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'The Challenge for Pacific Leaders: Economic Growth and Reform"

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Introduction: Pacific Islands Today

Mention of Pacific Islands once conjured up images of idyllic islands whose inhabitants valued leisure higher than any other activity, and had a lifestyle that was largely self-sufficient and affluent in the traditional sense.

Today the image is different – one of island states whose viability is threatened, not just by the volcanic rumblings of the "Ring of Fire" but, for some, from the effects of global warming and, for all, from the forces unleashed by globalisation and, more seriously, from the failure of governments to understand fully the existing and looming challenges.

What can Pacific Islands do to abate global warming? What can Pacific Islands do to withstand the forces of globalisation and growing bilateral trade arrangements between large economies? How can Pacific Islands position themselves to benefit from opportunities created by globalisation? How can Pacific Islands tackle the problems they themselves have created?

High rates of population growth, unsustainable exploitation of depletable natural resources, unemployment, poverty, public sector inefficiencies and lack of capacity, inadequate health and education services, inadequate and deteriorating infrastructure, and corruption, are fuelling social unrest, political instability and lawlessness. These problems exist to varying degrees in Papua New Guinea, the Solomon Islands, East Timor, Vanuatu, Nauru and Fiji, and remain real risks for most other of our neighbours. For some, particularly Papua New Guinea, the problems are exacerbated by high and rapidly increasing rates of HIV infection.

Pacific Islands Future

The overriding challenge we face is to increase productivity, and to grow and sustain our economies at much higher rates than in the past. That will take rebuilding the structure of our economies; it will take greatly increased private sector investment; it will take a switch in public investment; it will take political and economic reforms.

Dr Satish Chand has outlined the rate and type of economic growth required for Pacific economies to absorb their growing labour force, improve incomes and provide adequate services. The figures are stark, but compelling. To ignore these issues any longer risks condemning Pacific Islanders to poverty and an uncertain future.

I want to focus on specific aspects of the political, institutional and micro-economic reforms that I undertook, to show that reform is possible if leaders are committed to the need for action.

Reform in Papua New Guinea 1999-2002

When I became Prime Minister in 1999, the country was on the verge of collapse.

- Decision-making processes had weakened considerably, allowing narrow interest groups to exercise undue influence;
- Frequent changes of government had led to policies and decisions being made primarily for political profit;
- The key institutions of state were foundering;
- The economy was stagnant and public finances were sliding towards bankruptcy;
- Foreign exchange reserves had dwindled to less than one week's general import cover and the currency was facing inconvertibility;
- Multilateral agencies had withdrawn, and major bilateral donor governments were considering withholding support.

I had to act to halt the downward slide and lay the foundation for future political stability and economic growth. In doing so, I faced opposition.

The opposition was organised by politicians and their associates, for political advantage or because they benefited either directly or indirectly from the old system. They took advantage of peoples' emotions, lack of knowledge and understanding, fear and uncertainty. They spread lies about the purpose and process of reform. Indeed I faced violent opposition to some of the changes I introduced, including an army mutiny and student riot that tragically ended in the death of two students in a clash with the police. A futile Commission of Inquiry into the sale of PNG Banking Corporation was commissioned by the new government in 2002, which found no impropriety whatsoever, but cost the taxpayer over K12 million.

Despite such opposition, and after seeking advice and consulting widely, I was convinced that the reforms were in the nation's long-term interest. History has proven me correct.

What then were some of these reforms?

Political Reform

On the political front, Parliament enacted the Organic Law on the Integrity of Political Parties and Candidates, to strengthen and regulate the political party system.

Its provisions include a requirement for parties to have and to follow constitutions that had legal effect; to file annual financial returns and to elect office bearers with statutory obligations; a requirement for parties and candidates to declare the source of all contributions and account for all campaign expenditure; a limit on individual and corporate contributions to any one party or candidate; and measures to prevent individual Members of Parliament from jumping to different horses for political expediency. Thus members of a party were locked into remaining with that party except in specified circumstances, and were obliged to vote in accordance with party resolutions on election of a Prime Minister, votes of no confidence, the budget and on constitutional amendments.

The result is that for the first time ever, a Government will see out a full five-year term. The current Government has ridden on the wave of this reform but unfortunately done nothing to further strengthen the party system. I hope the next Government will.

Electoral Reform

Limited preferential voting was introduced, again by constitutional amendment, to ensure that those elected represented a majority of the electorate, and provide a greater chance for election of women. Under the previous first-past-the-post system, many Members of Parliament were elected with even less than 5 per cent of the votes cast.

Financial Sector Reform

Central Bank; and Superannuation Industry

The powers of the Central Bank were strengthened. It was made more independent. The Governor was given sole responsibility for the formulation and implementation of monetary policy. The supervisory functions of the Bank were strengthened and extended to include superannuation and insurance companies under its regulatory purview.

A durable wall was erected to insulate the operation and assets of super funds from political interference. Government representation on super fund boards was removed; the powers of the Minister for Finance to approve investments and determine the composition of investment portfolios were also removed.

The turnaround in the financial fortunes of the large funds has been monumental. When I took office, Nasfund (the major private sector fund) was virtually insolvent, with debt of K154 million. The Government provided half of the required rescue package of K125 million, with employers and members jointly contributing the balance, resulting in a write-down of members' accumulated savings of 15% instead of 51%.

In 2005 Nasfund achieved after-tax profit of K160 million, allowing interest of 29% to be credited to members for the year. Compare this with the losses made in 1998/99 of K176 million. The assets of Nasfund are now more than six times the level of 1999.

The two other large super funds, the Public Officers and Defence Force funds, have also benefited from the absence of Government influence and intervention. Their combined asset value has quadrupled in the last 5 years. Today, the asset value of the 3 funds is around K2.6 billion, making the funds major savers, major players in the domestic investment market and owners of an increasing stock of liquid assets.

Commercial Investments

In addition to establishing the legislative base for a more independent public service, and initial steps to restructure the public service, a programme of removing state involvement in the commercial sector, which had been fertile ground for corruption, was begun. All state enterprises suffered from operational inefficiency, technically poor and politically compliant management, lack of capital and lack of capacity to deliver services. Key infrastructure in telecommunication, power, air transport, ports and banking were in state hands and, through their inefficiencies, were retarding economic development and adding to and maintaining an unsustainable cost structure.

I took the decision that provision of reliable services at affordable costs was more important to the nation than ownership of the organisations that provided the services. The strategy was to bring in new partners with new capital and to improve management, but for Government to retain some shareholding in order to benefit from the expected growth in asset value and dividend flows.

The businesses that I had time to 'privatise' in this manner have subsequently prospered. The ones that remained, particularly Telikom and PNG Powa, are now charging exorbitant prices for still unreliable services, contributing to the excessive cost of doing business in Papua New Guinea and keeping services out of the reach of ordinary people.

<u>Orogen-Oil Search</u>

Orogen Ltd, the state-owned company with passive minority equity holdings in a number of mining and petroleum companies, was merged with Oil Search, making Oil Search the largest Papua New Guinean company on the Australian Stock Exchange. It is the largest oil operator in the country and the major champion of the Gas project. In addition to a significant cash payment for Orogen, the Government received 18% equity in Oil Search. That equity is now worth more than 3 times the value at the time of merger (April 2002), currently ranging between AUD750 and 800 million.

<u>PNGBC-BSP</u>

The merger of the state-owned PNG Banking Corporation with Bank South Pacific is a major success story. PNGBC had reached a point of collapse and prior to the merger was under the management of the Central Bank. As the largest commercial bank in the country, with 60% market share, its sinking would have created a financial and economic tsunami, capable of paralysing the financial sector and the economy.

Since the merger of 2002, the bank's assets have grown 61%. Its operating profit in 2005 was K143 million – compare this with an operating loss of K41 million in 2000. BSP post-merger has paid more tax than the total tax paid by PNGBC from the early 1970s. The branch network of the bank has increased, and BSP has operations in 3 other Pacific countries. The value of the government share in BSP is now worth more than five times its value in 2002, at over half a billion kina.

PNGBC was often referred to as "the people's bank", particularly by those opposing its sale. It was never the people's bank – it was "the leaders' bank". In 2000 when the Central Bank stepped in, provision had to be made for doubtful debts of K145 million. 85% of these bad loans were to politicians or their associates.

Among the top 20 shareholders in BSP are the 3 large super funds, landowner groups, Teachers and other Savings and Loans societies. These organisations have a membership of over 350,000 people. With the Government, they own 96% of the bank. Bank South Pacific can now in a true sense be called "the people's bank".

The combined value of the government share of Oil Search and BSP is now around 2.5 billion kina, more than half the nation's annual budget.

<u>Ok Tedi and PNGSDP</u>

Another story is worthy of mention, as a demonstration of the potential for productive use of revenues from resource projects. Papua New Guinea is blessed with rich natural resources. Yet per capita Papua New Guineans are poorer than they were 2 decades ago, and poorer than all other Pacific Islanders. Why? Because the revenues from mining, petroleum and forestry projects have been wasted and not invested in creating alternate productive assets.

When BHP Billiton exited the Ok Tedi mine, the Government was gifted 51% share of the mine. I saw this as an opportunity to establish a different model for local participation in resource projects, a model that emphasised the need to invest for growth and put aside money for future generations. To this end the Papua New Guinea Sustainable Development Program trust company was established.

The company has become the most important development partner and investor, both with Government and with the private sector. On its back we now have the International Finance Corporation investing in Papua New Guinea for the first time. I don't want to steal the thunder of Robert Igara, the CEO of PNGSDP - he will tell you more of this good story later.

The Challenges of Reform

Economic and political reforms are essential in all Pacific countries if we want to break the poverty trap and provide people the opportunity for healthy, productive lives.

Undertaking reform is not always a popular job. At times it can be a very lonely one. It requires strong, committed, determined leaders who are prepared to shoulder the weight of short-term unpopularity and criticism and put the nation's long-term future in the front of their thinking and actions.

Papua New Guinea has in the last four years taken reform off the agenda, wasting an enormous opportunity, engendered largely by high commodity prices; in part by the reforms I introduced; and thanks to the Treasurer for hiding the keys to the safe, successfully so far.

Unfortunately fiscal restraint is yet to be institutionalised and unfortunately it has been applied generally across all functions and activities, leaving under-funded schools, hospitals and universities, poorly paid and poorly housed teachers, health workers and police officers, and deteriorating roads, airstrips and wharves.

What do we need to do? In Papua New Guinea, and indeed in all Pacific Island countries:

1. We need to get more output, more productivity, from current investments, both public and private.
2. We need to undertake deep and extensive micro-economic reforms.
3. We need a decisive shift in public expenditure programmes to spend more on investment in people and in infrastructure.
4. We need policies (tax and other policies) to enable the private sector to be the major driver of economic growth.
5. We need to improve law and order, principally by enforcing existing laws, including laws of contract.
6. We need to encourage and attract new investment, at levels unprecedented.

It is obvious that the current crop of leaders have not succeeded in creating sufficient wealth for the growing number of their people. Maybe we need a different crop.