Morauta's masterclass in economic reform: part one

By Matthew Morris
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From boom to bust

Following independence, the PNG economy fared relatively well. From 1980 to 1994 it grew at an average of 4% a year. It was a bumpy ride though, with peaks and troughs in growth, notably the closure of the Panguna mine in 1989 and the start of the Kutubu oil project in 1992.

By the mid 1990s, it was clear that there were deep structural problems with the PNG economy: weak law and order; poorly maintained and inadequate infrastructure; an uncompetitive exchange rate; underinvestment in basic services such as health and education; and behind all of this chronic and widespread corruption and mismanagement.

In the second half of the 1990s, the PNG economy was hit by successive shocks against a background of political instability and turmoil: the Sandline affair and a major drought in 1997; falling commodity prices; and a deepening crisis of waste, mismanagement and corruption.

By 1999, the economy was spiralling out of control: government revenues had collapsed; reforms had stalled; an international bond issue had to be aborted; and international finance had dried up. Interest rates skyrocketed—peaking at 28% during 1999—as the government sucked as much credit as it could from the financial system, including through illegal borrowing from the central bank and pressure on commercial banks to keep lending to government.

The kina went into free fall. Looking back now, it is hard to imagine, but the kina lost roughly a third of its value during 1998 and the first half of 1999. Foreign exchange reserves evaporated, falling by half during 1998 (to US$187 million) and by half again during the first half of 1999 (to US$89 million, just one week of import cover). As the kina collapsed, CPI inflation surged out of control, reaching 21.8% in 1998 and 20.0% in 1999.

Teetering on the brink of an abyss in 1999, PNG reached an historic juncture: a choice between continued corruption, mismanagement and waste (and ultimately ruin), or an opportunity for reform and repair.

Cometh the hour, cometh the man

On 14 July 1999, Parliament chose the latter and voted overwhelmingly to elect Sir Mekere Morauta as the 7th Prime Minister.

In perhaps one of PNG's most powerful speeches, Morauta set out the purpose of his prime-ministership:

> *We have made a date with destiny. We have chosen order over chaos. We have chosen hope over despair. We have chosen pride in our young country over mindless pursuit of narrow interests. We have chosen to give our children the chance of a decent life in their own country, in the place of fearful descent into poverty, poor health, and disorder.*

He also detailed five objectives for his prime ministership. The first was to restore integrity to PNG's institutions of state: respecting the law, depoliticising the public service and seeking professional advice on public policy.

The second objective was to restore macroeconomic stability: through effective monetary and fiscal policies, supported by a productive partnership with the IMF, World Bank and the Australian Government.

Morauta's third objective was budget repair: restructuring expenditure to improve service delivery standards and to maintain and invest in infrastructure; and redrawing the boundaries between the public and private sector, encouraging the latter to play a greater role in service delivery.

His fourth objective was removing obstacles to investment and economic growth: ensuring the competitive provision of security, utilities, finance and foreign exchange, and transport; reviewing the tax system to remove barriers to growth; and prioritising major resource projects (notably gas).

Morauta's fifth and final objective was to continue the Bougainville peace process following the conflict fought from 1988 to 1998 that left 15,000 to 20,000 Bougainvilleans dead.

Reforms 1999-2002

In July 1999, Morauta embarked on delivering the most ambitious and intense reform program ever attempted in PNG. During the next three years he would face formidable obstacles: the economy was in ruins, the rot in financial institutions would turn out to run deep, and vested interests lined up to block change. In the short space of just three years though, he achieved extraordinary results.

Less than a month after taking office, the Morauta Government passed a Supplementary Budget to rein in expenditure, increase revenue and contain the deficit. In two years, inflation was reduced from 21.8% to 7.9%; interest rates were reduced from 28% to 10.9%; and foreign reserves rose from US$89 million to US$371 million.

From 1999 to 2002, the Morauta Government passed around 150 pieces of legislation, including:

- Amendments to the Organic Law on National and Local-level Government Elections to introduce limited preferential voting (LPV) as a means to ensure that those elected represented a greater share of the electorate, and to provide a greater chance for election of women. (LPV replaced an unrepresentative first-past-the-post system that had led to many MPs, especially in the Highlands, being elected with less than 10% of the vote);
- An Organic Law on the Integrity of Political Parties and Candidates to support political stability by strengthening and regulating the political party system.
- An Organic Law on Peace-Building in Bougainville to underpin the [Bougainville Peace Agreement] signed by the Morauta Government and Bougainville leaders in August 2001. The law established the Autonomous Bougainville Government and provided for a Bougainville Referendum.
- A new Central Bank Act to improve the framework for monetary policy, strengthen the powers of the Bank of PNG and make it more independent. And a new Banking and Financing Institutions Act to strengthen bank supervision.
- New superannuation legislation to bail out the National Provident Fund (NPF, now NASFUND), remove political interference in investments, and strengthen regulation by the central bank. (Morauta also established successful inquiries that laid bare the mismanagement and corruption that had robbed NPF and Defence Force Retirement Benefit Fund contributors of their savings.)
- Comprehensive amendments to taxation legislation (following a tax review in 2000), including to streamline and simplify taxes, to strengthen the independence of the Internal Revenue Commission and to encourage investment in the mining and petroleum sectors.
- A raft of legislation to strengthen the oversight of public enterprises, notably through a new and modern economic regulator (the Independent Consumer and

Competition Commission or ICCC) and an Independent Public Business Corporation to insulate public enterprises from political interference and ensure efficient and commercial operations. This was complemented by regulatory contracts between the ICCC and major public enterprises (including power, ports, telecommunications, and water) setting out rules for price control, investment requirements and service delivery standards for consumers. Other related reforms included a peoples' unit trust to vest a share of ownership with local governments to allow them to benefit directly from dividends, and a framework to subsidise community services from the budget rather than public enterprise cash flow.

Beyond this breathtaking legislative agenda, there were other major reforms:

- The PNG Banking Corporation was saved from insolvency and put into central bank administration, paving the way for a merger with the Bank of South Pacific. By 1999, PNGBC had reached the point of collapse. With a 60% market share, this threatened not only the savings of hundreds of thousands of people, but to sink the financial sector. The merger in 2002 saved the bank and created a major success story: a PNG bank that has grown from strength to strength, expanding services (in PNG and later the Pacific), while delivering huge increases in share value as well as large tax revenues and dividends for the state.
- Orogen Minerals, a majority state-owned mining and petroleum company, was merged with the private-sector Oil Search in 2002 to create a strong, PNG-focused resource company that championed the PNG LNG project. The merged business went on to deliver big dividends and huge growth in share value for the state, from $250 million at the time of the merger to $1.7 billion when sold to the International Petroleum Investment Company (IPIC) in 2009. The sale proceeds financed the state's equity in PNG LNG.
- An orderly exit of BHP from the Ok Tedi mine was negotiated in 2001. BHP wanted to exit the mine on environmental grounds. It gifted its 51% share of the mine for the benefit for the people of PNG, through PNGSDP, which was created (in 2002) to invest some of its profits for the benefit of the community and to put aside the rest for future generations. The Ok Tedi mine went on to invest heavily in higher environmental standards, and to underpin economic growth for the PNG economy for the next decade. It generated a staggering K17 billion in tax revenues and dividends for PNG between 2003 and 2012, and PNGSDP now has US$1.49 billion set aside in a long-term fund.

Even this lengthy list barely touches on the achievements of the Morauta Government.

Many of the other reforms included changes to the way government worked, behind the scenes, and are illustrative of how Morauta was able to achieve so much in a short space of time.

The second part of this blog explains Morauta's success, and assesses his legacy. The full two-part blog is available as a PDF file here.

Disclosure

Matthew Morris was an economic adviser to Sir Mekere Morauta from 1999 to 2002, and continued to work for him in later years.

About the author/s

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Matthew Morris helped to establish the Development Policy Centre and served as the Centre's first Deputy Director. Matt is a development economist with 25 years' experience. He is currently an independent consultant.