

## HARD CURRENCY STRATEGY AND ECONOMIC DEVELOPMENT IN PAPUA NEW GUINEA

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### Introduction

Papua New Guinea (PNG) is characterized by an aggregation of several hundred cultural groups and its linguistic diversities. There are about 750 distinct languages and thousands of dialects in the region. The basic socio-political unit is the clan. A village or a family is the basic unit of production. Labour is controlled by a household or group of households whose members are closely related. Most of the population live in the villages and are engaged in subsistence agriculture. But in recent years, a money economy has developed in the town and village. In accordance with the development of a money economy, the traditional society of PNG is changing rapidly. The socio-economic structure of PNG is dualistic. There remains a traditional socio-economic system in the core, and modern one is penetrating the surface.

According to the classification by the World Bank, PNG is situated in the middle income group (per head income : US. \$ 890 in 1989). But if we see PNG's socio-economic indications, the country would surely be classified as a less developed country. For example, the ratio of nonliteracy of PNG residents (55%) in 1985 is much higher than that of Ethiopia (38%) and China (31%), which are classified among the low income countries (the least developed countries). Therefore, I have some questions about whether or not we can analyze the socio-economy of PNG with the instruments of modern economic theory. We can surely analyze and understand only a part of the economic activities with the modern economic theory. With this caution in mind, I will discuss the problems of the hard currency kina strategy in PNG in this paper.

### Hard Currency Kina Strategy

At the time of independence in 1975, the government declared to take three main economic policies. They are 1) the hard currency kina strategy, 2) the minimum wage policy, and 3) the commodity stabilization scheme. As PNG is a small open economy with its domestic price levels largely determined by externally set export-import prices, the exchange rate was primarily intended as an anti-inflation instrument. The government decided that the value of the national currency kina should be equal with Australian dollar. As we see in table 1, during the period from 1976 to 1979, the kina was revalued six times (31%) against the Australian dollar which is the currency of their most major trading partner. In 1987, the kina recorded the highest exchange rate against the Australian dollar. The kina is one of the most appreciated currencies among the developing countries, and it is said that hard currency kina strategy has succeeded in the anti-inflation policy.

On the other hand, the balance of payments which had been generally in surplus until the end of 1979, has generally had a deficit since then (table 2). Unfavorable movements in the

Table 1. Exchange Rates of Kina

	A. \$	US. \$	YEN		A. \$	US. \$	YEN
1975	1.00	1.26	383	1983	1.27	1.14	265
1976	1.13	1.23	361	1984	1.28	1.06	265
1977	1.16	1.32	317	1985	1.47	0.99	198
1978	1.26	1.45	281	1986	1.57	1.04	166
1979	1.31	1.45	348	1987	1.58	1.14	140
1980	1.32	1.55	315	1988	1.42	1.21	152
1981	1.30	1.47	323	1989	1.47	1.16	167
1982	1.36	1.34	313	1990	1.36	1.05	141

Source : Bank of Papua New Guinea (1992).

Table 2. Balance of Trade (million kina)

	1978	1979	1980	1981	1982	1983	1988	1989	1990
Export	550	687	692	564	569	687	1276	1132	1111
Import	478	562	684	738	752	815	1199	1152	1050
Balance	72	125	8	-174	-183	-127	77	- 20	61

Source : Bank of Papua New Guinea (1992).

Table 3. Export Prices (kina/tonne, f. o. b.)

	1980	1982	1984	1985	1986	1987	1988	1989	1990
Cocoa	1,615	1,114	1,964	2,022	1,768	1,634	1,230	970	822
Coffee	2,326	1,892	2,241	2,894	3,927	2,079	2,533	1,652	1,623
Copra	271	173	523	324	108	180	252	231	158

Source : Bank of Papua New Guinea (1992).

balance of payments in the early 1980s were mainly caused by external factors. From mid 1980 to the end of 1982, the value of exports fell markedly (table 3). The deficit of the current account has been financed by a combination of private and government overseas borrowing.

It is often said that the weakness of PNG's economic performance is due to the hard kina strategy. The appropriateness of the hard kina strategy was increasingly questioned in academic circles as well as among government policy makers. It was suggested from time to time that the kina was overvalued in relation to PNG's balance payments position. The prevailing kina exchange rate was adversely affecting domestic economic development, and the rate was not low enough to provide the financial incentives necessary to increase growth of export and import-substitution industries. These arguments implied the appropriateness of devaluation, as a general macroeconomic policy measure, aimed at achieving a balance of payments equilibrium and increased domestic economic growth via the expansion of export

and import-substitution industries.

In 1990, a report of the World Bank insisted that the PNG government should devalue the kina about 30 percent. In January 1990, the government decided to devalue the kina ten percent.

### Effectiveness of a Kina Devaluation in PNG

In early 1982, the government commissioned a major study by consultants to review the country's macroeconomic policy and performance since independence, particularly the exchange rate policy. A comprehensive report prepared by R. Garnaut and P. Baxter was submitted to the government in February 1983. It recommended the need for an increase in the price of tradables relative to labour of around 25 to 30 percent, and suggested two alternative approaches to achieve this; a gradual approach to adjust with discrete devaluation, and a sudden approach through devaluation.

M. D. Dayananda (1987) discussed the devaluation of the kina, and examined the necessary conditions for a successful devaluation in PNG. He says the necessary conditions for a successful devaluation are a reduction in real expenditures, a downward flexibility in real wages, and a removal of price controls and subsidies. If these conditions are met, and further, if exports and imports are substantively to responsive to price changes, a devaluation will induce a switch in the patterns of production and demand as a result of the devaluation-induced rise in the domestic prices of tradables relative to non-tradables.

The ten percent devaluation of the kina in January of 1990 provided a valuable opportunity to assess the effectiveness of this policy instrument. The expected gain from devaluation of the kina is a more competitive economy, i. e., lower labour cost. According to Andrew Elek's study, it was very difficult to achieve gains in competitiveness through devaluation (ELEK, 1992). The devaluation was not accompanied with wage restraint because of the shortage of skilled workers. The wage level of workers in PNG is higher than that of the other developing countries.

There still remains a necessity to assess the influence on export industries. Andrew Elek suggests to us that the influence is not so large as expected because of increase of costs. According to his analysis, ten percent devaluation increases kina receipts at any given level of world prices, but the cost in kina terms also increases five to six percent (table 4).

Table 4. Effects of Devaluation on Export-crops (kina/tonne)

	Production costs pre-devaluation	Costs after devaluation	Total costs increases
Cocoa	1,566.7 (100.0%)	1,660.6 (106.0%)	93.9 ( 6.0%)
Copra	226.7 (100.0%)	238.9 (105.3%)	12.1 ( 5.3%)
Coffee	1,986.0 (100.0%)	2,103.1 (105.9%)	117.1 ( 5.9%)

Source : Elek (1992).

### Conclusion

Although the hard kina strategy benefited the wage-earners and expatriates, but it damaged the rural economy and indigenous industries. About 80 percent of population live in the small villages and are engaging in subsistence agriculture.

According to the data of World Bank (IBRD, 1990), per head income of PNG (US. \$ 890 in 1989) is classified in the middle income group. The average cash income per head from agriculture is only 50.4 kina in the rural district in 1980. It is evident that there are large inequalities between the income of wage-earners, expatriates and agriculture. So the hard currency kina strategy should not only be executed from the stand point of wage-earners and expatriates but also from national stand point in general.

As M. D. Dayanada stated in 1987, and Andrew Elek analyzed in 1992. the exchange rate policy is not likely to be successful in achieving external and internal balance in an economy such as the Papua New Guinea.

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