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ODA Loan to Support Balance of Payments and Economic Structural Reform of Papua New Guinea

1. Japan Bank for International Cooperation (JBIC; Governor: Hiroshi Yasuda) today extended an ODA loan totaling 5.35 billion yen to Papua New Guinea for its "structural adjustment program" with the signing of an agreement at its head office. As the result of this loan, the cumulative loan approvals to date total 14, with their aggregate value amounting to 62.185 billion yen.
2. The objectives of this loan are to give assistance to improve the balance of payments position and attain macroeconomic stability by providing funds that will finance general imports, and to achieve economic and social structural reforms through supporting the structural adjustment program, with the purpose of regaining confidence in Papua New Guinea's economy.
3. Papua New Guinea was hit by a major drought and earthquake at the end of 1997, which dealt a serious blow to its economy. In addition, gold and timber prices which are major export goods of the country plunged in the world commodity markets. As a result, the country's balance of payments deteriorated, registering a deficit of $204 million in 1997. The economic downturn continued into 1998 and 1999, leading to dire consequences, including a sharp decline in international reserves and growing fiscal deficits. The IMF estimated that the country would face a foreign currency shortage of $300 million in 2000.
4. To improve the economic conditions, the Government of Papua New Guinea will embark on a structural adjustment program with financial support from international donors including JBIC. The program is aimed at improving fiscal control, official debt management, business environment, efficiency in the public sector, health and educational services, budgetary allocations, forest management and efficiency in financial services.
5. The revenues obtained by making use of this loan will be mainly allocated to the four priority areas for development: health and medical care, education, rural infrastructure and the primary industries.

(See Appendix for details.)

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The objective of this loan is to support economic reform efforts by the Government of Papua New Guinea which is facing economic difficulties.
The loan amount, terms and conditions are as follows.

1. Loan Amount and Conditions

Project Name	Amount (billion yen)	Interest Rate (%)	Repayment Term (Grace Period)	Procurement Conditions
Structural Adjustment Program	5.35	2.2	30 (10)	general untied

2. Outline of the Loan

Structural Adjustment Program

(1) Background and the Need for the Program

Papua New Guinea has a land area of 460,000 square kilometers, or 1.25 times the size of Japan, divided into two segments by rugged terrain. Accordingly the economy has a dual structure. Twenty per cent of the population, estimated to total 4.6 million in 1998, lives in the urban areas, predominantly around the capital, with their livelihood supported by income generated in the manufacturing and oil industries as well as from government expenditures. By contrast, 80% of the population lives in rural highlands, and a half of these people are living in poverty without access to basic public services.

The national economy has traditionally been dependent on the mining industry, which is at the mercy of the ups and downs in the world market of mineral products. Hence the economy is vulnerable to external shocks. During the 1990s, in particular, failed economic policies, natural disasters and extraordinary weather often led to unstable production activities. Thus despite its abundant endowment with gold, copper, oil, natural gas, vast stretches of arable land, and forest and marine resources, the average annual per capita income was $890 in 1998, a low level even among the developing countries. The country is lagging in social development compared with other low-income developing countries, with a significant gap in the distribution of income.

A major drought and earthquake that hit Papua New Guinea at the end of 1997 dealt a substantial blow to its economy. In addition, depressed prices of gold and timber in the world commodity markets worsened its balance of payments situation. Export earnings dropped due to a fall in product prices, exacerbated by the downturn in the non-mining industries. Unemployment reached 36% in 1998, and inflation soared to an annual rate of 20% by yearend. The result was a steep decline in real wages and increasingly lower standards of living.

The balance of payments posted $204 million and $189 million deficits in 1997 and 1998. This was due to an adverse development in the current account, caused by a jump in imports, and large-scale capital outflows, brought on by an excessively loose monetary policy and loss in confidence. As a result, foreign currency reserves plunged from $586 million (5.4-month worth of imports) at the end of 1996 to $204 million (2.1-month worth of imports) at the end of 1999. The fiscal deficit reached 3.5 per cent of GDP in the first half of 1999. The exchange rate of its currency, the Kina, fell as much as 50 per cent from 1996 to 1999. The IMF estimates that the country will face a foreign currency shortage of $300 million in 2000.

(2) Outline of the ODA Loan

To improve the economic conditions, the Government of Papua New Guinea will embark on a structural adjustment program with financial support from the international donors including JBIC. The program aims at improving fiscal control, official debt management, business environment, efficiency in the public sector, health and educational services, budgetary allocation, forest management and efficiency in financial services.

The objectives of this loan are to give assistance to improve the balance of payments position and attain macroeconomic stability by providing funds that finance general imports; and to achieve economic and social structural reforms through supporting the structural adjustment program, thereby restoring confidence in its economy. The revenues obtained by making use of this loan will be mainly allocated to the four priority areas for development: health and medical care, education, rural infrastructure and the primary industries.

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