

Australia should listen to PNG not the IMF

by Stephen Howes

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In late 2021, following the first phase of a [review of the 2000 Central Banking Act \(CBA\)](#) by an [independent advisory group](#), the Papua New Guinea parliament unanimously amended the CBA. Among other things, the amendments broadened the objectives of the Bank of PNG (BPNG) away from an exclusive focus on inflation to a broader mandate covering both growth and inflation.

The International Monetary Fund (IMF) was not pleased. According to its [2022 report](#), the amendments “weakened” the CBA, and raised “new concerns”. The IMF singled out the change in the mandate as problematic since the focus on growth “could come into conflict with the price stability mandate”. Indeed, so concerned was the IMF about the CBA reforms that it declared the 2021 amendments to be PNG’s only failure under its recently completed [staff-monitored program](#).

An IMF staff-monitored program has no funding attached to it, but PNG has now shifted to a [funded IMF program](#), which Australia is also backing. As one of the conditions for that loan, the Government of PNG has had to agree to reverse its 2021 amendments and return to making price stability “BPNG’s primary objective”. The program requires that amendments to the CBA “will be drafted in consultation with Fund staff and submitted to Parliament by end-2023”, now just weeks away.

The Australian government is implicated because [it has made a large loan](#) in support of the IMF program. This is particularly ironic given that the recent [Australian central bank \(RBA\) review](#) concluded, and the Australian government accepted, that the RBA’s dual mandate should be *strengthened*. (Australia’s central bank is required to pursue both price stability and full employment.)

Admittedly, every country is different, but siding with the IMF is also at odds with Australia’s [stated emphasis](#) on listening to the Pacific. Listening doesn’t have to mean agreeing, but there should be solid grounds for requiring a country to reverse a democratically made decision: the 2021 amendments passed unanimously with support from the opposition.

The IMF clearly has a strong attachment to the view that every central bank should put the fight against inflation first. In fact, most central banks in the Asia-Pacific have multiple, unranked objectives. But even if an “inflation first” mandate is the right approach to take in many countries, it is completely the wrong approach for PNG.

The main problem that the IMF program is trying to solve is that the PNG kina is inconvertible on the current account (that is, there is foreign exchange rationing or queuing) and overvalued. This is now agreed by both the IMF and BPNG.

Exchange rate management is a BPNG responsibility, so how did the Bank allow the current situation of rationing and overvaluation to develop? It was precisely because it was trying to limit inflation. Devaluations are definitely inflationary, and BPNG’s only mandate for monetary policy (prior to 2021) was to limit inflation. And so, as depreciationary pressures grew when PNG’s resource boom ended in 2013, the Bank tried to reduce the extent of devaluation required by introducing rationing to manage the resultant excess demand, taking no account of the damaging impact rationing has on growth. (PNG businesses have since annually [ranked](#) foreign exchange shortages as one of if not their top concern.)

We can see this play out through successive IMF annual reports on PNG (the so-called Article IV reports) in the late 2010s which the IMF repeatedly called on BPNG to devalue the currency and the Bank repeatedly responded by expressing its disagreement with this recommendation on the grounds that it would be inflationary.

It is only recently that BPNG has agreed to do more to devalue the kina, albeit only gradually, and to reduce rationing. In part this reflects IMF pressure, but it also reflects the central bank’s new, broadened and pro-growth mandate. In a [recent speech](#), BPNG justified devaluation on the grounds that it will “support growth in the export industries”.

In the same speech ([available on the UPNG Facebook page](#)) the Acting Assistant Governor admitted that the kina has been overvalued, and conceded that “the Bank did that in terms of trying to fulfil its mandate of price stability” (45:24).

Clearly, exchange rate regime decisions – which are BPNG’s to make – need to take into account the consequences for both growth and inflation. Otherwise, as PNG’s recent experience has all too clearly shown, a dread of depreciation can take root resulting in foreign exchange rationing being introduced, despite its highly damaging impact on growth, to reduce the need for devaluation.

While the IMF has money on the table it may be able to convince BPNG not to ration foreign exchange, or at least to reduce the degree of rationing, but there will be nothing to stop the central bank returning to rationing once the IMF program is

finished. That may not happen straight away, but we need to think about the next bust after the next boom, when the IMF program is a distant memory. What will happen when pressures for devaluation once again mount if there is nothing in BPNG's mandate to tell it not to revert to rationing?

It makes no sense at all that the IMF is pushing for BPNG to return to a primary price stability mandate. It can only be described as an instance of the IMF pushing conditions on the basis of ideology rather than analysis. Australia, rather than passively supporting the IMF conditions, should listen to PNG, respect the amendments passed unanimously in 2021, and tell the powerful lender to back off.

Disclosures:

The author is a member of the [Independent Advisory Group](#) advising the PNG Treasurer on the Central Banking Act. These are his private views.

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