95	23.51	23.83	9.9	21.7	12.75	14.7	9.4	9.1	7.0	0.4390	65.9
October	17.44	18.50	22.85	23.67	22.72	9.6	20.6	12.75					0.4600	64.8
November	17.88	19.01	21.82	21.81	23.20	8.9	19.4	12.75					0.4750	66.9
December	18.15	19.00	21.92	23.41	23.94	8.7	20.2	12.75	21.8	13.6	2.1	-1.6	0.4770	67.7
1999														
January	17.88	17.48	19.12	20.84	19.76	8.8	21.0	12.75					0.4680	67.9
February	14.99	17.49	19.67	19.68	19.94	8.4	20.2	12.75					0.4470	66.2
March	15.04	20.00	20.77	20.69	21.52	8.1	19.4	12.75	14.2	15.1	7.3	5.2	0.4200	63.6
April	15.03	18.97	18.98	20.92	21.33	7.7	18.7	12.75					0.4120	62.0
May	15.79	20.95	21.76	23.68	24.62	7.5	18.6	12.75					0.3800	58.0
June	19.18	21.84	24.98	25.05	26.50	7.9	18.2	12.75	14.1	16.2	12.4	4.1	0.3900	55.0
July	19.36	22.17	24.36	25.54	27.16	7.7	18.6	12.75					0.3765	57.2
August	20.32	21.25	25.77	26.38	28.03	7.9	18.3	12.75					0.3410	52.4
September	17.36	21.25	20.00	20.00	20.58	8.0	17.8	12.75	18.2	17.1	2.3	-0.4	0.3375	49.3
October	17.00	21.34	21.91	21.05	20.89	8.3	18.7	12.75					0.3710	52.1
November	15.17	22.38	22.07	22.08	21.63	8.7	18.7	12.75					0.3520	52.8
December	12.80	22.68	22.87	21.66	20.44	8.5	18.2	12.75	13.2	14.9	7.2	5.0	0.3710	53.7
2000														
January	13.08	21.92	21.94	21.32	20.42	8.7	18.1	17.75					0.3210	46.6
February	12.40	23.04	23.18	23.06	21.96	8.9	18.0	17.75					0.3290	49.0
March	11.98	23.50	22.82	22.96	19.69	9.0	17.8	17.25	19.6	16.3	0.1	-1.8	0.3815	57.3
April	16.25	22.00	22.57	22.04	20.54	9.3	17.8	17.25					0.3845	58.2
May	11.23	22.39	20.85	19.99	18.54	9.1	17.6	17.25					0.4110	63.9
June	8.99	20.61	20.28	19.92	16.12	9.1	17.7	17.25	21.9	18.2	-5.8	-4.2	0.4075	62.1
July	10.00	18.51	17.84	15.34	14.71	8.9	17.4	17.25					0.3780	58.1
August	8.72	15.75	15.83	15.78	14.49	8.5	17.3	17.25					0.3735	58.1
September	7.45	15.27	15.01	14.87	13.77	7.9	17.2	17.25	12.2	16.6	1.6	5.0	0.3620	57.6
October	6.66	14.68	14.54	14.56	13.95	7.8	17.3	16.75					0.3310	53.7
November	5.90	15.45	15.25	14.99	14.90	7.5	17.1	16.75					0.3390	55.4
December	4.41	15.67	15.56	15.51	14.86	6.7	17.3	16.75	10.0	15.6	4.9	7.3	0.3255	52.2
2001														
January	4.25	15.94	15.98	15.63	15.01	6.3	17.4	16.75					0.3185	49.0
February	14.25	15.91	15.91	15.77	14.75	6.3	17.5	16.75					0.3076	50.3
March	13.75	15.60	15.80	15.36	14.10	6.6	17.5	16.75	8.9	12.9	5.2	8.6	0.3030	50.2
April	13.50	15.34	15.35	14.90	13.00	6.3	17.4	16.75					0.3415	53.7
May	12.75	12.68	12.55	12.57	12.09	6.1	17.4	16.75					0.2950	54.5
June	12.75	12.71	12.69	12.71	12.09	5.6	17.3	15.75	7.8	9.7	4.2	9.5	0.3000	51.9

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

1/ Prior to February 2001, the kina deposit rate was determined by a weekly auction for deposits conducted by the central bank. Since then the Bank of Papua New Guinea has announced a Kina Facility rate, and the deposit rate was set 125 basis points below this rate until July 2001, when the margin was reduced to 75 basis points.
2/ A 10 percent value-added tax was implemented in the September quarter 1999, which raised the headline rate of inflation.

Table 13. Papua New Guinea: Balance of Payments, 1996-2002

(In millions of U.S. dollars)

	1996	1997	1998	1999	2000	Prog. 2001	Proj. 2001	Proj. 2002
Current account balance	289	-263	23	53	282	-27	118	112
Mineral	736	311	564	718	932	728	875	822
Nonmineral	-447	-574	-540	-665	-650	-755	-756	-710
Trade balance	813	213	424	494	713	471	566	593
Exports (f.o.b.)	2,603	2,186	1,849	2,019	2,214	2,054	2,033	2,080
Mineral	1,777	1,328	1,239	1,438	1,737	1,585	1,667	1,629
Nonmineral	827	857	610	581	477	469	366	451
Imports (c.i.f.)	-1,791	-1,972	-1,425	-1,525	-1,502	-1,583	-1,466	-1,487
Mineral	-496	-573	-287	-308	-363	-390	-361	-349
Nonmineral	-1,294	-1,399	-1,138	-1,218	-1,139	-1,193	-1,105	-1,138
Services balance	-690	-673	-629	-615	-609	-658	-609	-637
Mineral (net)	-544	-444	-389	-413	-442	-468	-431	-459
Nonmineral (net)	-146	-229	-240	-202	-167	-191	-178	-178
Unrequited transfers (net)	166	197	228	174	178	160	161	155
Official	219	229	215	181	188	172	173	170
Private	-53	-32	13	-8	-10	-13	-13	-15
Capital account balance	68	53	-167	-123	-291	-69	-211	-127
Medium- and long-term loan disbursements	-196	189	-185	-391	-239	-210	-152	-143
Official (net)	-5	-76	-46	-10	-64	-57	-60	-47
Private (net)	-191	266	-139	-381	-174	-153	-92	-96
Direct investment (net)	226	23	121	307	106	152	29	121
Commercial banks	-12	-10	15	-2	-10	0	-27	-9
Other (net)	49	-149	-118	-37	-148	-11	-61	-95
Exceptional financing	15	25	0	80	70	125	125	35
Errors and omissions	10	-19	-45	34	9	0	0	0
Overall balance	382	-204	-189	44	70	28	32	20
Change in net international reserves (- increase)	-382	204	189	-44	-70	-43	-33	-20
Gross official reserves	-318	206	194	-19	-90	-122	-102	-20
IMF (net)	3	0	-4	-23	18	73	69	0
Purchases	3	0	0	0	37	74	71	0
Repurchases	0	0	-4	-23	-19	-1	-1	0
Other liabilities	-67	-1	-1	-2	2	7	0	0
Financing gap	0	0	0	0	0	15	0	0
Memorandum items:								
Current account (in percent of GDP)	5.5	-5.3	0.6	1.4	7.7	-0.8	3.8	3.5
Mineral	14.1	6.3	14.7	19.5	25.5	20.4	27.9	25.8
Nonmineral	-8.6	-11.6	-14.1	-18.1	-17.8	-21.2	-24.2	-22.3
Net international reserves								
In millions of U.S. dollars	532	328	139	183	256	300	290	309
In months of nonmineral imports	4.9	2.8	1.5	1.8	2.7	3.0	3.1	3.3
Gross official reserves (end-year)								
In millions of U.S. dollars	586	380	187	206	296	418	398	418
In months of nonmineral imports	5.4	3.3	2.0	2.0	3.1	4.2	4.3	4.4
Public debt-service ratio (percent of goods and nonfactor services exports)	5.3	8.6	7.3	7.5	6.7	6.9	6.8	6.8
Public debt-to-GDP ratio (in percent)	27.0	26.6	35.2	37.3	39.3	44.1	50.4	49.2

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

Table 14. Papua New Guinea: Public and Publicly Guaranteed Debt Outstanding, 1994-2001 1/

(In millions of U.S. dollars, unless otherwise indicated)

	1994	1995	1996	1997	1998	1999	2000	Proj. 2001
Total	1,414	1,452	1,408	1,310	1,346	1,371	1,434	1,580
Central government	1,312	1,335	1,354	1,258	1,298	1,348	1,394	1,472
Multilateral creditors	785	813	796	801	814	798	790	853
World Bank Group	353	366	357	376	359	334	345	387
Asian Development Bank	355	368	361	363	384	401	387	413
EU	44	49	47	41	47	60	54	51
Other	33	31	30	21	24	4	4	0
Bilateral	353	419	450	389	428	507	571	597
Australia	10	60	61	27	4	1	85	105
China	8	5	5	6	10	13	15	14
Japan	296	315	346	326	384	447	423	432
Other	39	40	37	31	30	46	48	47
Commercial creditors	174	102	109	68	56	43	33	22
Banks	150	82	82	45	39	31	30	19
Other	24	20	27	22	17	12	4	3
Central bank	103	117	54	52	48	23	40	108
IMF liabilities	14	47	50	50	46	23	39	106
Other	89	70	3	2	1	0	1	2
Memorandum items:								
Government debt/GDP (in percent)	24.5	28.9	25.9	25.5	34.0	36.7	38.2	47.0
Total public debt/GDP (in percent)	26.4	31.5	27.0	26.6	35.2	37.3	39.3	50.4
Net present value (NPV) of debt 2/	1,681.9	1,650.6	1,560.3	1,413.8	1,409.1	1,506.2	1,650.1	1,524.7
NPV of government debt/GDP (in percent)	28.6	33.0	27.6	26.2	33.4	37.3	42.0	45.4
NPV of total public debt/GDP (in percent)	31.4	35.8	29.9	28.7	36.9	40.9	45.2	48.7
NPV of debt/exports of goods and services (in percent)	57.5	52.9	52.3	54.6	66.1	65.8	66.6	65.5
NPV of government debt/government revenues (in percent)	158.6	131.9	115.6	119.7	101.0	104.2	172.6	172.2
Grant element of total debt (in percent of nominal debt stock) 3/	-18.9	-13.7	-10.8	-7.9	-4.7	-9.8	-15.1	3.5
GDP	5,354.5	4,613.5	5,221.5	4,928.3	3,820.8	3,679.2	3,649.2	3,132.3
Exports of goods and services	2,926.7	3,120.3	2,980.8	2,591.6	2,131.3	2,288.6	2,476.7	2,328.3
Government revenues	964.1	1,154.0	1,246.7	1,077.3	1,265.2	1,318.3	889.0	826.1

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ All calculations based on contracted debt, and excluding new money (for example for program financing).
2/ Calculated on basis of six-month average currency specific commercial interest reference rates (CIRRs) for the period July-December 2000.
3/ Calculated as difference between face value of debt and NPV of debt.

Table 15. Papua New Guinea: Indicators of Capacity to Repay the Fund, 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006
			Projection					
Outstanding UFR	21.4	38.7	106.5	107.1	89.3	35.8	0.0	0.0
Obligations to the IMF	24.9	20.9	5.0	5.6	23.5	57.5	36.8	0.0
Repurchases	22.8	19.1	1.2	0.0	18.0	53.7	35.9	0.0
Charges	2.1	1.8	3.7	5.6	5.5	3.8	0.9	0.0
Outstanding UFR in percent of:								
GDP	0.6	1.1	3.4	3.4	2.7	1.0	0.0	0.0
Exports of good and nonfactor services	0.9	1.6	4.6	4.6	4.2	1.7	0.0	0.0
External public debt	1.6	2.8	7.0	7.1	5.9	2.4	0.0	0.0
Net official international reserves	11.7	15.1	36.7	34.6	23.8	8.2	0.0	0.0
Quota	11.9	22.7	64.9	64.9	54.1	21.6	0.0	0.0
Obligations to the IMF in percent of:								
GDP	0.7	0.6	0.2	0.2	0.7	1.6	1.0	0.0
Exports of good and nonfactor services	1.1	0.8	0.2	0.2	1.1	2.7	1.9	0.0
Public debt service	14.6	12.6	3.2	3.6	12.1	25.9	20.5	0.0
Net official international reserves	13.6	8.2	1.7	1.8	6.3	13.2	7.6	0.0
Memorandum items								
Public debt service (percent of goods and nonfactor services exports)	7.5	6.7	6.8	6.8	9.1	10.5	9.1	6.9

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

Table 16. Papua New Guinea: External Financing Requirements and Sources, 2000-06

(In millions of U.S. dollars)

	2000	Prog. 2001	Proj. 2001	2002	2003	2004	2005	2006
Current account excluding interest obligations and official transfers	193	-69	59	108	109	92	64	53
Debt-service obligations	-386	-465	-429	-462	-460	-429	-359	-317
Official	-147	-159	-154	-158	-176	-168	-144	-127
Concessional	-132	-142	-137	-141	-163	-159	-143	-127
Interest	-47	-51	-46	-52	-54	-51	-46	-43
Amortization	-85	-91	-91	-89	-109	-108	-97	-83
Nonconcessional	-13	-13	-14	-11	-7	-5	0	0
Interest	-3	-3	-3	-1	-1	0	0	0
Amortization	-10	-10	-11	-10	-7	-5	0	0
IMF charges	-2	-4	-4	-6	-6	-4	-1	0
Private sector	-240	-306	-275	-304	-285	-261	-215	-191
Mineral	-195	-246	-222	-205	-191	-172	-134	-114
Nonmineral	-44	-60	-53	-99	-93	-89	-81	-77
Changes in net international reserves (- increase)	-70	-43	-33	-20	-66	-62	-48	-59
Of which : IMF (net)	18	73	69	0	-18	-54	-36	0
Gross financing requirement	-263	-576	-403	-374	-417	-400	-343	-323
Gross capital inflows	263	562	403	374	417	400	343	323
Loans	119	249	289	187	221	216	200	192
Medium- and long-term	49	124	164	152	160	131	105	98
Official	31	45	42	52	62	38	26	25
Private	18	80	122	100	98	94	80	72
Exceptional financing	70	125	125	35	61	85	95	95
Concessional	70	125	125	35	61	85	95	95
World Bank	35	55	55	0	41	62	64	64
Asian Development Bank	0	25	25	35	21	22	31	31
Other	35	45	45	0	0	0	0	0
Nonconcessional	0	0	0	0	0	0	0	0
Japan-JBIC	0	0	0	0	0	0	0	0
Australian loan	0	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0
Grants	188	172	173	170	153	152	152	151
Australian budgetary support	6	0	0	0	0	0	0	0
Project and commodity aid	177	159	159	153	153	152	152	151
Other (EU, China)	6	13	14	17	0	0	0	0
Other capital flows (net)	-43	141	-59	17	43	32	-9	-20
Financing gap	0	15	0	0	0	0	0	0
Memorandum items:								
Government net loans (disbursements less amortizations) (In percent of GDP)	0.2	2	2.1	-0.4	0.2	0.3	0.7	1.0
Gross external financing (loans plus grants) (In percent of GDP)	3.3	7.0	9.2	5.9	6.6	6.1	5.5	5.1

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates.

Table 17. Papua New Guinea: Proposed Schedule of Purchases
Under the Stand-By Arrangement

Amount	Availability Date	Conditions Necessary for a Purchase
SDR 10.000 million	March 30, 2000	Board approval of the arrangement.
SDR 18.885 million	August 15, 2000	Observance of end-June performance criteria and completion of the First Review.
SDR 37.770 million	April 15, 2001	Observance of end-December 2000 performance criteria and completion of the Second and Third Reviews.
SDR 18.885 million	August 15, 2001	Observance of end-June 2001 performance criteria and completion of the Fourth Review.
Memorandum item:		
Total access	SDR 85.540 million (65 percent of quota; 55.7 annualized access)	

Table 18. Papua New Guinea: Medium-Term Scenario, 1998-2006

	1998	1999	2000	Projection 1/ 2001	2002	2003	2004	2005	2006
Growth and prices (change in percent)									
Real GDP 2/	-3.8	5.4	-1.8	-2.0	1.5	2.8	2.5	1.2	1.7
Mineral	16.8	8.7	2.4	-9.2	-4.1	-1.8	-2.7	-10.8	-10.8
Nonmineral	-8.1	4.5	-3.0	0.1	3.0	3.9	3.7	3.9	4.0
CPI (average)	13.6	14.9	15.6	10.0	6.0	3.0	2.1	2.1	2.1
Savings and investment (in percent of GDP)									
Foreign savings	-0.6	-1.4	-7.7	-3.8	-3.5	-2.9	-2.6	-2.4	-2.3
Public saving-investment balance 3/	-1.7	-3.5	-1.3	-2.6	-1.1	-1.2	-1.2	-1.0	-0.8
Private saving-investment balance 4/	2.3	4.9	9.0	6.4	4.6	4.1	3.8	3.4	3.1
Central government operations (in percent of GDP)									
Total revenue and grants	29.2	27.7	29.5	30.1	29.6	28.7	28.0	27.4	27.1
Of which: Mineral tax revenue	3.1	2.8	4.2	3.7	3.3	2.7	2.2	1.7	1.3
Total expenditure 5/	31.6	30.0	30.9	32.6	30.6	29.9	29.2	28.4	27.9
Primary balance	2.5	0.7	2.9	1.7	2.9	2.1	1.9	2.0	2.3
Overall balance	-1.7	-3.5	-1.3	-2.6	-1.1	-1.2	-1.2	-1.0	-0.8
Domestic borrowing (net) 6/	2.8	1.3	0.8	0.5	1.4	0.7	0.6	0.1	-0.4
Foreign borrowing (net)	-1.2	1.9	0.6	2.0	-0.4	0.2	0.3	0.7	1.0
Privatization (net)	0.2	0.3	-0.1	0.0	0.0	0.3	0.3	0.3	0.3
Central government net debt (in percent of GDP) 7/	51.7	53.2	53.7	63.5	62.9	60.4	58.3	57.3	56.2
Domestic	17.7	16.6	15.5	16.5	17.0	16.8	16.6	16.1	15.1
External	34.0	36.7	38.2	47.0	45.8	43.6	41.8	41.2	41.0
Money and credit (annual percent change)									
Net foreign assets	-49.6	13.9	33.0	42.6	7.5	13.6	10.0	12.7	14.2
Net domestic assets	19.2	0.9	-8.9	-6.1	10.5	6.2	5.5	2.7	-0.1
Of which: Credit to private sector	29.0	10.5	3.0	8.8	10.6	9.6	7.8	7.4	6.7
Broad money	1.8	8.9	5.4	3.5	9.3	9.1	7.4	6.9	6.2
Balance of payments (in millions of U.S. dollars)									
Exports, f.o.b.	1,849.3	2,019.4	2,214.5	2,032.8	2,080.2	2,062.3	2,052.6	1,938.5	1,816.6
Of which: Mineral	1,239.4	1,438.5	1,737.0	1,666.9	1,629.2	1,532.7	1,455.1	1,287.0	1,118.7
Imports, c.i.f.	-1,425.1	-1,525.1	-1,501.9	-1,466.3	-1,487.0	-1,477.1	-1,507.6	-1,489.3	-1,432.7
Current account	23.2	53.0	282.0	118.4	111.5	97.5	91.6	87.7	87.4
Overall balance	-189.1	43.8	70.1	32.3	20.0	65.6	62.3	48.0	58.7
Gross official reserves (in millions of U.S. dollars)	186.5	205.8	296.0	398.0	418.0	465.7	474.2	486.3	545.0
(In months of imports of goods and services)	2.0	2.0	3.1	4.3	4.4	4.9	4.8	4.7	5.4
Net official reserves (in millions of U.S. dollars)	138.9	182.9	256.0	290.0	309.4	374.8	436.9	484.8	543.5
(Percent of base money)	17.1	10.1	14.8	15.6	14.6	16.5	18.1	18.9	20.0
External assistance (in millions of U.S. dollars)									
Grants	215.4	181.5	188.0	173.2	170.2	152.9	152.3	151.8	151.3
Disbursements	52.5	160.9	100.6	166.7	86.8	122.8	122.2	120.5	120.0

Sources: Department of Treasury; Bank of Papua New Guinea; and Fund staff estimates and projections.

1/ Projections for 2001-06 are based on policies recommended by the mission.

2/ GDP figures for 1999 and 2000 are preliminary.

3/ Central government operations only.

4/ Derived as the difference between foreign savings and the public savings-investment balance.

5/ Assuming that the gap in 2002 will be closed by expenditure cuts.

6/ Includes changes in float.

7/ End-period.

PAPUA NEW GUINEA: FUND RELATIONS
(As of July 31, 2001)

I. Membership Status: Joined October 9, 1975; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	131.60	100.0
Fund holdings of currency	198.49	150.8
Reserve position in Fund	0.27	0.2

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	9.30	100.0
Holdings	8.41	90.5

IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
Stand-By Arrangement	67.16	51.0

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	3/29/00	5/28/01	85.54	66.66
Stand-by	7/14/95	12/15/97	71.48	35.34
Stand-by	7/31/91	9/30/92	26.36	0.00
Stand-by	4/25/90	6/24/91	26.36	0.00

VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	07/31/01	2001	2002	2003	2004	2005
Principal	0.0	0.5	0.0	11.9	33.3	21.4
Charges/interest	0.0	1.5	2.8	2.8	1.8	0.4
Total	0.0	2.0	2.8	14.8	35.1	21.8

VII. Exchange Rate Arrangement:

The kina was pegged to a basket of currencies of Papua New Guinea's major trading partners from December 1976 through October 1994. Kina trading was suspended on October 4, 1994, and the currency was floated as of October 10, 1994. Since August 14, 1995, the value of the kina has been determined through a screen-based foreign exchange market; this replaced the auction system initially introduced when the kina was floated. Exchange restrictions against Iraq were imposed in August 1990 and continue to be maintained in accordance with UN Security Council Resolution 661.

VIII. Article IV Consultation and the Stand-By Arrangement:

Papua New Guinea is on the standard 12-month consultation cycle. The last Article IV consultation discussions were held during July 24–August 6, 2000, and the consultation was concluded on October 13, 2000 (SM/00/226, EBS/00/53, and EBS/00/201).

A 14-month Stand-By Arrangement was approved by the Executive Board on March 29, 2000.

IX. Technical Assistance:

FAD: A mission visited Port Moresby in December 2000 to provide advice on the reconciliation of large and volatile differences in fiscal reporting based on information provided by the Department of Finance and Treasury and the information reported by the Bank of Papua New Guinea. A joint FAD/PFTAC mission in March 2000 assisted the authorities in filling out the self-assessment questionnaire on good fiscal practices.

LEG: A mission visited Port Moresby in November 1996 to provide advice on the legal framework for the National Value-Added Tax (NVAT).

MAE: A mission visited Port Moresby in June 2001 to conduct an assessment of the monetary policy implementation framework in Papua New Guinea. A mission visited Port Moresby in September 1995 to provide assistance in developing monetary instruments and primary and secondary markets. Missions in November 1997, June 1998, and January 1999 provided advice on banking supervision. Ongoing technical assistance is being provided for the current financial sector restructuring. In November 1999, an MAE mission reviewed technical assistance requirements.

PFTAC: A mission in May 1996 provided advice on fiscal reporting of provincial governments. In July 1996, a mission visited Port Moresby to provide assistance in upgrading bank supervision. A mission in January 1997 provided advice on implementation of the NVAT. A mission in March 1998 (in conjunction with the Asian Development Bank and AusAID) discussed financial management. A mission in November 30–December 11, 1998 provided assistance in the areas of national accounts and balance of payments statistics. A mission on March 13–24 reviewed statistical operations in the context of the GDDS. A mission in July 24–28, 2000 identified priorities for improvement of the National Statistical Office. A mission in early March 2001 was involved in discussions for the implementation of a Household Income and Expenditure Survey in late 2001.

STA: Four missions visited Port Moresby over the period August 1995 to April 1996 to provide advice on the compilation of national accounts.

X. Resident Representative:

A new post was opened in Papua New Guinea in May 2000 and is currently filled by Mr. M. Tareen.

PAPUA NEW GUINEA: RELATIONS WITH THE WORLD BANK GROUP
(As of August 24, 2001)

To date the World Bank has provided 33 IBRD loans and 13 IDA development credits amounting to $729.3 million and $115 million, respectively. There are eight active loans, totaling $206.2 million in commitments. This includes a $90 million Governance Promotion Adjustment Loan, approved in June 2000, of which $55 million has been disbursed. The first tranche of $35 million was disbursed in June 2000, and a floating tranche of $20 million in July 2001. Other loans are supporting investments and capacity-building in the agriculture and mining sectors, infrastructure development, and improvement of health and education services. New loans under preparation will support capacity-building for forest management, and road rehabilitation and periodic maintenance.

The World Bank's assistance strategy to Papua New Guinea aims to improve the governance framework for sustainable development and support more effective rural development. This comprises four elements: (a) provision of analytical support to develop a coherent set of macroeconomic and structural reforms; (b) provision of a judicious combination of balance of payments support, project, and technical assistance to assist reforms and build institutional capacity to sustain them; (c) coordination of donor assistance to Papua New Guinea through Consultative Group Meetings and bilateral arrangements with Australia, Japan, the Asian Development Bank, and other donors; and (d) working with NGOs and other civic organizations to improve service delivery, strengthen resource management, and engender broad-based ownership of reforms in the context of Fund/World Bank programs.

IFC, through the South Pacific Project Facility, has secured financing for eight projects to support small and medium-sized enterprises. IFC is currently reviewing a potential investment in Papua New Guinea's second largest bank, Bank South Pacific. Any IFC investment would be accompanied by extensive technical assistance.

IFC has invested $3 million (18 percent interest) in the Port Moresby-based Kula Fund which was established to invest in medium-sized enterprises in Pacific island countries. Kula Fund has made three investments in Papua New Guinea totaling $3.8 million since its establishment in March 1997.

The Multilateral Investment Guarantee Agency has facilitated a total of $892 million in foreign direct investment in Papua New Guinea. MIGA currently has one guarantee in Papua New Guinea, in the mining sector, worth $51 million in gross exposure.

Papua New Guinea: IBRD/IDA Lending Operations
(In millions of U.S. dollars)

	1995	1996	1997	1998	1999	2000	2001[1]
Loan approvals	50.0	0.0	0.0	5.0	25.3	107.0	0.0
Loan disbursements	34.3	21.3	48.1	13.6	8.0	43.1	26.8
Balance undisbursed (end period)	132.8	106.0	57.7	49.1	66.3	120.2	93.4

Source: Data provided by the World Bank.
[1]As of July 31, 2001.

PAPUA NEW GUINEA: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(As of July 31, 2001)

Through end-July 2001, the Asian Development Bank (AsDB) had approved 53 loans totaling \$774 million for 44 projects. Of this total, 23 loans (\$394 million) had been extended from ordinary capital resources and 30 loans (\$381 million) from special funds resources. In addition, \$35.0 million had been provided for 113 technical assistance projects.

With the overarching objective of alleviating poverty, the AsDB strategy for Papua New Guinea focuses on improved governance, private sector development, and improved social conditions. Poor governance and ineffective public sector management being the main development problems, AsDB is focusing on strengthening public sector financial management and enhancing public sector management. For private sector development, in addition to improving the supportive performance of the central agencies, AsDB will help improve sector policy and institutional frameworks (especially in agriculture and fisheries), enhance factor productivity (skills development and financial services), and improve market access by selected infrastructure investments (transport) especially in rural areas. In the social sectors, AsDB will continue to assist in policy development in health and to support infrastructure investments and service delivery, especially in rural areas.

In 2001, current plans now call for approval of a program loan of about \$60 million for public sector reform, as part of the government's ongoing structural reform program. Current plans envisage annual lending of about \$60 million during 2002–04. The current 2001 program for grant-financed technical assistance comprises six projects totaling about \$3.0 million.

Papua New Guinea: Loan Approvals and Disbursements, 1994–2000
(In millions of U.S. dollars)

	1994	1995	1996	1997	1998	1999	2000
Loan approvals	0.5	0.0	0.0	60.0	14.1	109.0	45.5
Loan disbursements	29.9	17.6	11.9	24.3	24.0	35.1	13.0

Source: Data provided by the AsDB.

[1]Prepared by Asian Development Bank staff.

Papua New Guinea: Social and Demographic Indicators

Area	452,860 square kilometers
Population 1/	5.1 million
Rate of growth 1/	3.1 percent per annum
Density 1/	11.3 persons per square kilometer
Population characteristics 2/	
Life expectancy at birth	58 years
Infant mortality	58 per thousand
Fertility rate	4.2 births per woman
School enrollment ratios 3/	
Primary	
Total	80 percent
Female	74 percent
Secondary	
Total	14 percent
Female	11 percent
Health 4/	
Population per physician	13,760
Population per hospital bed	248
Access to safe water 4/	
Total population	28 percent
Urban population	84 percent
Rural population	17 percent

Source: World Bank, World Development Indicators, 2001.

1/ Figures are based on the preliminary results of the 2000 Census of Population and Housing.
2/ Figures are for 1999.
3/ Figures are for 1995.
4/ Figures are for 1998.

Papua New Guinea: Statistical Issues

In general, the quality, coverage, and timeliness of economic statistical releases significantly impede the conduct of macroeconomic policy in Papua New Guinea. The National Statistical Office (NSO) is underfunded and suffers from a lack of staff, especially those with computer training. It has been unable to obtain and collate data from businesses and other government departments, even though it does have the legislative authority to do so. As a result, the only economic release it is able to produce on a somewhat timely basis is the Consumer Price Index (CPI). The NSO, with assistance from AusAid, completed the collections for the 2000 census and released the preliminary results in July 2001. Using some of the expertise and equipment it acquired for the census, the NSO intends to conduct a Household Income and Expenditure Survey (HIES) in 2002. The Bank of Papua New Guinea (BPNG) and the Department of Treasury produce most current data.

Monetary data are not available on a timely basis and are subject to revisions. The timeliness of monetary data reporting to the IMF's Statistics Department (STA) needs to be improved. The latest money and banking data for Papua New Guinea to be published in the September 2001 issue of *International Financial Statistics (IFS)* for the accounts of the monetary authorities and the deposit money banks are for May 2001.

The December 2000 FAD technical assistance mission identified several deficiencies that contribute to the discrepancy between monetary and fiscal accounts. These include the misclassification of government accounts by the commercial banks in their returns to BPNG, and the lack of an electronic registry for treasury bills.

National accounts: In July 2001, the NSO released a preliminary set of national accounts for 1999. As these figures are still subject to revisions due to problems in compiling the GDP deflators, they have not been used to update staff's estimates. In mid-2000, the NSO released a set of national income accounts: *National Income, Expenditure and Product, 1993–98*. These are compiled on a consistent basis with their previous published series (using the *1968 System of National Accounts*). The NSO is currently working toward moving to the *1993 System of National Accounts*. Estimates of GDP and its components are compiled on the basis of the production approach. Estimates are also provided by expenditure categories, with private final consumption calculated as the residual category.

A Pacific Financial Technical Assistance Centre mission in February 2001 identified several administrative sources that could be used to generate timely and accurate measures of business activity:

- Corporate income tax data from the Internal Revenue Commission (IRC): corporate profits, revenues and other financial data for 4,000 companies.
- Value-added tax data from the IRC: sales and inputs data for a broad range of businesses.
- Membership data from the superannuation funds: employment numbers for both the private and public sectors.

These partial measures of activity would be extremely useful for the formulation of macroeconomic policy. The government needs to ensure that the NSO is granted access to these data and that additional resources are provided to compile these series on a timely basis.

Prices: The only price data produced is a quarterly CPI; the main deficiencies include outdated weights that are based on consumption studies from the mid-1970s and the weakness of data collection. The NSO intends to use the results of the planned HIES to reweight the CPI. However, there is a need for technical assistance to computerize the collation and production of the CPI data, since this is currently done manually.

Government finance: While central government tax revenue statistics are generally accurate and timely, nontax revenue and public expenditure data are deficient. In particular, development budget expenditures and the utilization of grants and project loans are only recorded with large lags, and few records on the use of accrual trust accounts are available. Recently, however, the government has taken significant steps to improve government statistics. The timeliness of data after the end of the fiscal year and of current data throughout the year has improved. With the recent decision to pay market interest rates to all holders of government securities including the central bank, interest payment records should become fairly accurate. However, there are still some timing issues regarding the recording of interest on discount securities. No data are available on deferred pension liabilities to civil servants, and on provincial and local level government budgets, off-budget outlays and corresponding liabilities, and potentially large implicit transfers between the government and public enterprises.

The weaknesses in fiscal statistics lead to large discrepancies between observed domestic financing from monetary and debt data and the domestic financing requirement derived from fiscal data. The report of the December 2000 FAD technical assistance mission[1] identified the major deficiencies leading to this discrepancy. The authorities have agreed to implement the recommendations of the report and will request technical assistance from the Fund and Australia to assist them in doing so.

External sector: Although aggregate quarterly data on the balance of payments are published by the BPNG on a regular basis, the data reported to the Fund for publication are not timely. (The latest data published in the *IFS* are for the fourth quarter of 1999.) Balance of payments data are based on the exchange record system, which is not tightly monitored despite BPNG reporting requirements. The financial account data are of poor quality because of major deficiencies in data collection, especially in the areas of private external debt. In many cases, donors and lenders disburse funds directly to contractors for the purchase of goods and services, effectively bypassing the exchange record system. Therefore, a substantial proportion of current account and capital flows are not recorded. The authorities are attempting to address the problem with the coverage of the merchandise trade statistics by moving to customs-based data. The ASYCUDA customs system being used by the IRC now electronically records about 80 percent of trade transactions, but currently neither BPNG nor the NSO have the resources to access this database.

[1]Steven Symansky and others, "Papua New Guinea: Improving Fiscal Reporting," Fiscal Affairs Department, December 2000.

Papua New Guinea: Core Statistical Indicators
(As of August 22, 2001)

	Exchange Rate	Interna-tional Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/GNP	External Debt/Debt Service
Date of latest observation	08/10/01	08/10/01	06/30/01	06/30/01	06/30/01	08/06/01	2001 Q2	April 01	2001 Q1	06/30/01	1999	2001 Q1
Date received	08/16/01	08/16/01	07/17/01	07/17/01	07/17/01	08/16/01	09/05/01	6/27/01	07/17/01	07/17/01	07/17/01	07/17/01
Frequency of data 1/	D	W	M	M	M	W	Q	M	Q	M	A	Q
Frequency of reporting1/	D	W	M	M	M	W	Q	M	Q	M	A	Q
Source of data 2/	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 3/	C	C	C	C	C	C	C	M	M	O	V	M
Confidentiality 4/	C	D	D	D	D	C	D	C	C	C	C	C
Frequency of publication 1/	W	W	Q	Q	Q	Q	Q	M	Q	M	A	Q

1/ D-daily; W-weekly; M-monthly; Q-quarterly; A-annually.
2/ A-direct reporting by Bank of Papua New Guinea and/or Department for Treasury and Planning.
3/ C-fax; M-mail; O-Internet; V-obtained during mission and/or Annual Meetings.
4/ C-for unrestricted use; D-embargoed for a specified period and thereafter for unrestricted use.

Port Moresby, Papua New Guinea
August 31, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The attached Memorandum of Economic and Financial Policies supplements the understandings specified in our letters and attached memoranda to Mr. Fischer on March 20, 2000, and to you on October 2, 2000 and on April 6, 2001. It also describes the recent progress in implementing the economic policies and attaining the economic objectives of the Government of Papua New Guinea, which are supported by the Stand-By Arrangement approved by the Fund on March 29, 2000. As indicated in the Memorandum, we remain committed to achieving a sustainable fiscal position, reducing inflation, strengthening international reserves, and implementing structural reforms.

In support of these policies, the Government of Papua New Guinea hereby requests completion of the fourth review and the fifth and last purchase under the arrangement. The Government of Papua New Guinea also requests waivers for the nonobservance of the performance criteria for end-June 2001 on the floor of the net international reserves of the central bank of Papua New Guinea (BPNG) and the ceiling on the net domestic financing of the government. These criteria were not met largely as a result of a shortfall in tax revenue and the later-than-expected disbursement of the floating tranche under the World Bank's Governance Promotion Adjustment Loan.

In line with the commitment specified in our letter of intent of April 6, 2001, the Government of Papua New Guinea has decided to cut expenditure by K 80 million from the levels agreed at that time in order to offset in part the lower tax revenue now projected for 2001. Most of the cuts (K 47 million) became effective on July 21, with the remainder to be implemented in early September 2001. The Government agrees that implementation of these cuts will be a prior action for completing the fourth review under the program. Also, the Government will continue to adhere to the guidelines introduced in 2000 for the operation of the Rural Development Program, which are aimed at improving governance and the quality of expenditure.

The government remains committed to privatisation, including of the Papua New Guinea Banking Corporation (PNGBC), which was brought to the point of sale in April 2001 (prior action for the completion of the second and third reviews).

The Government of Papua New Guinea recognizes the importance of a close relationship with the Fund, among other things, to facilitate continued donor support, particularly in view of the country's vulnerability to shocks. The Government of Papua New Guinea will stand ready to take any additional measures necessary to keep the economic program on track, and it will remain in close consultation with the Fund, in accordance with Fund policies.

In the interest of solidifying private sector confidence through a commitment to transparency, the Government requests that the Fund publish the attached Memorandum.

Sincerely yours,

/s/	/s/
Hon. Sir Mekere Morauta, Kt, MP	Mr. L. Wilson Kamit, CBE
Prime Minister and Treasurer	Governor, Bank of Papua New Guinea

Attachment: Papua New Guinea: Supplementary Memorandum of Economic and Financial Policies

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOURTH REVIEW UNDER THE STAND-BY ARRANGEMENT

I. INTRODUCTION

1. The Government's policies continue to be guided by the macroeconomic adjustment and structural reform program described in the March 2000 Memorandum of Economic and Financial Policies and the October 2000 and April 2001 supplements. The Government's economic program continues to be developed in consultation with multilateral and bilateral donors.

II. PERFORMANCE UNDER THE PROGRAM

2. **Policy implementation in the first half of 2001 remained generally satisfactory.** While indicative targets for end-March and the quantitative performance criteria for end-June on the Bank of Papua New Guinea's net international reserves (NIR) and on the Government's net domestic financing (NDF) were not observed, the deviations resulted largely from a shortfall in tax revenue and the later-than-expected disbursement of the floating tranche under the World Bank's Governance Promotion Adjustment Loan (GPAL). The performance criterion on the Bank of Papua New Guinea's net domestic assets (NDA) was observed. Weaker-than-expected economic activity contributed to the revenue shortfall while complications in meeting World Bank conditionality delayed to mid-July the release of the floating tranche.

3. **Inflation has continued to decline, with the 12-month rate falling further to 9 percent for the quarter ending March 2001**. Economic activity, however, has remained weak. Both tax and monetary indicators point to a contraction in business activity despite recent declines in interest rates. The coffee industry has been adversely affected by depressed international prices, rising costs, deteriorated infrastructure, and the lack of bank credit due to a weakening in debt-service capacity. With mineral output expected to fall markedly and most nonmineral activities projected to stagnate, overall real GDP growth is likely to contract by 2 percent in 2001.

4. **The fiscal deficit was lower than programmed in the first half of 2001, but the domestic borrowing requirement was higher than expected**. Expenditure restraint helped address cash flow difficulties arising from the shortfalls in tax revenue and external financing relative to program projections. Nevertheless, the Government had to resort to larger-than-planned domestic borrowing, which led to a breach in the central bank's lending limit to the Government in March. To remedy this situation, the Government secured early release of the second tranche ($10 million) of the budgetary support loan from Australia that was tied to the completion of the second review under the Stand-By Arrangement (SBA). Even though the third tranche of the loan from Australia ($10 million) was received following completion by the Fund Board of the second and third reviews of the SBA, a substantial placement of government securities in the domestic market was required to fund government operations in the first half of 2001.

5. **Volatility in market sentiment has contributed to exchange rate fluctuations in 2001**. Due to noneconomic factors, the kina came under pressure in February and March, but pressures eased somewhat during the second quarter, as confidence recovered with the announcement of the financing from Australia and the Fund purchases associated with the second and third reviews.

6. **The central bank has viewed delays in external financing and noneconomic events affecting market sentiment as temporary in nature, selling foreign exchange to dampen exchange-rate volatility**. While this intervention contributed to a reserve loss of $29 million through end-March, net purchases permitted a recovery of NIR of around $13 million during the second quarter to $240 million.[1]

7. **The central bank has reduced its benchmark interest rate in recent months.** In response to the decline in inflation in the six-month period through end-March 2001, and cuts in interest rates in key partner countries, the central bank lowered the kina facility rate (KFR) on several occasions. As a result, commercial bank lending and deposit rates fell, and interest rates on treasury bills declined across all maturities. However, in the context of continued weak activity, monetary aggregates have grown at a relatively slow rate, with base and broad money both increasing by around 6½ percent over the year ending June 2001. Excluding a large loan extended by a single bank, bank credit to the private sector has grown by only 2½ percent during the same period.

8. **The external current account surplus is expected to decline to about 4 percent of GDP in 2001.** Both mineral and nonmineral exports are projected to decline as a result of lower coffee and oil production and depressed coffee prices. Also, imports are expected to fall as a result of weaker economic activity, including declining investment in the mineral sector. The capital account deficit is projected to moderate mainly as a result of a substantial increase in net official capital inflows. In all, the balance of payments is projected to remain in surplus, permitting a gain in NIR of $33 million in 2001, $10 million less than previously targeted under the program.

9. **The Government has moved forward with its privatisation agenda in recent months despite difficult circumstances.** The Papua New Guinea Banking Corporation (PNGBC) was brought to the point of sale in early April 2001, when the Government issued an Information Memorandum for the sale of PNGBC, advertised in the international press its decision to proceed with this sale, and solicited bids with the assistance of international financial advisors. Also in April, the Government, in consultation with the World Bank, formulated a plan for the privatisation of Motor Vehicle Insurance Limited. In early July, the Government took action that permitted the lifting of a court injunction against the sale of PNGBC. The injunction was issued in May in the context of a civil claim on PNGBC's parent company, Finance Pacific Limited, by a former executive. Preparations have

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[1] Valued at program exchange rates, NIR at end-June was $235 million.

continued for the privatisation of state enterprises, especially the development of the regulatory framework for the electricity, water, telecommunications, and port industries. The sale of Air Niugini, originally planned for March, was postponed because bids received were judged to be unsatisfactory, reflecting in part difficulties in the international airline industry. Subsequently, however, the Government initiated discussions with bidders on ways to involve private sector participation in the company.

10. **Progress has continued in public sector reform**. Functional reviews have been completed for the Departments of Finance and Treasury, Prime Minister and National Executive Council, Personnel Management, and Foreign Affairs, as well as for the National Fisheries Authority. In line with the recommendations emanating from functional review of the Foreign Affairs Department, three missions abroad were closed in July 2001. This, along with retrenchments of public servants in December 2000, should help rationalize expenditure and raise efficiency. A contract for a new integrated human resources management system was awarded in August to replace the outdated payroll system and personnel records. Adherence to the guidelines governing the implementation of the Rural Development Program (RDP) has improved governance and is expected to result in a more efficient use of resources, and current delays in project execution are likely to diminish as parliamentarians gain experience with the procedures. However, the Government remains concerned about these delays, and will seek to improve the pace of project execution in consultation with the World Bank.

III. Policies for the Remainder of 2001

11. **The Government remains committed to macroeconomic stabilization and economic reform**. The Government is determined to persevere with program implementation to help solidify confidence and create the conditions for an economic recovery. Consequently, it will adhere to the fiscal path agreed under the program and will work to meet multilateral conditionality on a timely basis. This is expected to facilitate the release of external assistance, including that envisaged for the remainder of 2001 to be disbursed by the World Bank, the Asian Development Bank, Japan, the European Union, and China.

12. **Notwithstanding the difficult economic environment, the Government's financial policy objectives remain broadly unchanged**. Policies continue to be aimed at reducing the rate of inflation to 8 percent by end-December 2001, and to further strengthen the international reserve position of the country. However, due to the weaker activity projected for 2001 and its adverse effect on the government finances, the fiscal deficit will now be slightly higher at 2.6 percent of GDP compared to 2.3 percent of GDP previously agreed, as full compensation for revenue underperformance will not be feasible. Nevertheless, this fiscal outturn will permit an increase in NIR to $290 million by end-December 2001, compared to the $300 million originally envisaged. In line with the commitment in the letter of intent of April 6, 2001, any net privatisation proceeds will be used to reduce net government debt.

Fiscal policy

13. **Early action to cut government expenditure will help limit the fiscal deficit to 2.6 percent of GDP in 2001.** In the absence of measures, the fiscal deficit would reach 3.4 percent of GDP in 2001, raising the domestic borrowing requirement substantially and thus placing pressure on credit and foreign exchange markets during the remainder of the year. Consequently, the Government has decided to cut K 80 million from the programmed level (one-third from goods and services and the remainder from development and other programs). Most of these cuts (K 47 million) became effective on July 21, with the remainder to be implemented in early September (prior action for the completion of the fourth review), following consultations with government departments to ensure adequate funding for essential services. Notwithstanding these cuts, government expenditure is projected to increase from 31 percent of GDP in 2000 to 32½ percent of GDP in 2001. In addition, the Government will refrain from wage increases beyond existing commitments as well as from increases in staffing (except for priority areas, namely education, health, revenue collection, law and order, infrastructure, and agriculture), which will help avoid a further rise in the government wage bill in relation to GDP.

14. **The revised fiscal plan for the second half of 2001 will allow the Government to meet its core functions and obligations without incurring arrears**. As the programs selected for cuts were underexecuted in the first half of the year, the expenditure reductions will help maintain quality control by avoiding too fast an acceleration in the budget execution rate, given limited implementation capacity. Further scope for expenditure reductions would occur during the second half of the year, if execution of the RDP continues to be slow. This would be in addition to the deferral of K 30 million of RDP expenditures adopted by the Government prior to the completion of the second and third reviews.

15. **The Government is committed to improving tax administration.** While lower output and imports and higher value-added tax refunds were key factors behind the revenue underperformance, slower-than-envisaged recovery of tax arrears also played a role. To improve conditions for tax administration, the Government will submit to Parliament by end-2001 legislation to increase penalties on tax evasion, and will also allocate additional staff to the Internal Revenue Commission, which will permit strengthening inspections, audits, and the prosecution of delinquencies. The Government will initiate a review of taxation of the forestry industry aimed at designing an equitable revenue-sharing arrangement among operators, landowners, and the State that fosters resource sustainability, the viability of the industry, and environmentally sound management.

16. **A number of risks apply to the fiscal plan.** A further weakening of economic activity could lower tax revenue from revised targets and delay dividend payments to the Treasury by selected enterprises. On the financing side, delays in the release of external resources ($85 million) envisaged to materialize late in the year would considerably increase the domestic borrowing requirement and lead to higher interest rates. More generally, the revenue, expenditure, and financing situation will need to be monitored very closely in the months ahead, with additional measures taken, if necessary, to achieve the fiscal targets for

2001. Given the Government's intention to maintain a stable tax system, further adjustment measures, if needed, would focus on reductions in spending.

Monetary and exchange rate policies

17. **BPNG will maintain monetary policy focused on attaining price stability**. While the support of fiscal policy is needed for achieving NDA and NIR targets, the central bank will stand ready to conduct open market sales to ensure adherence to these targets, even if interest rates need to firm. Treasury and BPNG will strengthen coordination with regard to short-term cash flow, debt, and liquidity management, which should prevent breaches of the limit on central bank lending to the government.

18. **BPNG will intervene in the foreign exchange market to smooth short-term volatility of exchange rates, while facilitating achievement of the NIR target**.

Structural reform policies

19. **The Government remains committed to the privatisation program.** In the weeks ahead the Government will provide qualified parties interested in purchasing PNGBC with the additional information necessary for conducting due diligence and preparing bids. The Government expects the sale of a controlling interest in this bank to take place during November or December 2001. The Government plans to divest through a People's Unit Trust (PUT) part of its remaining shares in PNGBC and shares in public utilities and other public enterprises. Buying shares sold by PUT would enable the general public to acquire a financial interest in privatised enterprises. As part of the work to develop the regulatory framework for utilities, the Government plans to establish early in 2002 a single authority to regulate these industries. The Government is also committed to formulating policy to ensure adequate provision of utility services to the rural areas.

20. **Further progress will be made on the Public Sector Reform Program, which is aimed at ensuring efficient use of budgetary resources and improving public service delivery**. During the second half of 2001 functional and expenditure reviews will be completed for the Departments of Health, Works and Transportation, Lands and Physical Planning, National Planning and Monitoring, and the Attorney General. Recommendations contained in reviews completed by October 2001 will be incorporated in the budget for 2002. The Government will continue to implement the RDP in accordance with guidelines designed with support from the World Bank in 2000.

21. **The new Superannuation and Life Insurance Acts, which were passed by Parliament in December 2000, will be gazetted by the end of 2001**. A task force has been established to draft necessary regulations in consultation with the industry and the BPNG, the supervising authority. Pension funds are preparing to meet the new requirements, which include the appointment of qualified trustees, and professional investment management. The National Provident Fund, which was in financial distress, has repaid its debt, and is expected to continue to improve its operations.

IV. Policies for 2002

22. **The Government will press forward with stabilization and reform in 2002.** To this end, it will formulate the budget for 2002 in a manner consistent with prudent fiscal management. Taking into account the need to facilitate an economic recovery, the Government intends to aim policies in 2002 to further reduce inflation and increasing NIR. Efforts in the structural area will continue to focus on improving governance, including through public sector reform, privatisation, and other efforts to facilitate private sector activity. Against the backdrop of the declining trend in mineral output, overall real GDP is expected to grow moderately on the strength of nonmineral output growth. In this context, the fiscal deficit will be reduced in order to limit the domestic borrowing requirement to a level consistent with adequate bank credit to the private sector. As mineral tax revenue is likely to fall in relation to GDP in 2002, overall expenditures will need to be restrained to ensure sustainability over the medium term. The external current account balance is projected to register a small surplus aided by a projected recovery in export prices for agricultural commodities, and a contraction in imports by the mineral sector.

V. Statistical and Technical Assistance Issues

23. **The Government recognizes that statistical weaknesses hamper policy formulation.** It intends to seek donor support to strengthen the capacity of the National Statistical Office to compile the national accounts and the price statistics, along the lines of recent recommendations from PFTAC. Priority will also be attached to conducting a household income and expenditure survey in the second half of 2001 that should permit the reweighting of the CPI in 2002. The Government will continue to work to implement the recommendations of the FAD mission that visited Port Moresby in December 2000 to address inconsistencies in the coverage and timing between monetary and fiscal statistics. In this regard, the BPNG will finalize and implement shortly a revision of the Manual of Reporting Framework for commercial banks that will improve the classification of government deposits in the monetary survey. The manual will be discussed with an FAD expert expected in the weeks ahead. This, along with the introduction of an electronic registry of government securities planned for 2002, will help improve the compilation of the monetary survey and reconciliation of government financing data. Efforts are under way to compile a database of financial and operating leases contracted by the public sector.

24. **BPNG will consider implementation of the recent MAE mission recommendations to improve monetary policy formulation and management.** In this regard, a draft of the proposed Master Repurchase Agreement has been circulated to the commercial banks for comment, and is expected to be adopted in the coming months. BPNG has changed the procedures for its weekly government securities auction to allow additional sales of oversubscribed maturities, subject to the overall amount remaining unchanged.

25. With regard to the Fund's Safeguards Assessment, BPNG has provided its 1999 audited accounts to the Fund staff, and is committed to continue to provide audit reports to Fund staff on a timely basis.

Table 1. Papua New Guinea: Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2000

	Dec. 31, 1999	Mar. 31, 2000			Jun. 30, 2000			Sep. 30, 2000			Dec. 31, 2000			
		Original Program Indicative Targets			Original Program Performance Criteria			Original Program Performance Criteria			Original Program Indicative Targets	Third Review Performance Criteria		
	Actual Stock	Unadjusted	Adjusted	Actual	Unadjusted	Adjusted	Actual	Unadjusted	Adjusted	Actual		Unadjusted	Adjusted	Actual
	(In millions of kina)													
Ceiling on net domestic assets of the central bank 1/, 2/, 3/	194	251	244	91	226	199	-102	83	158	-16	-144	-267	-131	-112
Ceiling on net domestic financing of the government 1/, 3/, 4/, 5/	1,548	59	45	-76	133	34	16	101	176	-30	-123	-156	-20	22
	(In millions of U.S. dollars)													
Floor on net international reserves of the central bank 1/, 6/, 7/, 8/	182	130	133	164	150	160	230	214	186	218	307	339	287	256
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the public sector with a maturity of over one year 4/, 8/, 9/	14	0	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the stock of public sector and publicly guaranteed nonconcessional short-term external debt with initial maturity of up to one year 4/, 8/, 10/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of external payments arrears by the public sector		Continuing												

1/ Figures in the "actual" column for December 1999, March 2000, and June 2000 have been revised slightly from those presented in EBS/00/201.
2/ Defined as reserve money less net foreign assets of the central bank.
3/ The ceiling on net domestic assets of the central bank and net domestic financing of the government will be adjusted downward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the Bank of Papua New Guinea (BPNG) foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) total net receipts from asset sales. Upward adjustments will be made by the amounts that the values of the following items fall short of the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow (to a maximum adjustment of K 20 million); (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow (to a maximum upward adjustment of $70 million); and (iii) total net receipts from asset sales. With respect to the adjuster in (iii), if net receipts from asset sales are negative, the value of net receipts from asset sales shall be set at zero for the purposes of comparison with the benchmark values in Table 4.
4/ Cumulative flow since the beginning of the year.
5/ For adjustments to the ceiling on net domestic financing of the government prior to September 2000 refer to IMF Staff Report EBS/00/53. From September 2000 onward the ceiling on net domestic financing of the government will be adjusted downward by the full amount of the excess of the sum of nontax revenue (excluding grants) and non-mineral tax revenue, less domestic interest payments over the program levels shown in Table 4.
6/ The floor on net international reserves of the central bank will be adjusted upward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) foreign currency-denominated net receipts from asset sales. Downward adjustment will be made by the amounts that the values of the following items fall short of the program targets laid out in Table 4: (i) MRSF receipts, as recorded in the BPNG foreign exchange cash flow (to a maximum downward adjustment of $7.6 million); (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow (to a maximum downward adjustment of $70 million); and (iii) foreign currency-denominated net receipts from asset sales. With respect to the adjuster in (iii), if net receipts from asset sales are negative, the value of net receipts from asset sales shall be set at zero for the purposes of comparison with the benchmark values in Table 4.
7/ Valued at the program exchange rates.
8/ The public sector is defined to include the national and provincial governments, and statutory authorities. Excluded from the limits on external borrowing are the use of Fund resources, loans from the World Bank, the Asian Development Bank, and other multilateral and official bilateral donors; loans contracted for debt rescheduling or refinancing (provided the terms of the new loans are at least as concessionary as the terms of the debt being rescheduled or refinanced); and credits that are regarded as concessionary.
9/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines con Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are leases.
10/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Excluded from this performance criterion are normal import-related trade credit and leases. Included in this performance criterion are off-balance sheet assets and liabilities (e.g., swaps and forwards).

Table 2. Papua New Guinea: Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2001

	Dec. 31, 2000	Mar. 31, 2001			Jun. 30, 2001				Sep. 30, 2001		Dec. 31, 2001	
									Indicative Targets		Indicative Targets	
	Actual	Indicative Targets			Performance Criteria				Second	Fourth	Second	Fourth
	Stock	Unadjusted	Adjusted	Actual 1/	Unadjusted	Adjusted	Actual 1/	Actual 2/	and Third Reviews 1/	Review 2/	and Third Reviews 1/	Review 2/
						(In millions of kina)						
Ceiling on net domestic assets of the central bank 3/, 4/	-112	-11	-42	-41	-40	-55	-96	-253	-183	-196	-174	-361
Ceiling on net domestic financing of the government 5/, 6/, 7/	1,569	187	156	172	133	118	186	186	-12	229	47	106
						(In millions of U.S. dollars)						
Floor on net international reserves of the central bank 7/	256	217	229	227	232	238	235	240	292	230	300	290
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the public sector with a maturity of over one year 5/, 8/, 9/	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the stock of public sector and publicly guaranteed nonconcessional short-term external debt with initial maturity of up to one year 5/, 8/, 10/	0	0	0	0	0	0	0	0	0	0	0	0
Nonaccumulation of external payments arrears by the public sector	Continuing											

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ Net international reserves and net domestic assets of the central bank are valued at the original program exchange rates, which were US$1.3713/SDR and US$0.38/kina.

2/ Net international reserves and net domestic assets of the central bank are valued at the revised program exchange rates for September and December 2001, which are US$1.2457/SDR and US$0.31/kina.

3/ Defined as reserve money less net foreign assets of the central bank.

4/ The ceiling on net domestic assets of the central bank will be adjusted downward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; and (iii) foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate. Upward adjustment will be made by the amount that mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out in Table 4 (to a maximum adjustment of K 20 million). Upward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out Table 4 (to a maximum adjustment of K 26.4 million). Upward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate.

5/ Cumulative flow since the beginning of the year.

6/ The ceiling on net domestic financing of the government will be adjusted downward by the full amount of the excess of the sum of nontax revenue (excluding grants) and nonmineral tax revenue, less domestic interest payments over the program levels shown in Table 4. Downward adjustment will be made by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate; and (iii) total net receipts from asset sales. Upward adjustment will be made by the amount that mineral tax receipts, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out in Table 4. (to a maximum adjustment of K 20 million). Upward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow and converted into kina at the program exchange rate are less than the program targets laid out Table 4 (to a maximum adjustment of K 26.4 million). Upward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales, converted into kina at the program exchange rate.

7/ The floor on net international reserves of the central bank will be adjusted upward by the full extent to which the value of the following items exceeds the program targets laid out in Table 4: (i) mineral tax receipts, as recorded in the BPNG foreign exchange cash flow; (ii) exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow; and (iii) foreign currency-denominated net receipts from asset sales. Downward adjustment will be made by the amount that the value of mineral tax receipts, as recorded in the BPNG foreign exchange cash flow, is less than the amount indicated in Table 4 (to a maximum downward adjustment of $7.6 million). Downward adjustment will be made by the amount that exceptional external financing flows to the budget, as recorded in the BPNG foreign exchange cash flow are less than the amount indicated in Table 4 (to a maximum downward adjustment of $10 million). Downward adjustment will also be made by the full amount of any external debt repayment made ahead of schedule with the prior agreement of Fund staff and funded by foreign currency-denominated net receipts from asset sales.

8/ The public sector is defined to include the national and provincial governments, and statutory authorities. Excluded from the limits on external borrowing are the use of Fund resources, loans from the World Bank, the Asian Development Bank, and other multilateral and official bilateral donors; loans contracted for debt rescheduling or refinancing (provided the terms of the new loans are at least as concessionary as the terms of the debt being rescheduled or refinanced); and credits that are regarded as concessionary.

9/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are leases.

10/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Excluded from this performance criterion are normal import-related trade credit and leases. Included in this performance criterion are off-balance sheet assets and liabilities (e.g., swaps and forwards).

Table 3. Papua New Guinea: Prior Actions, Structural Performance Criteria, and Benchmarks Under the Stand-By Arrangement, 2000-01

	Program Target Date	Status
I. Prior actions for first review.		
Endorsement by cabinet of a plan and timetable for the Public Sector Reform Program (PSRP).		Observed.
II. Prior actions for the second and third reviews.		
Bringing the Papua New Guinea Banking Corporation (PNGBC) to the point of sale.		Observed.
Rescission of central bank guarantee to PNGBC.		Observed.
II. Prior actions for the fourth review.		
Implementation of central government expenditure cuts totalling K 33 million.		
III. Structural performance criteria.		
Completion of financial and managerial audits of the two major pension funds: the Public Officers' Superannuation Fund (POSF) and the National Provident Fund (NPF).	By end-March 2000.	Observed.
Passage by parliament of the Central Bank Act.	By end-April 2000.	Observed.
Passage by parliament of the Bank and Financial Institutions Act.	By end-April 2000.	Observed.
Completion and submission to cabinet of the design and timetable for the public sector reform program.	By end-June 2000.	Not observed by target date. Waiver requested based on subsequent completion (see above).
Finance Pacific brought to the point of sale.	By end-December 2000.	Not observed. Waiver requested based on bringing PNGBC to the point of sale as a prior action for completing the second and third reviews.
IV. Structural benchmarks.		
The self-assessment questionnaire on good fiscal practices will be completed and submitted to the Fund.	By end-March 2000.	Observed.
The Privatization Commission will have identified candidates for privatization and will have formulated a detailed schedule and methodology to be employed.	By end-March 2000.	Observed.
Actuarial reviews of the NPF and POSF will have begun.	By end-April 2000.	Superseded by future comprehensive industry reform.
Endorsement by cabinet of the recommendations on the PSRP.	By end-August 2000.	Observed, also a prior action for the first review (see above).
Endorsement by cabinet of the recommendations of the Public Expenditure Review.	By end-August 2000.	Replaced by ongoing departmental reviews.
Cabinet approval of the tax system review.	By end-September 2000.	Not observed by the target date. However, the tax review was presented to cabinet in October 2000 and recommendations incorporated into the 2001 budget enacted by parliament.
Ongoing effort to close down remaining pyramid schemes.	Continuing.	

Table 4. Papua New Guinea: Quantitative Benchmarks Under the Stand-By Arrangement, 2000-01

	Actual							Indicative Targets								
								Original Program			First Review	Second and Third Reviews		Fourth Review	
	Dec. 31	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Sep 30.	Dec. 31
	1999	2000				2001		2000				2001			
	(In millions of kina, cumulative from the beginning of each year)														
Ceiling on central government wages and salaries 1/	777	149	364	567	813	185	419	144	377	570	814	185	414	622	859
Ceiling on central government recurrent expenditures 2/, 3/, 4/	2,015	470	1,016	1,520	2,219	485	1,012	436	1,006	1,515	...	...	...	...	...
Ceiling on central government noninterest recurrent expenditures 2/, 3/, 5/	1,628	364	790	1,192	1,790	367	793	372	815	1,236	1,705	410	835	1,254	1,801
Floor on pre-1999 domestic arrears reduction 6/	149	40	64	75	193	11	14	37	77	99	109	...	...	...	...
Floor on nonmineral tax revenue 7/	1,662	402	935	1,391	1,888	420	870	393	842	1,318	1,931	476	1,022	1,391	1,950
	(In millions of U.S. dollars, cumulative from the beginning of each year)														
Floor on mineral tax receipts 8/	131	8	54	92	147	9	49	5	43	74	129	8	33	77	116
Memorandum items:															
Exceptional external financing (in millions of U.S. dollars) 8/	80	0	35	35	70	14	24	0	36	81	180	4	49	49	138
Privatization receipts, net of cost of sales (in millions of kina) 9/, 10/	26	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Of which: Foreign currency denominated															
In millions of kina 9/, 11/	...	...	...	0	0	0	0	0	0	0	0	0	0	0	0
In millions of U.S. dollars 9/, 11/	...	...	...	0	0	0	0	0	0	0	0	0	0	0	0
Nontax revenue	166	26	56	102	145	19	73	19	92	148	169	20	47	150	209
Domestic interest payments	261	79	159	226	284	87	143	42	123	175	317	88	143	207	268

Sources: Data provided by the Papua New Guinea authorities; and Fund staff estimates and projections.

1/ Defined as sum of national and provincial department expenditures on wages and salaries including wages and salaries for teachers of provincial governments (items 111, 112, 113, 141) but excluding retrenchment allowances, contributions to superannuation funds, and some other benefits (leave benefits (item 114) and education benefits (item 116)).
2/ Refers to gross expenditure, including spending on services provided by the Department of Works to the rest of the government. A corresponding amount is recorded as nontax revenue.
3/ The benchmark on total recurrent expenditure in the original program was modified to noninterest recurrent expenditure at the time of the first review.
4/ Includes net lending.
5/ Excludes net lending.
6/ Amount for December 31, 2000 includes K 68 million in identified pre-1999 arrears, and the remainder may also include the clearance of arrears incurred in 1999. There are no floors set for 2001, as remaining pre-1999 claims are under dispute subject to court decision.
7/ In 1999 excludes VAT revenue collected in trust accounts.
8/ As recorded in the foreign exchange cash flow of the Bank of Papua New Guinea. Prior to 2001 these figures refer to MRSF receipts.
9/ Net revenues from the privatization of the Halla Cement Company in the third quarter of 2000 are set at zero because the costs of sales were greater than the receipts.
10/ As reported by the Department of Treasury.
11/ As recorded in the balance of payments of the Bank of Papua New Guinea.

Statement by the IMF Staff Representative
September 26, 2001

1. The following information, which does not change the substance of the staff appraisal in EBS/01/159, has become available since the staff report was issued.

2. The prior action for the Fourth Review of the Stand-By Arrangement has been completed. In a circular to heads of government departments and statutory authorities dated August 8, 2001, the Treasury Secretary specified K 79.8 million in expenditure cuts, including K 33 million agreed as a prior action for the completion of the Fourth Review. These cuts have been reflected in revised annual warrant ceilings in the Public Planning and Budgetary System.

3. On September 10, 2001, the Bank of Papua New Guinea, citing the recent declines in inflation and the weak state of the economy, reduced its indicator Kina Facility Rate by 100 basis points to 12 percent, following a similar cut in July. The last mission had recommended a more gradual reduction of interest rates, particularly because of the risks of delays in external financing. However, in the context of continued weakness in domestic credit demand and the latest reductions in interest rates in major world markets, the current level of interest rates in Papua New Guinea appears appropriate.

4. Net official international reserves are estimated to have risen from \$240 million at end-June to \$275 million as of September 7, 2001, compared with an indicative target of \$230 million for end-September and \$290 million for end-December. The comparatively high level of reserves is largely related to a better than expected fiscal performance, as there are indications that government revenue has been higher than programmed.

5. The recent change in the external environment is not expected to have an immediate effect on economic conditions in Papua New Guinea because foreign portfolio investment in the country and reliance on commercial financing are limited. However, prospects for 2002 and the medium term are highly sensitive to the evolution of world commodity prices and interest rate developments in major financial markets. More than two-thirds of exports are accounted by oil, gold, copper, and coffee; the country does not export manufactures; and earnings from tourism are not significant. Around 25 percent of the central government external debt, contracted mainly with official creditors, is linked to LIBOR. Consequently, major changes in the prices of these commodities and/or in world interest rates (including the effects of a weakening in the world economy) would have a significant impact on Papua New Guinea's external current account, as well as on tax revenue and the government interest bill.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/95
FOR IMMEDIATE RELEASE
September 24, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Fourth Review of Papua New Guinea Program, Approves US$24 Million Credit

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Papua New Guinea's performance under a Stand-by Arrangement, which enables the release of SDR 18.885 million (about US$24 million). The Executive Board's decision will bring total disbursements to Papua New Guinea under the Stand-by Arrangement to SDR 85.54 million (about US$111 million).

At the conclusion of the Executive Board discussions of Papua New Guinea's economic program, Eduardo Aninat, Deputy Managing Director, stated:

"Despite difficult political and economic circumstances, Papua New Guinea has made progress toward stabilization and structural reform under the program supported by the Stand-By Arrangement. Inflation has declined and official international reserves have increased over the course of the program period. Structural reform has also progressed, albeit at a slower pace than previously anticipated. The weak state of the economy led to a shortfall in tax revenue during the first half of 2001, but the authorities cut government expenditure to limit the overall fiscal deficit while protecting the provision of essential social spending.

"The authorities should continue to monitor the fiscal position closely, and stand ready to take corrective measures in order to safeguard the government's macroeconomic objectives. Close collaboration with multilateral agencies and bilateral donors and effective provision of technical assistance will be essential to ensure that agreed structural reforms are completed in the near future, thus allowing the timely release of the external financing expected to materialize during the fourth quarter of 2001 and beyond.

"In the period ahead, monetary policy should be focused on reducing inflation and strengthening the official international reserve position. The credibility of the authorities' macroeconomic policies will also be closely linked to the implementation of a prudent budget for 2002. External financing of the budget would need to be secured for 2002. Expenditure restraint, including through wage moderation and increased efficiency in the delivery of services, will need to be observed and the size of the deficit limited to available non-inflationary financing.

"The authorities intend to press ahead with their structural reform agenda. Proceeding with privatization of key public sector entities and improving governance will be critical," Mr. Aninat said.

Statement by Michael J. Callaghan, Executive Director for Papua New Guinea
September 24, 2001

The past six months have clearly demonstrated the commitment of the Papua New Guinea Government to pursing macroeconomic stabilization policies and a comprehensive program of structural reforms.

The Government has continued to pursue its comprehensive reform agenda, notwithstanding very difficult economic and political conditions, because it recognizes that achieving a sustainable fiscal position, reducing inflation, strengthening international reserves and implementing structural reforms are vital to lifting the growth performance of the economy and the economic well-being of its citizens.

The economic, social and political environment has been particularly difficult. The Government faced military unrest in March in response to proposals to reduce the defense forces; anti-privatization and anti-reform protests in June which resulted in the deaths of four demonstrators; and strike action by employees of the Papua New Guinea Banking Corporation (PNGBC) in response to the plans to privatize the Corporation.

These conditions have made the challenge of achieving program outcomes significantly more difficult, in a situation where significant capacity constraints already exist. Yet notwithstanding these difficulties, which have been compounded by a weaker domestic economy and a deterioration in the international economic environment along with delays in external financing, the Papua New Guinea Government has persevered and achieved much in its efforts to stabilize and reform the economy. In particular, the Government has pursued and further developed its structural reform agenda, as well as limiting the fiscal deficit and ensuring that monetary policy is directed towards lowering inflation.

In pursuing these policies, my authorities have greatly appreciated the advice and support provided by the Fund. They value the effective working relationship they have with Fund staff, including the Fund's resident representative, as well as the support they have received from Fund management.

Macroeconomic Performance and Policy

The domestic economy has weakened over the past six months, with the construction, retail and wholesale trade sectors declining. The coffee industry in particular has been affected by weak international prices, rising costs, deteriorating infrastructure and a lack of bank credit. Economic activity has also been adversely affected by social disturbances.

On the positive side, inflation has continued to decline. The latest inflation figures, for the year to June 2001, show the 12-month rate falling further to 7.9 per cent. This compares with an inflation rate of 21.8 per cent for the year to June 2000.

The Government kept a tight rein on expenditure so as to address cash flow difficulties arising from shortfalls in tax revenue and external financing. The authorities responded decisively with additional expenditure cuts in the context of the Fourth Review to keep the deficit on a path consistent with program objectives. In making these cuts, priority has been given to ensuring there is no impediment to the delivery of essential services.

To improve cash flow management, particularly given risks in relation to external financing, the Government is enhancing the scope for domestic borrowing. This is being done via the issuance of longer-term government securities – up to K105 million in one–year notes will be issued in three tranches over coming months. This would allow the retirement of treasury bills and give greater flexibility in debt management.

With a view to improving monetary policy formulation and management, the Government is considering implementing the recommendations arising from the recent MAE technical assistance mission.

Structural Reform

The Government is actively advancing a comprehensive structural reform agenda, with privatization a key focus of the reforms. Private sector provision of all services has been an integral part of the Government's policy agenda since it took office in mid-1999.

However, as is the case in many countries – developed and developing alike – privatization plans have been met with significant domestic opposition. Against this background, the government has strengthened its communication strategy to explain the benefits of, and build support for, the structural reforms, and in particular privatization. Prime Minister Morauta has been particularly active in defending the Government's reform agenda and, in the face of strong domestic political opposition, explaining the importance of maintaining a close relationship with the Fund and other multilateral organizations.

To address some of the concerns that have been raised, the Cabinet recently approved principles for the community service obligations for privatized government businesses, including Air Nuigini, Telikom, Elcom, the Harbors Board, Post PNG, Eda Ranu and the Water Board. Cabinet also endorsed the establishment of an independent regulator designed to ensure that the services provided after state enterprises are privatized are efficient, better and less costly. The independent regulator will be established by an Act of Parliament and will have a key regulatory role in the electricity, telecommunications, postal services, harbors and water sectors. The Government has also announced the creation of the People's Unit Trust to ensure that a broad base of Papua New Guinean ownership is possible.

Turning to more specific aspects of the privatization program, following bringing PNGBC to the point of the sale at the time of the last review, further steps have been taken to advance the sale, including presentations to interested parties. The Government expects that the sale of 51 per cent of the business to a banking investor will be completed this year.

At the time of the last review, I noted that although the national airline (Air Nuigini) had been brought to the point of sale and expressions of interest had been received, the Government had decided to delay the sale. Given the state of the aviation industry, and the global environment more generally, the sale is still on hold but steps have been taken to improve the efficiency of the airline. A new management team is in place and is pursuing a comprehensive value enhancement program.

Several functional reviews of government departments have been completed and reviews of the Departments of Health, Works and Transportation, Lands and Physical Planning, National Planning and Monitoring, and the Attorney General are expected to be completed before the end of the year. The results review completed by October will be taken into consideration in formulating the 2002 budget.

Public sector reform is a fundamental aspect of the Government's reform efforts and towards this end it has requested a loan from the Asian Development Bank to improve government administration. Policy action has already commenced.

The Government has also enhanced efforts to meet the conditions for the release of the second tranche of funds under the World Bank's Governance Promotion Adjustment Loan. The range of measures covered by this loan are very broad and complex and the authorities are fully committed to implementing the identified improvements in government administration, despite the significant technical capacity limitations they face. Any delays in the release of funds under this loan or from other multilateral agencies can pose significant cash flow problems for the authorities, and can result in the need for difficult further expenditure reductions, including expenditure on developmental needs.

The Government is progressing reforms to the superannuation and life insurance industries. Parliament has passed legislation that provides a basic framework for the prudential supervision of these industries. Before this legislation is gazetted, however, there is a need to further develop the broader policy settings. This will be done in consultation with all interested parties and towards this end the Government has appointed a task force to advise on the development of the architecture for the superannuation and life insurance industries.

Program Performance

In order to complete the Fourth Review, my authorities are requesting waivers for the non-observance of performance criteria for end-June 2001. As staff notes, program performance through end June was significantly affected by difficult economic and political circumstances. It was also affected by delays in access to external sources of financing.

The performance criterion on the central bank's net domestic assets (NDA) was observed with a comfortable margin. However, the end-June performance criteria on the central bank's net international reserves (NIR) and the government's net domestic financing (NDF) were not observed. These deviations arose largely as a result of later than expected disbursement of the $20 million floating tranche under the World Bank's Governance Promotion Adjustment Loan and a shortfall in tax revenue associated with weaker than expected economic activity.

The condition for the release of the $20 million from the World Bank was to bring the PNGBC to the point of sale. While the authorities had completed all necessary steps to bring the Corporation to the point of sale, court injunctions were granted against the sale. The authorities took all necessary actions to ensure that the injunctions were lifted. However, the resulting delay in the disbursement of funds under the World Bank loan caused significant difficulties for the Government, including meeting the NIR performance criterion.

In terms of the lower than expected tax revenue, as agreed in the context of the second and third reviews, the authorities cut expenditure to compensate for the tax revenue shortfalls. However, despite this action, delays in external financing required larger than planned domestic borrowing in the first half of 2001.

In the circumstances, I believe that the authorities' request for waivers for the non-observance of performance criteria should be supported and the Fourth Review under the Stand-By Arrangement completed.

Statistical Issues

My authorities are keenly aware of the statistical shortcomings referred to in the staff report and are taking steps to implement the required improvements. In this regard, they value the technical assistance provided by the Fund.

Conclusion

The PNG government has persevered in implementing much-needed reforms against the background of a very difficult economic and political environment, particularly over the past six months, and it deserves commendation and support for its achievements to date and its ongoing commitment to reform. We often talk about the importance of ownership when it comes to Fund programs. I believe there can be no question about the authorities' ownership of the reform agenda which has been supported by this Stand-By Arrangement. If there was any questioning of the reform credentials of the Papua New Guinea Government, it would have abandoned its ambitious reform agenda much earlier, and well before it confronted the many difficulties of the past six months. However, it has persevered with a fundamental restructuring of the economy because it firmly believes that this is necessary to enhance the long term well-being of the Papua New Guinean people.