



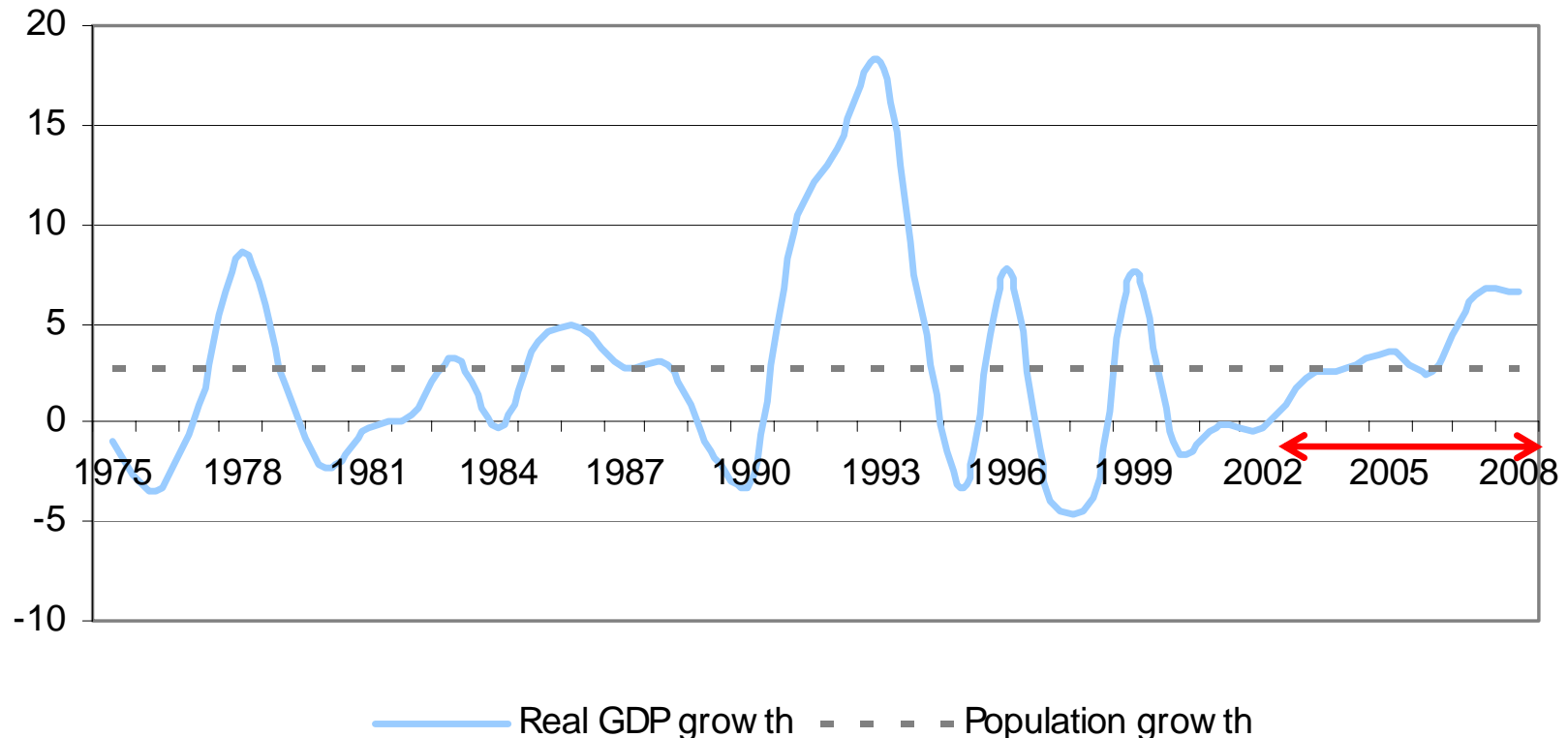
Linking growth and poverty reduction in Papua New Guinea

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funded by the
Lowy Institute for International Policy

Economic growth



Figure 1: Real GDP Growth (annual rate)



- Over **80 per cent** of the variation in incomes of the poor within developing countries can be explained by variation in GDP per capita (Dollar and Kraay, 2001)
- **MTDS** growth target

Poverty



Key features:

- **37.5 per cent** of the population lived in extreme poverty in **2004** (Datt & Walker, 2006)
- HDI ranking 2009: **148th** of 182
- Remote, vulnerable
- Geography matters

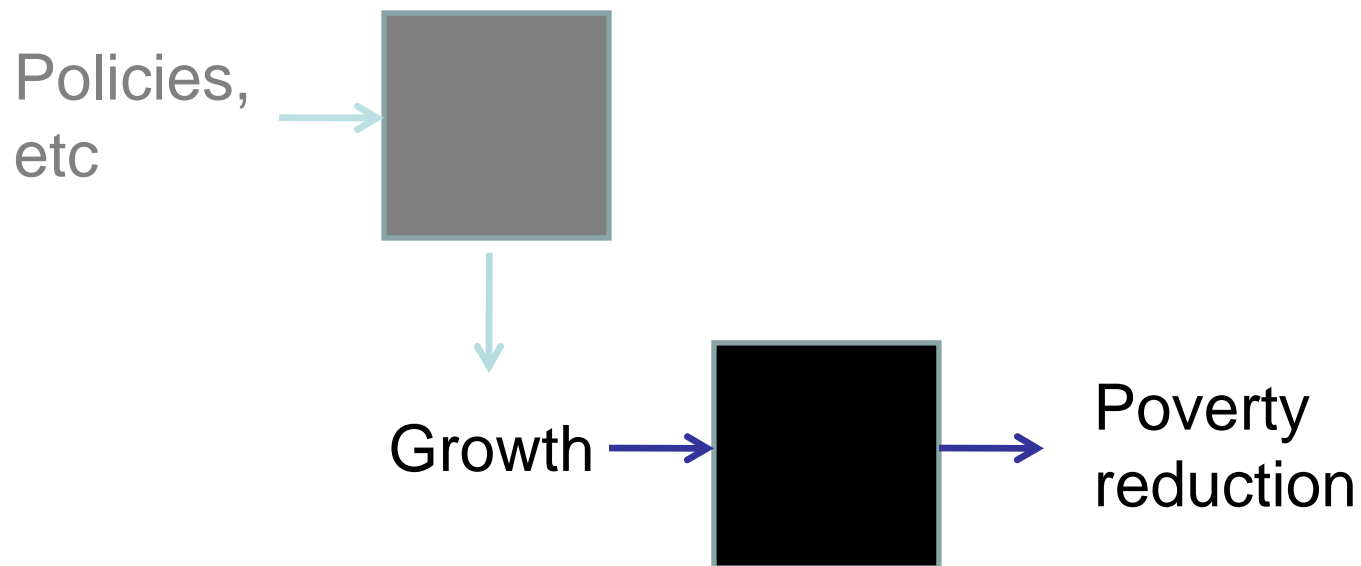
136	Congo
137	Cambodia
138	Myanmar
139	Comoros
140	Yemen
141	Pakistan
142	Swaziland
143	Angola
144	Nepal
145	Madagascar
146	Bangladesh
147	Kenya
148	Papua New Guinea
149	Haiti
150	Sudan
151	Tanzania (United Republic of)
152	Ghana
153	Cameroon
154	Mauritania
155	Djibouti
156	Lesotho



Growth-poverty relationship



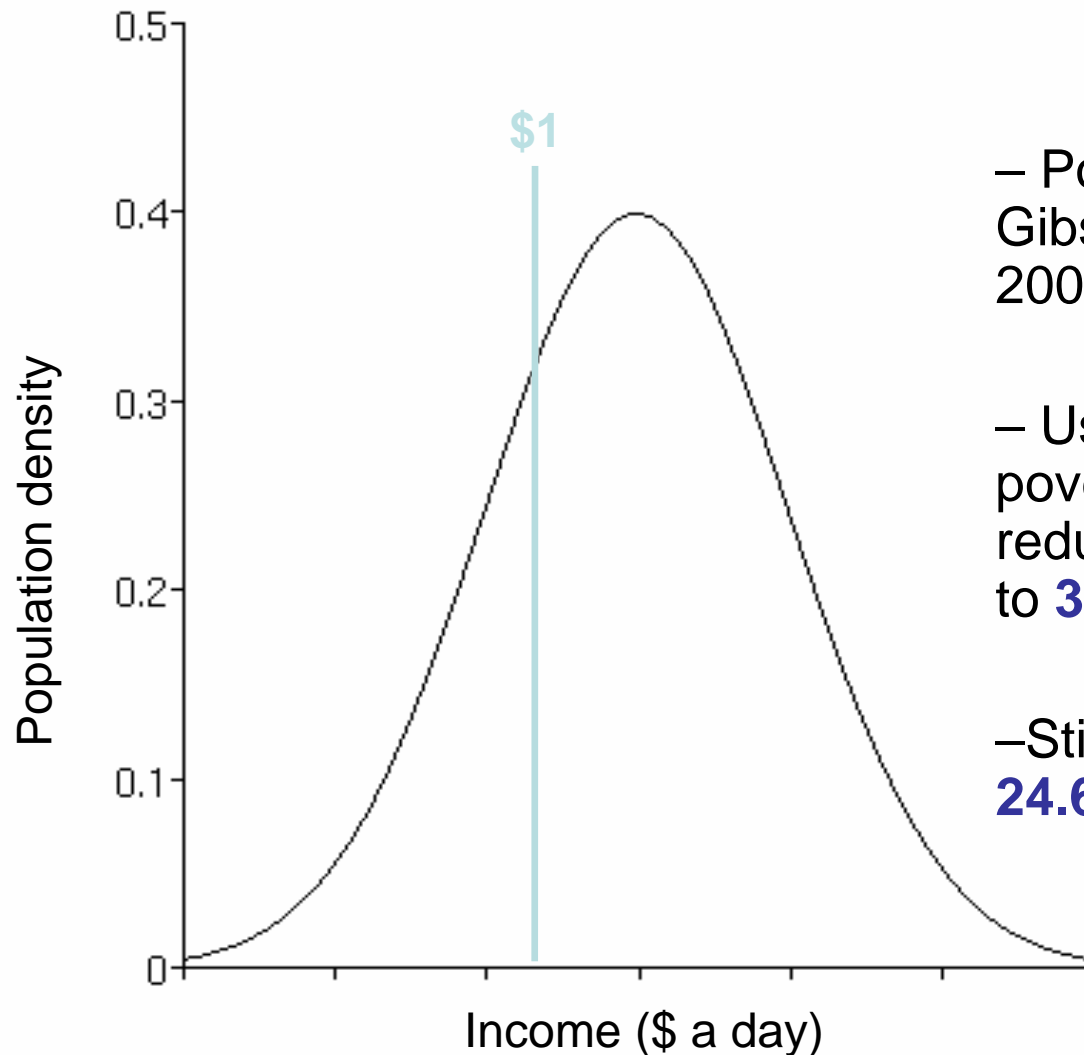
Flawed Interpretation #1: **The Black Box**



Growth-poverty relationship



Flawed Interpretation #2: The Income Distribution Function



– Poverty elasticity measures:
Gibson, 2000; Datt & Walker,
2006

– Using D&W, from 2003-2008,
poverty rate estimated to have
reduced **8.8** percentage points,
to **30.4%**

– Still above 1996 figure of
24.6%

Growth-poverty relationship



A better interpretation

- **Bad circulation**: leakages, limited connectivity, high fragmentation
- Geography, transport, culture, financial development
- Not one circular flow, but several co-joined

A better approach

- Unpack in terms of different agents:
individuals, companies, government
- Trace how they accrue income, how they disperse it and the likelihood that it will reach the poor
- Help in accounting for how well-known aspects of PNG economy impact growth-poverty relationship

Individuals



- Contribute labour and physical capital
- Remunerated through wages and rents
- Some modest increases in period, but excludes many until **2nd order effects**

Average Expenditure per Capita (% share)						
Decile	Food & Drink	Merit	Demerit	Transport	Residual	Total
1	76%	2%	8%	1%	12%	100%
2	70%	3%	7%	4%	16%	100%
3	70%	3%	6%	5%	16%	100%
4	72%	2%	8%	4%	13%	100%
5	72%	2%	7%	4%	14%	100%
6	73%	2%	7%	5%	13%	100%
7	61%	2%	9%	7%	20%	100%
8	60%	2%	9%	6%	23%	100%
9	58%	2%	9%	8%	23%	100%
10	39%	3%	12%	8%	37%	100%

Individuals



- Interpret inter-household transfers using Mourata, 1981
- Poor rarely participate in **reciprocal assistance**
- **Kin obligations** more inclusive
- No **distributional effect**

Figure 4: Household Participation in Inter-household Transfers

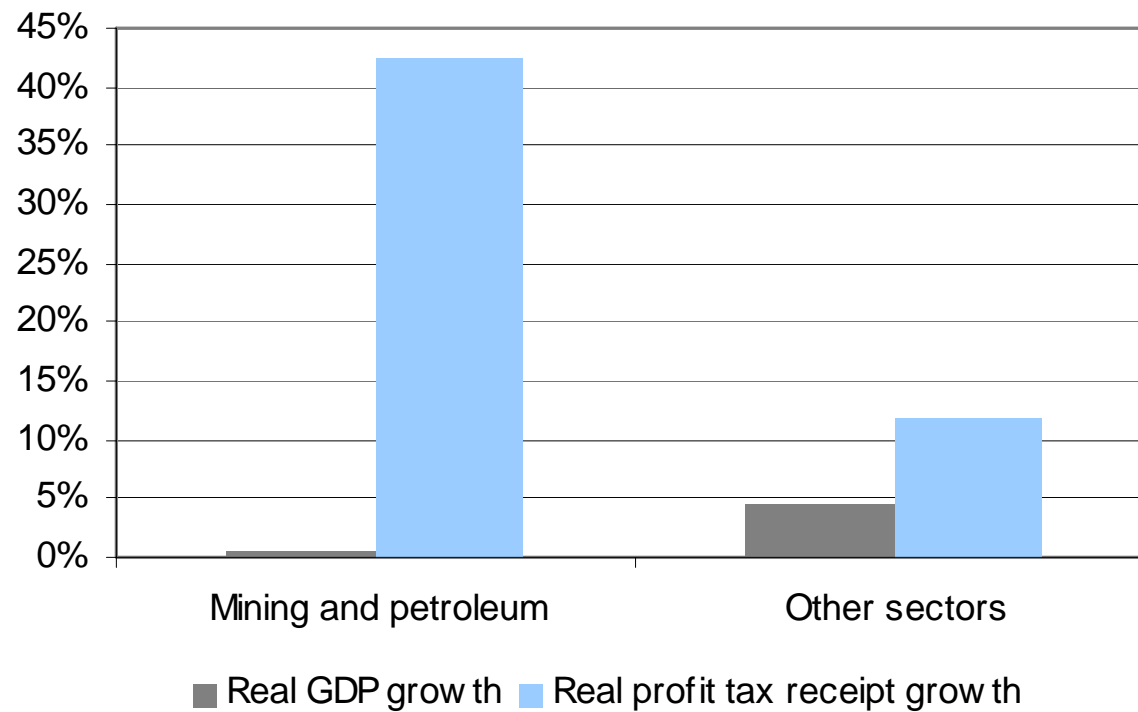
Decile	Receiving	Giving	Either	Both	Either Minus Both
1	14%	13%	24%	2%	22%
2	20%	18%	35%	3%	32%
3	23%	26%	38%	11%	27%
4	31%	26%	43%	14%	29%
5	33%	40%	56%	17%	39%
6	37%	33%	54%	16%	38%
7	42%	45%	68%	19%	49%
8	49%	51%	70%	30%	40%
9	44%	61%	76%	30%	46%
10	63%	72%	88%	47%	41%

Companies



- Generate returns (profits) from capital

Figure 5: GDP vs Profits
(average annual growth rate, 2003-2008)



Companies



		Reinvested	Dividends
Ownership	Domestic		
	Overseas		

- In the mining sector, the welfare effect to the PNG economy is typically only **one third of export values**, after discounting the returns that accrue to foreign capital and the purchase of intermediate imported inputs (Chand & Levantis, 2000)

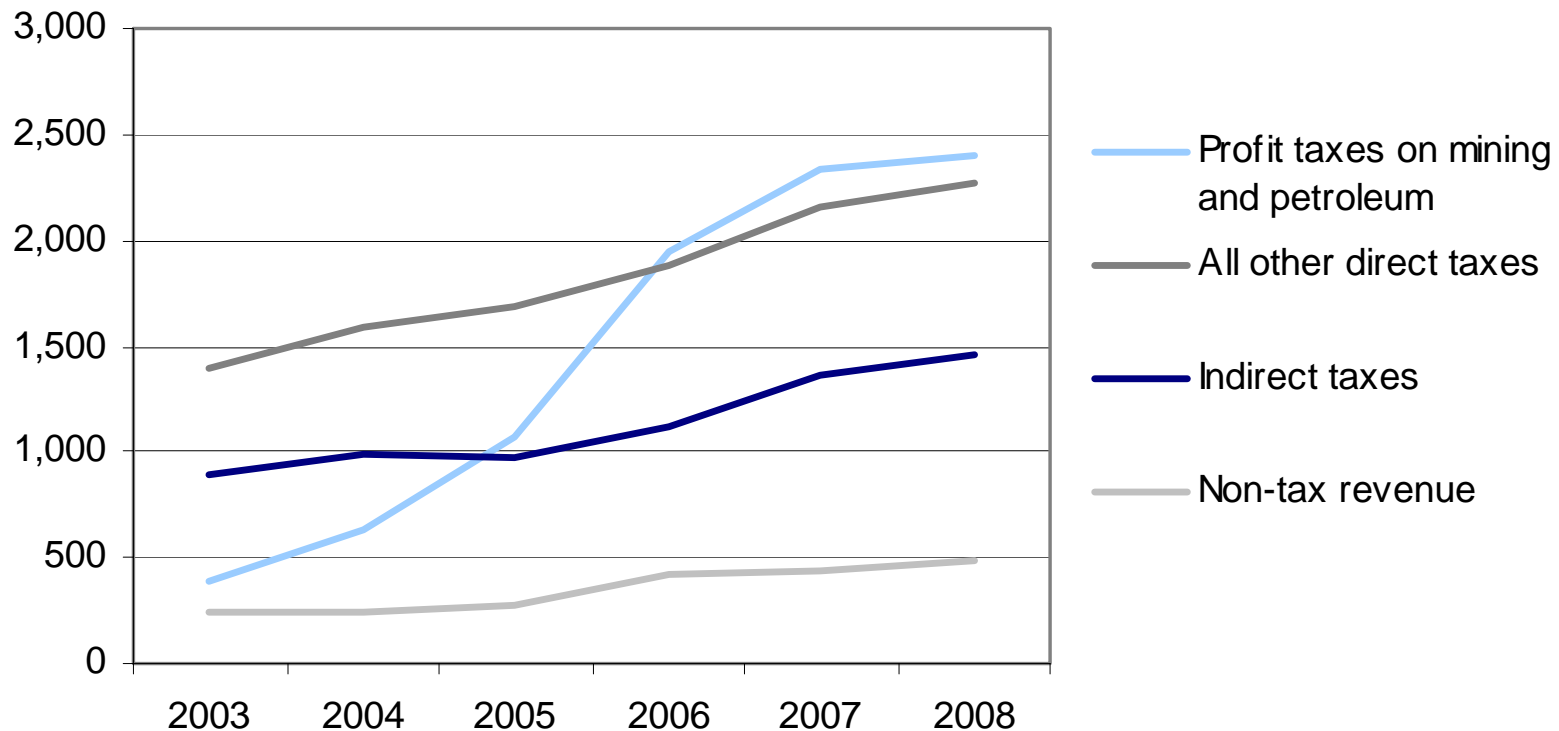
- Inability to motivate reinvestment reflects broader investment problem. **Doubling of investment rate** required to sustain recent growth rates (Faal, 2006)

Government



- Tax economic activity or draw rents from productive assets
- A big winner from boom period: from **23.2%** to **30.6%** of GDP

Figure 6: Government Revenue (current prices, Kina, millions)



Government



- Recurrent expenditure:

- Salaries: **80,000** staff
- Goods and services: imports, formal
- Services

- Development expenditure :

- Extension of recurrent
- Transfers to landowners and MPs: increased share from **15 to 35%** over period; optimistic assumption of **70% MTDS**
- Actual investment : crowded out and low scope



More fundamental constraints on actual investment

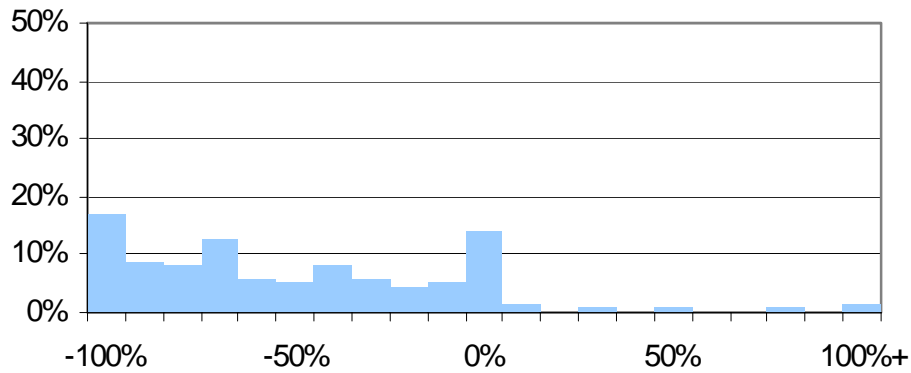
- Few efforts targeted at poor
- Preoccupation with **equality in expenditure**
- Capacity and planning constraints
- Reliance on redundant systems of service delivery
- Virements

Government

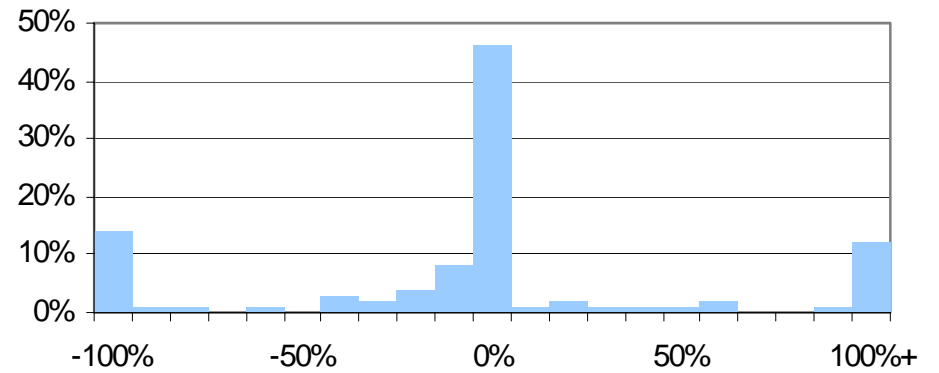


Virements in Government Development Expenditure 2003-2006

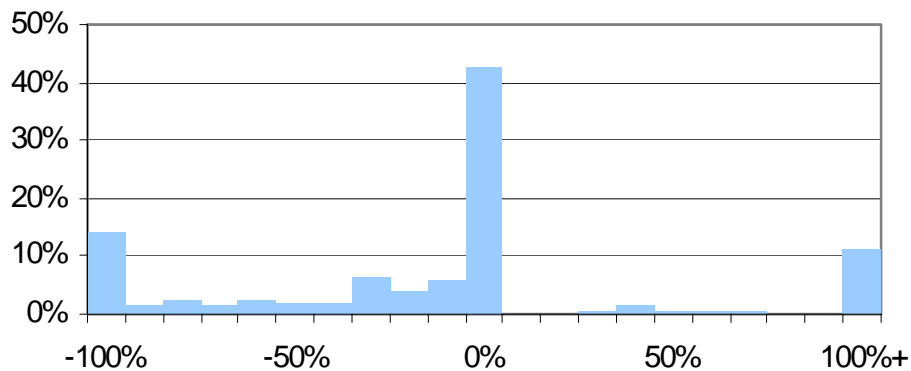
2003



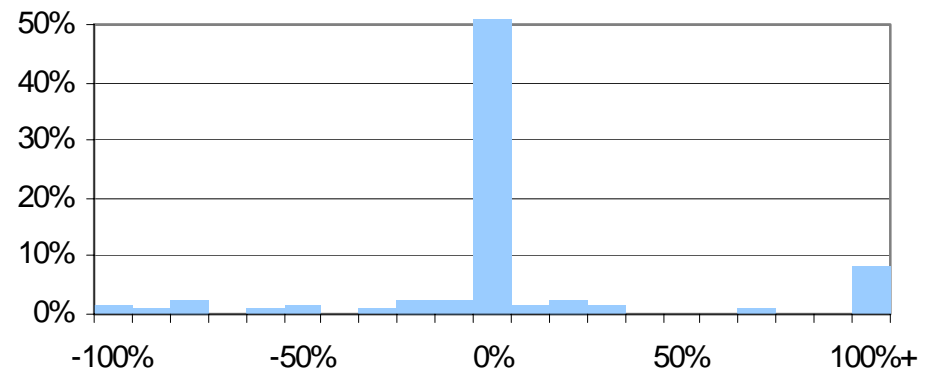
2004



2005



2006



Recommendations



Two strategies

- **Favouring types of growth** in which income accrues to higher elasticity channels
- Strengthening existing poverty elasticities by **bringing the poor in closer connection** to the economy

Interventions for different agents

- **Individuals**: consider employment, financial services, education
- **Companies**: incentives for re-investment
- **Government**: back to basics; rolling out of essential services

Other

- Initiate **small-scale** income surveys

Implications for LNG project



- Reinforces existing structure of economy where growth-poverty link is weak
- **~60%** of pre-tax income generated directly from the project may immediately be repatriated overseas
- Fewer local staff than a **single tuna cannery**
- Warning for GoPNG from previous windfalls:
 - topping up Treasurer's advance
 - less aligned
 - lower “threshold”
 - no shovel-ready projects, no scaling-up
 - incremental increases work best
- How **consumption patterns** change with higher incomes
- Government's ability to manage **large capital inflows**
- Kina appreciation kind to urban but **hurts rural** and undermines a manufacturing-led growth strategy

LNG Implications for Australia

Getting prepared

- Lessons from **2005-6**: drawbacks of a denial strategy
- Greater focus on where **MTFS stops**
- Sector expenditure “**pathways**” – plan for different revenue outcomes; reject threshold approach; incorporate incrementalism
- Improving rule and discretion-based governance
- Advocating for a narrower focus to increase accountability; e.g., 2 sectors, 2 objectives
(GoPNG claims that DSIP is a response to low visibility of development expenditure)
- Address imbalance in expertise; introduce simple cost-benefit analysis in public expenditures
- Encourage NGOs to push for transparency on Member funds
- Offer assistance with monetary challenges