



# Report and Recommendation of the President to the Board of Directors

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Project Number: 54346-001  
November 2020

## Proposed Countercyclical Support Facility Loan Papua New Guinea: COVID-19 Rapid Response Program

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Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 4 November 2020)

Currency unit	–	kina (K)
K1.00	=	\$0.2860
\$1.00	=	K3.4965

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
BPNG	–	Bank of Papua New Guinea
COVID-19	–	coronavirus disease
CPRO	–	COVID-19 pandemic response option
DOT	–	Department of Treasury
GBV	–	gender-based violence
GDP	–	gross domestic product
ICU	–	intensive care unit
IMF	–	International Monetary Fund
MSME	–	micro, small, and medium-sized enterprise
NCC	–	National Control Centre
NCD	–	National Capital District
PFM	–	public financial management
PNG	–	Papua New Guinea
PPE	–	personal protective equipment
TA	–	technical assistance
UN	–	United Nations
UNDP	–	United Nations Development Programme
UNOPS	–	United Nations Office for Project Services

## **NOTE**

In this report, “\$” refers to United States dollars, unless otherwise stated.

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 54346-001</b>	
<b>Project Name</b>	COVID-19 Rapid Response Program	<b>Department/Division</b>	PARD/PASP
<b>Country</b>	Papua New Guinea	<b>Executing Agency</b>	Department of Treasury
<b>Borrower</b>	Papua New Guinea		
<b>Country Economic Indicators</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=54346-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=54346-001-CEI</a>		
<b>Portfolio at a Glance</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=54346-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=54346-001-PortAtaGlance</a>		
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Health</b>	Disease control of communicable disease		57.00
	Health system development		38.00
<b>Agriculture, natural resources and rural development</b>	Agricultural production		20.00
<b>Finance</b>	Small and medium enterprise finance and leasing		100.00
<b>Public sector management</b>	Social protection initiatives		35.00
		<b>Total</b>	<b>250.00</b>
<b>3. Operational Priorities</b>		<b>Climate Change Information</b>	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
✓ Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ Promoting rural development and food security			
✓ Strengthening governance and institutional capacity			
		<b>ADB Financing</b>	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		<b>Cofinancing</b>	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
<b>Sustainable Development Goals</b>		<b>Gender Equity and Mainstreaming</b>	
SDG 1.5		Effective gender mainstreaming (EGM)	✓
SDG 2.1, 2.3, 2.c			
SDG 3.3, 3.7, 3.c, 3.d			
SDG 5.2, 5.4			
SDG 9.3			
SDG 10.4			
<b>4. Risk Categorization:</b>		Complex	
<b>5. Safeguard Categorization</b>		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
<b>6. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>250.00</b>	
Sovereign COVID19 Pandemic Response Option (Regular Loan): Ordinary capital resources		250.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>250.00</b>	
<b>Currency of ADB Financing: US Dollar</b>			

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to Papua New Guinea (PNG) for the COVID-19 Rapid Response Program under the Countercyclical Support Facility's COVID-19 pandemic response option (CPRO).<sup>1</sup>

2. Among the Pacific developing member countries of the Asian Development Bank (ADB), only PNG is currently affected by community transmission of the coronavirus disease (COVID-19). The country is classified as a small island developing state, in a fragile and conflict-affected situation.<sup>2</sup> It exhibits vulnerabilities in its economy and health system, limited fiscal space, and significant reliance on development partners to help it achieve its development objectives. The economy is projected to contract by 2.9% in 2020, and poverty and unemployment are rising. To manage the adverse socioeconomic impacts of COVID-19, the government is implementing a \$769 million countercyclical program, including an economic stimulus package that encompasses the government's COVID-19 health, education, and multisector response plans.<sup>3</sup> Collectively, these represent the government's overall pandemic response plan, and the proposed CPRO will help the government implement it. PNG meets the access criteria of the CPRO (Table 1).<sup>4</sup>

**Table 1: Summary Assessment of Compliance with the Access Criteria for the Countercyclical Support Facility and the COVID-19 Pandemic Response Option**

Access Criterion	Asian Development Bank Assessment
1. Adverse impact of exogenous shocks	GDP is projected to contract by 2.9% in 2020 in real terms, against 2.1% growth projected prior to the pandemic, driven by contractions in construction, accommodation and food services, and transport (main text, para. 8). The 2020 fiscal balance is estimated to worsen from –5% of GDP pre-COVID-19 to –8.2% of GDP post-COVID-19. Public sector debt is expected to reach 49.8% of GDP in 2020, compared with 39.8% in 2019. The 2020 current account surplus is projected to decline to 15.9%, from 22.3% in 2019. The pandemic resulted in immediate and significant negative impacts on unemployment (31% of household heads lost their jobs) and poverty (increase by 4.5 percentage points) (main text, paras. 11–12).
2. Countercyclical development expenditures	Countercyclical development expenditures approved and prepared for 2020 total \$769 million (3.2% of GDP). This includes support for pro-poor countercyclical expenditures of \$445 million through the budget and \$324 million from domestic institutions—in the form of support for the health system response; improved social assistance; better hygiene; support for agricultural development and food security; support for micro, small, and medium-sized enterprises; loan repayment holidays; and superannuation withdrawals to mitigate the impacts of COVID-19, especially on vulnerable groups (main text, paras. 14–16).
3. Pre-shock record of generally sound macroeconomic management	Growth, which averaged 4.2% during 2015–2019, was undermined by falling commodity prices, droughts, and an earthquake. Despite the multiple shocks, fiscal policy was generally sound, and the deficit averaged 3.9% during 2015–2019. The government managed to limit the fiscal deficit to 2.5% of GDP in 2017 and 2.6% of GDP in 2018 under a fiscal consolidation strategy. In 2019, as it stepped up capital expenditures to stimulate growth, the deficit

<sup>1</sup> Asian Development Bank (ADB). 2020. *Policy Paper: ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.

<sup>2</sup> ADB uses the harmonized multilateral development bank approach for categorizing fragile and conflict-affected situations. It is based on the average of ADB's country performance assessment and the World Bank's country policy and institutional assessment.

<sup>3</sup> *Ministerial Statement on an Economic Stimulus Package*. Address by the Treasurer to Parliament on 2 April 2020; Government of PNG, Department of Health. 2020. *Papua New Guinea Emergency Preparedness and Response Plan COVID-19*. Port Moresby; Government of PNG, Department of Education. 2020. *Papua New Guinea COVID-19 Education Emergency Response and Recovery Plan*. Port Moresby; United Nations (UN). 2020. *COVID-19 Multi-Sector Response Plan*. Port Moresby. The COVID-19 Multi-Sector Response Plan is approved by the Disaster Management Team. The team is led by the Controller and the UN Resident Coordinator. Operations in each sector are co-led by government departments and UN agencies.

<sup>4</sup> A detailed assessment is in Appendix 4.

Access Criterion	Asian Development Bank Assessment
	expanded to 4.9% of GDP. Fiscal reform is ongoing and supports revenue-raising measures and expenditure control guided by IMF technical assistance under a Medium-Term Revenue Strategy (2018–2022) and an IMF SMP. The central bank has managed price stability (inflation averaged 5.3% during 2015–2019) through its exchange rate mechanism and other monetary policy tools. However, the exchange rate mechanism, combined with a policy of foreign currency rationing, resulted in foreign exchange shortages, which dampened growth (main text, para. 7).
4. Structural reforms (including health response)	A state of emergency was declared on 23 March 2020, accompanied by the State of Emergency Act 2020. This was replaced by the National Pandemic Act 2020 on 16 June 2020. On 17 June 2020, the National Control Centre was set up to manage the response and coordinate national government agencies and development partner support. Borders have been closed since 26 March 2020 and remain so, but initial restrictions on domestic movements were relaxed. The Department of Health issued the Emergency Preparedness and Response Plan in March 2020, which outlined key actions to respond to COVID-19. The government added beds in intensive care units and isolation facilities, purchased medical and personal protective equipment, increased COVID-19 testing, strengthened contact tracing, and trained frontline health workers (main text, paras. 5 and 14). Lessons from the pandemic will feed into the preparation of the National Action Plan for Health Security 2021–2030, with longer-term public health and preventative measures.
5. Debt sustainability	Public sector debt in 2020 is forecast to expand to 49.8% of GDP post-COVID-19, compared with a 40.3% pre-pandemic projection. The IMF's DSA prepared in June 2020 puts PNG at high risk of debt distress, with no access to external market finance. The rating results from the COVID-19-induced breaches of the debt service–revenue ratio. However, debt is still assessed as sustainable, conditional on the implementation of sound fiscal policies and SMP commitments. A DSA conducted by ADB shows that the negative consequences of the pandemic are primarily short-to-medium term, with positive growth resuming as pandemic effects subside. ADB's proposed loan is not expected to add significantly to the debt service obligations or affect PNG's debt sustainability (main text, para. 27).
6. Coordination with the IMF	ADB has been in close communication with the IMF on the CPRO. In June 2020, the IMF disbursed \$364 million to PNG under an RCF, noting the need for additional financing support. The IMF's RCF report is provided in lieu of an assessment letter. The IMF began an SMP in February 2020, and ADB closely coordinated with the IMF on the proposed State-Owned Enterprise Reform Program, which is a benchmark in the SMP (main text, para. 24).

ADB = Asian Development Bank, COVID-19 = coronavirus disease, CPRO = COVID-19 pandemic response option, DSA = debt sustainability analysis, GDP = gross domestic product, IMF = International Monetary Fund, PNG = Papua New Guinea, RCF = Rapid Credit Facility, SMP = Staff-Monitored Program.  
Source: Asian Development Bank.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. **Resource-rich but inherently vulnerable.** PNG is a resource-dependent, lower middle-income country with an estimated population of 9.3 million and per-capita gross national income of \$2,685 in 2019.<sup>5</sup> The mineral sector (mining, petroleum, and natural gas) accounted for 28% of gross domestic product (GDP) in 2019, while agriculture, forestry, and fisheries contributed another 17.1%.<sup>6</sup> Micro, small, and medium-sized enterprises (MSMEs) account for about 25% of GDP (of the formal economy) and 24% of the labor force.<sup>7</sup> MSMEs are mainly engaged in retail and service industries and operate in urban and peri-urban settings. PNG, despite its wealth of natural resources, remains politically and socially fragile with high rates of violent crime, ethnic

<sup>5</sup> ADB. 2020. *Key Indicators for Asia and the Pacific 2020*. Manila.

<sup>6</sup> PNG. 2019. *National Budget 2020*. Port Moresby.

<sup>7</sup> United Nations Development Programme (UNDP). 2020. *Socio-economic Impact Assessment of COVID-19 on Papua New Guinea*. Port Moresby.



violence, and one of the highest rates of gender-based violence (GBV) in the world.<sup>8</sup> It has the lowest life expectancy in the Pacific region (65.9 years in 2018). An estimated 48% of children born in PNG are stunted or chronically undernourished (double the rate of countries with a comparable GDP per capita), risking cognitive limitations in a population where a majority of the workforce has completed a maximum of grade ten education.<sup>9</sup> These fragilities are reflected in the United Nations Development Programme (UNDP) human development index, which ranks PNG 155th out of 189 economies.<sup>10</sup> PNG is also prone to disasters caused by natural hazards. Since 2016, PNG has experienced droughts, earthquakes, and a volcanic eruption.

4. **Fragile health system.** PNG is making modest progress in improving its health outcomes. However, its performance is uneven. The maternal mortality ratio declined from 470 deaths per 100,000 live births in 1990 to 215 deaths in 2015, and was estimated at 171 during 2016–2018.<sup>11</sup> PNG's human development index rose by 43% between 1990 and 2017 and its ranking remains low (footnote 10). Health facilities are in poor condition and short of medical supplies. The country does not have enough health workers and is generally unprepared to respond to a pandemic (footnote 3). Financial constraints limit the number of outreach clinics, particularly in rural areas. Only 12 of the 22 provinces have pre-triaging areas and isolation facilities; most provincial hospitals (16 of 22) have limited capacity in their intensive care units (ICUs)—only 93 ICU beds and 12 functioning ventilators for COVID-19 patients are available nationwide; and the quality of these beds and the adequacy of supplies such as personal protective equipment (PPE) are unknown. According to the World Health Organization, PNG's preparedness and response capacity for COVID-19 is at Level 2 (where Level 5 is best).

5. **Government quick to act on COVID-19.** PNG's first case of COVID-19 was detected on 20 March 2020. The following day, a state of emergency was declared, which also activated the United Nations (UN) Humanitarian Cluster system. The government closed the borders from 26 March 2020, imposed internal travel restrictions, and decreed a national lockdown on 23 March–27 April 2020. On 23 March 2020, the Prime Minister appointed the Police Commissioner as "Emergency Controller," which Parliament confirmed in April 2020. Parliament also passed the National Pandemic Act 2020 on 16 June 2020, which outlines the legal powers conferred to the Controller, as well as the reporting obligations and financial management arrangements (including the need for audits) for the medium-term response to the pandemic.<sup>12</sup> With this act in place, the state of emergency was lifted. On 17 June 2020, the National Control Centre (NCC) was set up to manage the response and coordinate national government agencies and development partner support, including the implementation of the pandemic response plan (para. 2). A second lockdown was imposed on 29 July–14 August 2020. The lockdowns meant that most businesses and institutions, including schools, were shut for about 7 weeks. This depressed domestic demand and required education to be delivered virtually (para. 15). No domestic flight restrictions apply at present, but international travelers are admitted subject to strict entry regulations.<sup>13</sup>

<sup>8</sup> Médecins Sans Frontières (Doctors Without Borders) estimates that up to 70% of women in PNG have experienced physical or sexual assault in their lifetime. Médecins Sans Frontières. 2016. [Return to Abuser: Gaps in Services and a Failure to Protect Survivors of Family and Sexual Violence in PNG](#) (accessed 24 October 2020).

<sup>9</sup> World Bank. [Papua New Guinea Economic Update](#). January 2020. pp. 47–48.

<sup>10</sup> UNDP. *Human Development Report 2019—Inequalities in Human Development in the 21st Century*. [http://hdr.undp.org/sites/all/themes/hdr\\_theme/country-notes/PNG.pdf](http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/PNG.pdf) (accessed 21 August 2020).

<sup>11</sup> Government of PNG, National Statistical Office; and ICF. 2019. *Papua New Guinea Demographic and Health Survey 2016-18: Key Indicators Report*. Port Moresby; and Rockville, Maryland, United States.

<sup>12</sup> Government of PNG. 2020. *National Pandemic Act 2020*. <https://covid19.info.gov.pg/>

<sup>13</sup> The National Pandemic Act (Measure No. 2) outlines international travel measures. They restrict entry to four PNG seaports (Port Moresby, Rabaul, Morobe, Madang) and Port Moresby's international airport. No person is permitted entry unless provided with an exemption by the Controller. A 14-day quarantine period is required upon arrival.

6. **COVID-19 tally.** As of 16 November 2020, PNG recorded 602 positive cases of COVID-19 and 7 deaths across 13 provinces (out of 22 administrative regions), and had carried out 29,466 tests.<sup>14, 15</sup> While the rate of testing has increased since March 2020, testing in the provinces (and the settlement areas of Port Moresby) remains inadequate given that most cases are not epidemiologically linked, suggesting widespread community transmission. In mid-July 2020, PNG recorded a dramatic upsurge in COVID-19 infections, reflecting increased testing.<sup>16</sup> Testing is carried out through a network of public and private clinics with samples processed through two laboratories in Port Moresby and Goroka, and overseas. However, effective surveillance is limited by the slow processing time and lack of patient identification after the results. The ADB-financed public health surveillance system (electronic national health information system) is supporting surveillance by tracking COVID-19- associated symptoms, including pneumonia, and through death reports.

7. **Pre-shock record of generally sound fiscal management.** Growth averaged 4.2% between 2015–2019, but has been volatile because of falling commodity prices, droughts, and an earthquake (Table 2). Despite the multiple shocks, fiscal policy was generally sound, and the deficit averaged 3.9% during 2015–2019. The government managed to limit the deficit to 2.5% of GDP in 2017 and to 2.6% of GDP in 2018 under a fiscal consolidation strategy. Additionally, the government adopted fiscal reforms—including revenue-raising measures under a medium-term revenue strategy guided by International Monetary Fund (IMF) technical assistance (TA), and measures aimed at controlling recurrent expenditure.<sup>17</sup> A switch to a more expansionary fiscal policy in 2019 led to a deficit of 4.9% of GDP, largely driven by increased capital expenditure to stimulate growth, but also in a context of weaker revenues and a revision to nominal GDP.<sup>18</sup>

**Table 2: Selected Economic and Fiscal Indicators**

Item	2015	2016	2017	2018	2019 <sup>e</sup>	2020 <sup>p</sup>	2020 <sup>r</sup>
GDP growth (% , constant prices)	9.5	4.1	3.5	(0.8)	5.0	2.1	(2.9)
Inflation (CPI period average)	6.0	6.7	5.4	4.7	3.6	3.8	3.3
Total revenue and grants (% of GDP), of which	18.3	16.1	15.9	17.8	16.2	15.3	14.0
Domestic revenue (% of GDP)	16.9	13.9	13.9	15.5	14.1	14.3	12.8
Total expenditure (% of GDP), of which	22.9	20.9	18.4	20.4	21.1	20.3	22.2
Recurrent expenditure (% of GDP)	14.0	14.0	14.0	14.5	13.9	13.5	14.3
Fiscal surplus (deficit) (% of GDP)	(4.6)	(4.7)	(2.5)	(2.6)	(4.9)	(5.0)	(8.2)
Gross public debt (% of GDP), of which	29.9	33.7	32.7	38.3	39.8	40.3	49.8
Gross external public debt (% of GDP)	6.7	8.5	8.8	15.2	17.0	18.5	23.6
Gross official foreign reserves (\$ million)	1,738.0	1,656.1	1,735.6	2,214.8	2,312.8	2,431.6	2,281.7
In months of imports	10.0	6.4	5.1	6.7	5.4	6.2	5.8
Current account balance (% of GDP)	20.2	25.0	23.5	23.0	22.3	22.3	15.9

( ) = negative, COVID-19 = coronavirus disease, CPI = consumer price index, e = estimated, GDP = gross domestic product, p = projected (pre-COVID-19), r = revised projection (post-COVID-19).

Source: International Monetary Fund, Article IV Reports.

8. **Severe exogenous shock.** The economy has been increasingly battered by the COVID-19 pandemic. Forecasts of real GDP have changed drastically from an estimated growth of 2.1%

<sup>14</sup> This count includes 20 provinces, the Autonomous Region of Bougainville, and the National Capital District.

<sup>15</sup> World Health Organization (WHO). [WHO Coronavirus Disease Dashboard](https://covid19.who.int/) (accessed on 17 November 2020).

<sup>16</sup> On 15 July, PNG had 11 recorded cases with 7,690 cumulative tests. On 1 September, PNG had 460 recorded cases with 16,518 cumulative tests.

<sup>17</sup> 2019 Article IV Consultation and Request for a Staff-Monitored Program (accessible from the list of linked documents in Appendix 2).

<sup>18</sup> The 2020 budget used the October 2019 Supplementary budget revised nominal GDP calculations for 2016–2020 which were down by 4.0% from the 2019 budget, driven by an exercise to more accurately value GDP. Without this revaluation, the fiscal deficit would have been –4.7% (compared with –4.9% actual) and the debt stock would have been 38.2% (compared with 39.8% actual).

to a contraction of 2.9% in 2020. Export revenues fell as global commodity prices weakened along with weaker external demand, and declines in mining production also contributed to lower exports. Lockdowns and restrictions on international and domestic travel hurt several industries: transport, accommodation and food services, real estate, manufacturing, and construction. Cognizant that adverse business conditions and lower economic activity are anticipated to continue into 2021 because of the continued spread of COVID-19 and ongoing depressed regional demand, the government is formulating the 2021 national budget with support from development partners in an effort to continue critical pandemic response plan measures and identify opportunities for re-energizing productive economic sectors outside the extractive industries, such as infrastructure (para. 21). In response to this uncertainty, the government indicated that several critical elements of the pandemic response plan were likely to continue and be reflected in the 2021 budget.

9. **Fiscal impact of COVID-19.** The fiscal deficit is projected to expand to 8.2% of GDP, from 5.0% of GDP before the pandemic. This reflects an estimated fall in revenues of 19.4% and a net expenditure cut of 3.9% in 2020 when compared to projections before the pandemic. The government reduced its revenue projection from 15.3% of GDP to 14.0% of GDP. The supplementary budget announced expenditure cuts totaling K2.3 billion from the 2020 budget, and directed K1.6 billion to fund COVID-19-related and other expenditures.<sup>19</sup>

10. **COVID-19 impact on finance sector.** The impact on the finance sector is expected to be limited. Nonperforming loans, which were 4.0% of total loans prior to the pandemic, including those of MSMEs, are expected to increase moderately. Commercial banks are profitable and well capitalized, and are expected to be able to absorb credit losses.<sup>20</sup> Nonbank financial institutions typically lend only against collateral, such as movable assets, and have limited exposure to the high-risk market segment of MSMEs. While liquidity was sufficient prior to COVID-19, the Bank of Papua New Guinea (BPNG) has subsequently provided additional liquidity through a quantitative easing program and continues to monitor this closely.

11. **Socioeconomic impacts of COVID-19.** Poverty models suggest that the poverty rate was about 27.2% before the pandemic; based on a 10% decline in mean per capita consumption, the poverty rate could jump to 31.7% in 2020.<sup>21</sup> As of June 2020, up to 31% of household heads were reported to have lost their jobs (footnote 7). The most vulnerable are those without any alternative sources of income, such as low-income earners and subsistence workers. Of these vulnerable people, 79% are employed and 48% are women.<sup>22</sup> Disruption in the food supply chain and surges in food prices particularly threaten the 26.5% of the population below the national food poverty line (with an incidence of 28.5% in rural areas).<sup>23</sup> Protracted impacts on employment indicate a longer period of recovery, which could exacerbate pre-existing challenges of stunting, wasting, and malnutrition (para. 3). With limited social insurance programs in the country, vulnerable groups such as poor households, older people, people with disabilities, and households headed by women are at risk of slipping into poverty. Of these vulnerable people, 80% currently have no income or only limited ability to generate income, and 67% do not have access to basic services such as water and sanitation, health clinics, and primary schools.

<sup>19</sup> The supplementary budget showed a net reduction in recurrent expenditure of K0.8 billion, and a net increase in capital expenditure of K0.1 billion.

<sup>20</sup> Commercial banks reported a combined ratio of Tier 1 capital to risk-weighted assets of 34.9% as of June 2019.

<sup>21</sup> J. Bulan et al. 2020. *COVID-19 and Poverty: Some Scenarios*. Unpublished note prepared for ADB's Economic Research and Regional Cooperation Department. The poverty rate, based on a poverty line of \$1.90 per day, was last recorded at 39.9% (2009). Reflecting trends since 2009, including in GDP per capita, the poverty rate is modeled to have fallen to 27.2% as of 2020, pre-COVID-19.

<sup>22</sup> ADB. 2012. *Papua New Guinea Poverty Profile: Technical Report*. Manila.

<sup>23</sup> Government of PNG, National Statistics Office. 2010. *2009–2010 Household Income and Expenditure Survey*. Port Moresby.

Interrupted schooling because of domestic containment and lockdown measures will potentially have long-term effects on students' performance and learning (footnote 7).

12. **Women and girls particularly vulnerable.** In addition to the risk of COVID-19 infection, additional health impacts on women and girls include the diversion of resources from other essential services such as maternal and reproductive health care. The UN Population Fund research highlights that GBV is increasing and that the state of emergency severely curtailed women and girls' ability to access GBV services.<sup>24</sup> The COVID-19 pandemic is also undermining women's economic security. Women are more vulnerable to economic hardships given their reliance on informal work (60% of informal entrepreneurs are women). Even before the state of emergency, women's workforce participation was lower than men's—men were almost twice as likely as women to have wage jobs in the formal sector. The Women's Microbank is experiencing 95% customer default on either single or multiple loan repayments as many of their women entrepreneur clients feel the impacts of COVID-19. While the data is not disaggregated by sex, a UN survey of MSMEs found that 37% have temporarily ceased operations and a further 25% have reduced staff or wages (footnote 7). The same research indicates that the income of 80% of households has been negatively affected, with debt increasing by up to 42%.

## B. The Government's COVID-19 Countercyclical Responses

13. **Strong countercyclical expenditure plan.** The government's pandemic response plan (para. 2) totals \$769 million (3.2% of GDP). The plan (Table 3) comprises multiple measures (paras. 14–16) to improve core health sector capacities, respond adequately to the pandemic, minimize the impacts on vulnerable groups, and provide economic stimulus to boost aggregate demand and help the economy through the recovery.

**Table 3: Pandemic Response Plan, 2020**  
(\$ million)

Item	Total	Budget		Domestic Institutions' Support
		Government	Donor-Funded <sup>a</sup>	
<b>Health and safety</b>	<b>166</b>	<b>90</b>	<b>76</b>	<b>0</b>
Health system strengthening	92	33	59	
Water, sanitation, and hygiene	35	18	17	
Safety	39	39		
<b>Social assistance, food security, and protection of vulnerable groups</b>	<b>213</b>	<b>35</b>	<b>31</b>	<b>147</b>
Social protection (e.g., against GBV)	6		6	
Food security and nutrition	38	35	3	
Education	22		22	
Superannuation / unemployment	147			147
<b>MSMEs and other economic support</b>	<b>390</b>	<b>208</b>	<b>5</b>	<b>177</b>
MSMEs and agriculture	66	61	5	
MSME lending through commercial banks	59	59		
Infrastructure stimulus	88	88		
Loan repayment holidays	177			177
<b>Total</b>	<b>769</b>	<b>333</b>	<b>112</b>	<b>324</b>

GBV = gender-based violence; MSMEs = micro, small, and medium-sized enterprises.

<sup>a</sup> Development partners' support through the multisector response plan. This expenditure will be recorded in the 2020 Final Budget Outcome.

Source: Papua New Guinea Supplementary Budget, September 2020.

<sup>24</sup> United Nations Population Fund. 2020. *The State of Gender-Based Violence During the COVID-19 Crisis and State of Emergency*. Port Moresby.

14. **Health and safety (\$166 million).** Following confirmation of the first COVID-19 case in March 2020, the government, with development partner support, is expending \$92 million on health system strengthening, delivering (i) 400 non-ICU beds in temporary isolation facilities for COVID-19 patients across the country, (ii) clinical guidelines on how to manage COVID-19 patients and training in COVID-19 case management for about 4,836 health workers, (iii) a community education campaign and establishment of logistic arrangements, and (iv) rapid procurement of test kits and PPE to support national testing capacity.<sup>25</sup> To improve access to water, sanitation, and hygiene, the government and development partners are implementing actions to provide water supply to communities, schools, and health care facilities (\$35 million). To protect the people, the government set up the NCC to coordinate its pandemic response, and is strengthening quarantine facilities, border protection, and policing (\$39 million). Lessons learned during the pandemic will feed into the preparation of long-term activities to be designed and presented in the National Action Plan for Health Security 2021–2030 (footnote 3).

15. **Social assistance, food security, and protection of vulnerable groups (\$213 million).**<sup>26</sup> The government's social assistance and food security programs targeted poor and vulnerable groups at risk of being further marginalized because of COVID-19. The government, with development partners, is expending \$38 million on nationwide food security activities, including distribution of food rations during April–December 2020. The main recipients are those affected by income and job losses, especially in urban areas where they have fewer means to grow their own food; 5,000 individuals in the National Capital District (NCD) are estimated to have received food rations to date. Implementation is channeled through churches and local administration bodies to ensure correctly targeted and timely distribution of relief. This scheme draws on the databases of nongovernment organizations involved in volunteer and humanitarian work in the NCD. In addition, an estimated 10,000 smallholder farmers and poor rural households are receiving support to purchase seedlings or home gardening kits, or to manage threats to plant and animal health. The aim is to help them sustain their crop and livestock production for household consumption and/or market sale, and thus prevent income losses from COVID-19-induced disruptions to economic activities. A rapid assessment revealed that most schools find it difficult to deliver remote teaching. In response, the government, with development partner support, is spending \$22 million on broadcasting educational television and radio programs nationwide three times a week for secondary students, and daily radio programs for primary students. This benefits more than 370,000 children, including 168,000 girls, and minimizes learning disruptions. The humanitarian cluster system has been activated (para. 5), including the protection cluster. The government and development partners are implementing \$6 million worth of initiatives, e.g., through the GBV and child protection subclusters, to ensure the safety and protection of women, children, older people, and people with disabilities across the country. Women and community groups were encouraged to produce face masks as a source of immediate income. At least 200,000 locally made masks were procured by the government and are being distributed around the NCD. At least 14,000 superannuation fund members working mostly in the formal sector (about 38% of them women) will get early access to their superannuation equivalent to 20% of their own contributions to date, or a maximum of K10,000, for immediate cash assistance. This is estimated to total \$147 million, or less than 5% of overall assets held by the superannuation funds, so is not considered to impact the funds' sustainability.

<sup>25</sup> An amount of \$57,000 was disbursed to each province in June 2020 to support local COVID-19 activities and procure supplies. The PPE procurement follows the same advance procurement arrangements supported by the UN Office for Project Services (UNOPS) and the United Nations Children's Fund (UNICEF) as does the World Bank's \$19.38 million COVID-19 Emergency Response Project (P173834).

<sup>26</sup> Summary of Social Assistance Measures (accessible from the list of linked documents in Appendix 2).

16. **MSMEs and other economic support (\$390 million).** The government took several measures to safeguard small businesses and rural producers, and improve the hygiene in markets and business centers to allow trading to continue, especially for informal traders and small vendors. This includes \$66 million to support the prices for coffee, cocoa, and copra farmers and stabilize their income, and a market improvements program for producers. Smallholder producers receive logistics and transportation support, including aggregation of products to urban hubs and main commercial markets. To date, 14 shipments took place from Lae to Port Moresby, each containing 10,000 bags of produce or 912 dry and refrigerated containers. Lending to MSMEs is also being supported with a \$59 million credit guarantee program delivered through Bank South Pacific (about 65% market share) and National Development Bank (about 2.2% market share). This will enable MSMEs to retain their workers. The lending support comes with business training to build the resilience of small businesses to withstand the COVID-19 impacts. The package includes \$11 million for agriculture-related businesses; \$7 million for youth, women, and micro businesses; and a further \$2.2 million exclusively for women-run businesses. Interest rates range between 4%–5% with a term of 15–20 years. The government allocated \$88 million to support short-term employment through capital works in the education, health, judiciary, transport, and other infrastructure sectors. Finally, in April 2020, PNG's financial institutions began granting loan repayment holidays for 3 months or longer, estimated to cost \$177 million. Laid-off workers and businesses impacted by COVID-19 are eligible for this support.

17. **Monetary policy response.** The BPNG launched a 3-month quantitative easing program in April 2020, which injected K643 million into the financial system. As a further policy measure to support liquidity, it reduced the cash reserve ratio of commercial banks from 10% to 7%. It also reduced its policy rate, the kina facility rate, from 5% to 3%, and commercial banks responded by reducing lending rates.

### **C. Proposed Program, Impact, ADB's Value Addition, and Development Partner Coordination**

18. ADB's program will support the government in containing the pandemic and cushion its social and economic impact, particularly on the poor and vulnerable. It is aligned with PNG's overarching development objective of mitigating the health, social, and economic impact of the outbreak (footnote 3). The outcome will be: adverse effects of COVID-19 on businesses and the population reduced. The program has three outputs: (i) COVID-19 health response measures implemented, (ii) measures to protect and provide social assistance and food security to vulnerable groups enhanced, and (iii) MSMEs safeguarded from the economic downturn. The design and monitoring framework is in Appendix 1.

19. **Lessons learned.** The COVID-19 pandemic exacerbated the country's fragilities and required the use and strengthening of existing systems to meet the needs of the people. Policy dialogue and experiences from other CPROs have shown that support to areas where ADB is not traditionally involved, such as social protection, requires longer and more substantive engagement with the government. While ADB's ability to influence the design of social protection initiatives is limited, the CPRO provides a basis for greater ADB engagement and the opportunity to improve these areas through future projects and/or TA. COVID-19 presented time-sensitive challenges in procurement and logistics to which national agencies were not previously accustomed. Contracting the UN Office for Project Services (UNOPS) to procure and import medical supplies through both the government and development partners has worked well. The design of the proposed CPRO incorporates these lessons and reflects evaluation findings from

previous disaster responses, such as that to the 2018 earthquake, its coordination with the cluster system, and the use of both government and partner systems to respond most effectively.<sup>27</sup>

20. **ADB's value addition.** This CPRO is part of a wider package of assistance to meet short-term response requirements—it supports the stabilization of the fiscal situation and contributes to recovery efforts. It is complemented by TA funds (\$1.6 million) to directly procure health supplies, Asia Pacific Disaster Response Fund assistance (\$3 million) to further contribute to the health response, and a proposed policy-based operation focused on public financial management (PFM) reforms in the health sector (an additional \$50 million added to the originally planned \$100 million).<sup>28</sup> This operation has supported the government in achieving critical actions underlying their health sector response plan (para. 3).<sup>29</sup> In concert with other development partners, ADB contributed to policy discussions on the economic response and the development of the supplementary budget, especially on managing higher debt levels.<sup>30</sup> ADB also supported a public health surveillance system, and PFM regulatory reforms at the Department of Health's subnational agencies and four provincial health authorities (footnote 28). ADB will embed consultants in the Department of Treasury (DOT) to support monitoring and reporting of the program's implementation, and the development of a revised medium-term fiscal strategy that provides a path toward longer-term fiscal sustainability. ADB will also mobilize regional TA in support of social assistance and gender equality to help monitor these aspects of the CPRO, build the capacity of line agencies for social policy development, help them strengthen their systems to deliver social protection, and supplement their efforts to report on the effectiveness of these initiatives, particularly for women and girls.<sup>31</sup> This work will also inform any future ADB interventions.

21. **ADB's support for recovery.** ADB expects to provide further budget support through the Health Services Sector Development Program (\$150 million in 2020) and the State-Owned Enterprises Reform Program (\$100 million in 2020, \$150 million in 2021, \$250 million in 2022). These policy-based operations provide financial resources to help meet PNG's short-term financing needs while supporting policy reforms that promote longer-term growth and poverty reduction. To assist the country's medium-term economic recovery, ADB has planned significant investments in infrastructure to support road transport, maritime links, and domestic and air transportation. Quality infrastructure is a central component of the government's economic recovery strategy. This pipeline of programs and projects complements the CPRO by building on the government's desire for macroeconomic stability, fiscal sustainability, and greater economic growth, including beyond the extractive industries.

22. **Alignment with Strategy 2030 and country partnership strategy.** The CPRO is aligned with ADB's Strategy 2030, particularly the operational priorities of addressing remaining poverty and reducing inequalities, promoting rural development and food security, accelerating progress in gender equality, and strengthening governance and institutional capacity.<sup>32</sup> The program's design reflects Strategy 2030's approach to fragile and conflict-affected situations and small

<sup>27</sup> Australian Humanitarian Partnership. 2019. *Response to the 2018 PNG Highlands Earthquake Evaluation*. Canberra.

<sup>28</sup> ADB. [Papua New Guinea: Health Services Sector Development Program \(Subprogram 3\)](#) (proposed); ADB. [Regional: COVID-19 Emergency Response](#); and ADB. [Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases](#).

<sup>29</sup> Policy actions support effective emergency preparedness and response for COVID-19 as well as for future pandemics and other health emergencies. Actions include passing the National Pandemic Act 2020; preparation of a COVID-19 health emergency response plan, and operationalization of emergency response structures.

<sup>30</sup> ADB. [Papua New Guinea: Supporting Public Financial Management \(Phase 3\)](#).

<sup>31</sup> ADB. [Regional: Strengthening Social Protection in the Pacific](#); and ADB. [Regional: Strengthening Gender Outcomes in Pacific COVID-19 Response and Recovery](#).

<sup>32</sup> ADB. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#).



island developing states, particularly by overcoming capacity constraints through a tailored approach, such as embedding consultants in long-term advisory roles in DOT (footnote 30). The program is aligned with the PNG country partnership strategy, 2016–2020, particularly the operational priorities relating to inclusive economic growth, rural primary health delivery, and public sector management improvements.<sup>33</sup>

23. **Development partner coordination.** The support of development partners for the government's COVID-19 response is well coordinated through the NCC and the UN Disaster Management Team.<sup>34</sup> The NCC is at the center of the response, while the UN leads the coordination with the development partners. Several UN agencies also directly support the relief efforts.<sup>35</sup> The UN Disaster Management Team, of which ADB is a member, is the primary vehicle for the UN to align the efforts of development partners, keep the partners abreast of developments, and advocate for more financing to meet pressing needs as described in the COVID-19 Multi-Sector Response Plan (footnote 3).

24. ADB maintains a regular dialogue with the IMF on assessments of PNG's macroeconomic and fiscal situation. When the IMF prepared its Rapid Credit Facility and reviewed its Staff-Monitored Program, it sought ADB's views on the economic outlook in the context of ADB's budget support in 2020, the proposed State-Owned Enterprise Reform Program, which is a benchmark in the Staff-Monitored Program, and forward pipeline.<sup>36</sup> ADB also sought the IMF's views on the CPRO access criteria.<sup>37</sup>

#### D. Development Financing Needs, Budget Support, and Debt Sustainability

25. The budget deficit of 8.2% in 2020 is equivalent to a financing need of \$1.95 billion. This is \$558 million more than the pre-pandemic need. The deficit will be financed through a mix of domestic (\$566 million) and external (\$1,246 million) sources, with a further drawdown on the cash balance of \$138 million with the BPNG, which indicates an overall financing shortfall. External borrowing will be entirely financed by multilateral and bilateral partners (Table 4).

**Table 4: Urgent Financing Needs and Support for 2020**

(\$ million)		
Item	2020 (before COVID-19)	2020 (adjusted for COVID-19)
Revenues	4,146	3,341
Grants (COVID-19 related) <sup>a</sup>	0	112
Expenditure	5,508	4,958
COVID-19 pandemic response plan expenditure <sup>a</sup>	0	445
Budget balance	(1,362)	(1,950)
<b>Total budget financing needed:</b>	<b>1,362</b>	<b>1,950</b>
Net domestic borrowing	370	566
Drawdown from cash balance	0	131
Net external borrowing:	992	1,253
Commercial <sup>b</sup>	300	0
International Monetary Fund	0	364

<sup>33</sup> ADB. 2015. *Country Partnership Strategy: Papua New Guinea, 2016–2020*. Manila.

<sup>34</sup> Development coordination (accessible from the list of linked documents in Appendix 2).

<sup>35</sup> The World Health Organization is providing direct support to the NCC across all functions and set up a surveillance team. UNOPS and UNICEF are acting as procurement agents for the World Bank and the government's procurement of emergency PPE, and medical and diagnostic equipment.

<sup>36</sup> IMF. 2020. *Request for Disbursement under the Rapid Credit Facility*. Washington, DC.

<sup>37</sup> International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2). The IMF confirmed on 14 September 2020 that the Rapid Credit Facility report may serve as the IMF assessment letter.



Item	2020 (before COVID-19)	2020 (adjusted for COVID-19)
ADB: CPRO	0	250
ADB: policy-based loans	200	250
Others <sup>c</sup>	492	389

ADB = Asian Development Bank, COVID-19 = coronavirus disease, CPRO = COVID-19 pandemic response option.

<sup>a</sup> Details are provided in Table 3.

<sup>b</sup> Commercial financing originally included a facility of up to \$300 million from international banks backed by an ADB policy-based partial credit guarantee that did not progress due to changing market conditions.

<sup>c</sup> This includes financing provided by ADB project investments, the Government of Australia, the Government of Japan, and the World Bank, among others; and factors in loan repayment, including to ADB.

Source: Asian Development Bank.

26. The government has requested a regular loan of \$250 million from ADB's ordinary capital resources to help finance the program. The loan will have a 15-year term, including a grace period of 3 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; and such other terms and conditions set forth in the draft loan agreement. The government's development policy letter is in Appendix 3.

27. **Debt sustainability.** Despite the IMF classifying PNG at high risk of debt distress, debt sustainability analyses conducted by ADB and the IMF have shown that the consequences of the pandemic would primarily be short-to-medium term.<sup>38</sup> In the longer term, as PNG's major resource projects generate higher growth, the economic effects of the pandemic would gradually dissipate. Planned lending from development partners would lift public debt to 49.8% of GDP in 2020 and to 52.6% in 2023, before a downward trajectory resumes. The breaches of debt service limits are either one-off or short-lived. The longer-term sustainability of PNG's external and public debt is preserved. Debt management is guided by a medium-term debt strategy that seeks to make use of low-cost external financing. ADB provides TA support in debt management (footnote 30). ADB's proposed loan, which represents 2.5% of PNG's outstanding public debt stock, is not considered to add significantly to the debt service obligations of the government or affect debt sustainability.

## E. Implementation Arrangements

28. DOT will be the executing agency. The implementing agencies are the departments of health, education, community development and religion, agriculture and livestock, national planning and monitoring, and commerce and industries. DOT will monitor budget execution and the flow of funds for countercyclical measures, and submit a report to ADB by the end of May 2021. ADB will commit TA resources (para. 20) to monitor program implementation which will be aligned to the government's monitoring arrangements (para. 5). The program implementation period is February 2020 to June 2021. The proceeds of the loan will be withdrawn in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

## III. DUE DILIGENCE

29. **Governance.** The most recent public expenditure and financial accountability assessment was in 2015.<sup>39</sup> PNG scored relatively well on credibility of the fiscal strategy and budget, policy-based planning and budgeting, and comprehensiveness and transparency. However, it has scope for improvement in accountability; management of public assets, liabilities and associated fiscal risks; and timeliness of fiscal accounts. ADB and development partners are supporting the government's improvements in PFM. The current administration set up several institutional arrangements to ensure that COVID-19 funds are expended as intended. This includes the

<sup>38</sup> Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2).

<sup>39</sup> IMF. 2015. *Public Expenditure and Financial Accountability Assessment*. Washington, DC.

Pandemic Act (para. 5), financial instructions that prescribe how COVID-19 funds are to be disbursed, and the reporting required. Despite PNG ranking 137th out of 179 economies in corruption perception, improving governance is a priority, as evidenced by the Whistleblowers Act 2020, which protects civil servants who report maladministration or misconduct from retaliation.<sup>40</sup> ADB's Anticorruption Policy (1998, as amended to date) was discussed with the government.

30. **Poverty.** Poverty has increased with COVID-19 (para. 11). The impacts on the employment of heads of households are severe, and temporary relief such as cash support from superannuation funds will prevent households from falling into, or deeper into, poverty. Food supplies are an essential immediate response for those at high risk of reduced food intake, especially affected informal workers in urban areas. Most poor households are in rural areas dominated by subsistence and cash crop production; hence, agriculture support through price subsidies, payment of freight costs for transporting produce and distributing planting materials and livestock will help maintain food and cash crop production, a source of food security and income for small-scale producers. The government's assistance to MSMEs and informal traders through market improvements, small business training, provision of loans, and loan repayment holidays will prevent enterprises from going out of business or having to dismiss workers.

31. **Gender.** The program is categorized *effective gender mainstreaming*.<sup>41</sup> It includes proactive actions across all three output areas to support women's health, safety, and economic empowerment. To protect women's health, the National Guidelines on Clinical Management of COVID-19 Cases include gender actions such as provisions for pregnant women, continued antenatal care and prioritizing GBV risk assessments, training for frontline health workers (most are women) on the clinical management of COVID-19 (which has been provided), and ringfenced budget for maternal health care services. The GBV subcluster continues to be activated and meets regularly; agreements are in place to ensure that GBV services across PNG are considered "essential services" and can operate during lockdowns; and the government approved a code of conduct preventing sexual exploitation and abuse by humanitarian workers. To support women's economic empowerment, the government's package to support MSMEs will target women entrepreneurs through low-interest financial products, market improvements, training, and loan repayment holidays. In addition, women and women's groups in the NCD are producing face masks as an additional income-generating opportunity; 200,000 masks were procured by the government to be distributed to communities around the NCD.

32. **Safeguards.** In compliance with ADB's Safeguard Policy Statement (2009), the program was screened and classified *category C* for environment, involuntary resettlement, and indigenous peoples.<sup>42</sup> Additional due diligence confirmed that the program's component with the greatest risk—comprising a guarantee arrangement for lending to MSMEs—will not result in any adverse environmental impacts.<sup>43</sup> The banks will apply ADB's prohibited investment activities list in their lending to MSMEs. The program is not expected to have any significant environmental or social safeguards impacts as per the provisions in the Safeguard Policy Statement.

33. **Risks and mitigating measures.** Major risks and mitigation measures are summarized in Table 5 and described in detail in the risk assessment and risk management plan.<sup>44</sup>

<sup>40</sup> Transparency International. Corruption Perceptions Index. <https://www.transparency.org/en/cpi/2019/results/table> (accessed 1 October 2020). Government of Papua New Guinea. 2018. *Medium Term Development Plan III 2018–2022*. Waigani.

<sup>41</sup> Gender Monitoring Matrix (accessible from the list of linked documents in Appendix 2).

<sup>42</sup> ADB. [Safeguard Categories](#).

<sup>43</sup> Safeguards Assessment Matrix (accessible from the list of linked documents in Appendix 2).

<sup>44</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

**Table 5: Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigation Measures</b>
Economic and fiscal conditions deteriorate because of accelerating COVID-19 infections, which further depresses demand.	The government will continue to support the economy and focus expenditure on initiatives that will limit the economic impacts of COVID-19. The government, with the support of development partners, will monitor the effectiveness of interventions and make adjustments as required. The IMF will provide policy advice, through the implementation of the Staff-Monitored Program, to ensure a balance between economic stimulus and fiscal sustainability.
Poor execution of the government's countercyclical policies, not least because of limited capacity, results in fewer benefits than envisaged.	The government's countercyclical policies have been designed to limit the complexity of stimulus measures and use existing channels to ensure that they can be implemented. Existing channels, particularly for social assistance, have their limitations, but comprehensive and localized support from development partners is helping overcome these constraints and improve monitoring. ADB technical assistance resources will help supplement capacity. <sup>a</sup>
Political instability or a breakdown in law and order hampers the government's efforts to execute its countercyclical program.	ADB maintains strong relationships across the legislature, including those who may form a new government. ADB has strong relationships with key public servants in central government agencies. The government has increased funding to the police and the defense forces to maintain law and order.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, IMF = International Monetary Fund.

<sup>a</sup> ADB. [Papua New Guinea: Supporting Public Financial Management \(Phase 3\)](#); ADB. [Regional: Strengthening Social Protection in the Pacific](#); and ADB. [Regional: Strengthening Gender Outcomes in Pacific COVID-19 Response and Recovery](#).

Source: Asian Development Bank.

#### **IV. ASSURANCES**

34. The government has assured ADB that the implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, financial management, and disbursement as described in detail in the loan agreement.

#### **V. RECOMMENDATION**

35. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$250,000,000 to Papua New Guinea for the COVID-19 Rapid Response Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa  
President

19 November 2020

## DESIGN AND MONITORING FRAMEWORK

<b>Country's Overarching Development Objectives</b> Health, social, and economic impact of the outbreak mitigated (Papua New Guinea Emergency Preparedness and Response Plan Coronavirus Disease 2019) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Effect of the Program</b>  Adverse effects of COVID-19 on businesses and the population reduced <sup>b</sup>	a. At least 70% of businesses still in operation as of 31 December 2020 (31 December 2019 baseline: 100% [60,378 businesses])  b. By 31 December 2020, at least 400,000 (at least 50% of them women) benefit from at least one form of support under the program, with data disaggregated by sex (February 2020 baseline: 0)	a. Papua New Guinea Company Registry. Tracking using sex-disaggregated data  b. Department of Treasury report and World Bank high frequency phone surveys	Economic and fiscal conditions deteriorate because of accelerating COVID-19 infections, which further depresses demand.
<b>Outputs</b>  1. COVID-19 health response measures implemented	<b>By 31 December 2020:</b>  1.1 At least 4,500 health care workers (at least 50% of them women) have improved knowledge and skills in COVID-19 clinical management (February 2020 baseline: 0)  1.2 Gender-sensitive <sup>c</sup> National Guidelines on Clinical Management of COVID-19 Cases are approved (February 2020 baseline: no such guidelines)  1.3 An additional 49 polymerized chain reaction and/or GeneXpert machines procured (February 2020 baseline: 1 machine)	1.1 National Department of Health reports and health cluster minutes  1.2 COVID-19 Health Situation reports  1.3 COVID-19 Health Situation reports	Poor execution of the government's countercyclical policies, not least because of limited capacity, results in fewer benefits than envisaged.  Political instability or a breakdown in law and order hampers the government's efforts to execute its countercyclical program.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
2. Measures to protect and provide social assistance and food security to vulnerable groups enhanced	1.4 \$27.2 million of funding is preserved for maternal and reproductive health services in 2020 (2019 baseline: \$4.3 million)	1.4 Department of Treasury reports	
	2.1 At least 200,000 locally made face masks procured from community and women's groups and distributed around the National Capital District (February 2020 baseline: 0)	2.1 Department of Community Development and Religion reports, and gender and protection subcluster minutes	
	2.2 At least 10,000 small-scale farmers are provided with agriculture inputs or animal health support so they can continue to generate income and produce for their families and communities (February 2020 baseline: no support provided to small-scale farmers)	2.2 Department of Agriculture and Livestock reports, and food security cluster minutes	
	2.3 At least 5,000 people affected by income and job losses received food rations through churches and city councils (February 2020 baseline: 0)	2.3 Ministry of Women, Youth, Children, and Family Affairs reports	
	2.4 A code of conduct preventing sexual exploitation and abuse by humanitarian workers is endorsed by the National Controller (February 2020 baseline: no code of conduct)	2.4 National Control Center report	
3. MSMEs safeguarded from the economic downturn	3.1 The government provides \$51.7 million to at least 2 commercial banks for new lending to MSMEs (February 2020 baseline: 0)	3.1 Department of Commerce and Industry reports, and reporting from participating banks	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>3.2 The government provides \$2.3 million to at least 1 bank for a dedicated loan product for women-operated MSMEs (February 2020 baseline: 0)</p> <p>3.3 At least 10,000 small cash-crop producers, especially in the cocoa, coffee, and copra industries, are provided with some price subsidies (February 2020 baseline: no subsidies provided to small cash-crop producers)</p>	<p>3.2 Department of Commerce and Industry reports, and reporting from participating banks</p> <p>3.3 Department of Agriculture and Livestock reports, and food security cluster minutes</p>	

**Budget Support**

ADB: \$250 million (loan)

ADB = Asian Development Bank; COVID-19 = coronavirus disease; MSMEs = micro, small, and medium-sized enterprises.

<sup>a</sup> Government of Papua New Guinea, Department of Health. 2020. *Papua New Guinea Emergency Preparedness and Response Plan Coronavirus Disease 2019 (COVID-19)*. Port Moresby.

<sup>b</sup> Because of uncertainties over how the pandemic will unfold and its economic effects, because of the need for government responses to be flexible as the situation evolves, and because new data collection and reporting systems to monitor the crisis are being developed and evolving, it is not yet possible to set more specific and realistic program effect targets than those presented in the design and monitoring framework. Additional indicators to measure the effects will be identified at a later stage and used to report on the program's effectiveness as comprehensively as possible in the program completion report.

<sup>c</sup> Includes provisions for pregnant women, prioritization of antenatal care for particularly vulnerable groups such as adolescent girls, and prioritization of gender-based violence risk assessments.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=54346-001-3>

1. Loan Agreement
2. Development Coordination
3. Country Economic Indicators
4. International Monetary Fund Assessment Letter<sup>1</sup>
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. List of Ineligible Items
8. Debt Sustainability Analysis

**Supplementary Documents**

9. Gender Monitoring Matrix
10. Safeguards Assessment Matrix
11. Summary of Social Assistance Measures
12. 2019 Article IV Consultation and Request for a Staff-Monitored Program

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<sup>1</sup> An International Monetary Fund (IMF) assessment letter was requested on 13 September 2020. On 14 September 2020, the IMF confirmed that the attached staff report for the Papua New Guinea Rapid Credit Facility (1 June 2020) may serve as the IMF assessment letter.

## DEVELOPMENT POLICY LETTER



INDEPENDENT STATE OF PAPUA NEW GUINEA

### MINISTER FOR TREASURY

29 October 2020

Mr Masatsugu Asakawa  
President  
Asian Development Bank

Dear President Asakawa,

#### COVID RESPONSE LOAN WITH THE GOVERNMENT OF PAPUA NEW GUINEA

I write to you on behalf of the Government of Papua New Guinea (PNG) at a time when the COVID-19 pandemic is presenting health and socio-economic challenges on a global scale. PNG has been particularly hard hit, contending with the dual impacts of reduced commodity prices at the beginning of the fiscal year, coupled with ongoing lower regional and domestic demand. Added to this, the cost of the health and recovery plan, which the government is fully committed to implement, has seen the pandemic become the greatest single shock to PNG's economy in our 45-year history since independence.

With the first confirmed case of COVID-19 recorded in March 2020, the Government reacted quickly to contain the spread of infections with emergency measures which have included the declaration of a State of Emergency, and restrictions on domestic and international travel and public gatherings. These restrictions have served to keep confirmed infections and deaths relatively low – as of 11 October 2020, PNG has recorded 554 positive cases of COVID-19 and seven deaths - however the socioeconomic impacts have been severe.

Due to COVID-19, the PNG economy is forecast to contract by 2.9% of GDP in 2020. There have been unprecedented levels of job losses and the ADB estimates that the poverty rate in PNG may increase by 4.5 percentage points from 27.2% to



31.7% in 2020, based on a 10% decline on mean per capita consumption due to COVID-19.

Fortunately, PNG's partnership with the ADB remains strong. Our partnership represents the largest portfolio of development cooperation investments in the country and ADB-financed investments in health and infrastructure are bolstering both the immediate health response and supporting PNG's medium-term recovery. It is in this context that I write to request a \$250 million COVID-19 Pandemic Response Option (CPRO) loan under the Countercyclical Support Facility to provide critical macro-fiscal support to the national budget during this acute crisis.

#### The Government's COVID-19 response framework

Following the announcement of the first COVID case in PNG on 22 March 2020, the government enacted a State of Emergency between 23 March – 12 June, and passed the Emergency (General Provisions) (COVID 19) Act on 9 April, 2020, which granted powers to a Controller (the police commissioner) and established a National Control Centre (NCC). This legislation was replaced with the National Pandemic Act 2020 on 16 June which further expanded the powers of the Controller; authorised the NCC to issue Pandemic Measures; required annual reporting of all public expenditure under the COVID response to Parliament, and the full audit of public accounts used to disburse these funds. These measures have limited entry of the virus, established a whole-of-government response to the pandemic, and put in place appropriate oversight and fiduciary measures.

The government's pandemic response plan is tailored to the needs of PNG and to local conditions. It comprises various strategies focused on specific sectors and a coherent plan to support the economy during this crisis. Significantly, and prior to the first case of COVID-19 being confirmed, PNG's Department of Health released the PNG Emergency Preparedness and Response Plan in early March. The plan outlined PNG's public health response including incident and clinical management, infection prevention and control, surveillance and laboratory testing, and non-pharmaceutical public health interventions. Recognising the specific impact of the pandemic on school age children, the government also released an Education Emergency Response and Recovery Plan in April that drew on lessons learned from the 2018 earthquake in the Highlands. This plan provided a critical roadmap for schools to navigate remote learning options for children and a return to the classroom to minimise breaks in children's education. In addition, the Department of National Planning and Monitoring and the United Nations Disaster

Management Team produced a \$112 million COVID-19 Multi-Sector Response Plan that identified priority activities in each humanitarian cluster group building on a rapid needs assessment, and Social and Economic Impact Assessment conducted by the UNDP.

In addition to the need to protect our people from the public health risks, and reduce adverse social impacts of the pandemic, the economic toll of COVID-19 have been profound and have required stimulus measures to protect the economy and ensure businesses can continue to operate despite this once in a lifetime shock. On 2 April 2020, I announced a comprehensive economic stimulus package in Parliament which includes support to the agriculture sector, protection of jobs, and assistance for micro, small, and medium-sized businesses. Subsequent to this, my government announced more stimulus initiatives in the Supplementary Budget approved by Parliament in September. The counter-cyclical program is valued at \$769 million (3.2% of GDP) and has been designed to ensure that people's livelihoods are protected; the poor and vulnerable are supported; and economic measures are in place to help businesses recover. To do this the program has three components: (i) health and safety, (ii) social protection and food security, and (iii) MSMEs and other economic support. The proposed CPRO of \$250 million will assist in (i) the implementation of countercyclical measures; (ii) is part of a comprehensive package of ADB assistance; and (iii) is well-coordinated with other development partners (including the IMF).

#### Component one: Health and safety

The government is strengthening the public health system to contain the spread of COVID-19, while investing in health workforce training, and in capacities that can assist with front line service delivery. Following the confirmation of the first case in March 2020 the government has: (a) established 400 non-ICU beds in temporary isolation facilities for COVID-19 patients across the country; (b) in the process of procuring an additional 49 Polymerized Chain Reaction and/or GeneXpert machines; (c) trained over 4,836 health workers in COVID19 case management, (d) disbursed \$13 million via the National Department of Health for logistics arrangements and a national community education campaign, and (e) signed a \$12 million procurement contract with the United Nations Office for Projects Services to support national testing capacity and the early procurement of medical PPE. The government's Supplementary Budget, released in September 2020, outlined \$90 million in immediate health system strengthening activities including (a) funds for PPE, medical equipment, and subnational allocations to provinces (\$33 million); (b) water, sanitation and hygiene activities (\$18 million);

and (c) quarantine facilities, borders, and policing (\$39 million). Despite these additional resources, we recognize that critical services need to be maintained to ensure our people can access non-COVID-19 health services. With that in mind and as an example, we have maintained \$27.2 million in funding for reproductive health services in 2020 which is \$22.9 million more than 2019 – a 532% increase.

#### Component two: Social protection and food security

COVID restrictions have reinforced the need for the government to protect the most vulnerable in our communities. Lockdowns and job losses have placed enormous pressure on households, and sadly we have seen increased crime and violence in PNG – with a sharp rise in violence against women and children. To respond, the government will implement a \$38 million food security and nutrition program for districts and provinces to ensure food security. As part of this program, we will ensure that at least 10,000 small-scale farmers are provided with agriculture inputs or animal health support so they can continue to generate income and produce for their families and communities. For those in urban areas, at least 5,000 people affected by income and job losses will receive food rations through churches and city councils. To assist the most vulnerable and with support from development partners, \$6 million is being expended for social protection - funds for child protection, gender-based violence activities, and helping people with disabilities. This includes ensuring there is a code of conduct preventing sexual exploitation and abuse by humanitarian workers endorsed by the National Controller. Also, at least 200,000 locally made masks will be procured from community and women's groups to be distributed around Port Moresby.

Educating our young and rapidly growing population has also been a challenge. Schools have faced significant barriers to deliver remote learning, to ensure access to education, existing television and radio educational programs have been expanded with the support of development partners to broadcast television programs three times per week for secondary students with daily radio programs for primary students. This program will benefit over 370,000 children, including more than 168,000 girls to minimize disruptions in learning costed at \$22 million. In parallel, water, sanitation, and hygiene has been improved in schools with education and handwashing initiatives supported.

For those households hit with the loss of an income through redundancy or lay-offs, the government has permitted early access to superannuation savings (pension) on a once-off basis equivalent to 20% of a contribution balance up to a maximum of \$3,000.

### Component three: MSMEs and other economic support

According to the UNDP, MSMEs comprise roughly 25% of PNG formal economy GDP and 24% of the labour force participation rate. COVID-19 has seen 75% of MSMEs firms adversely affected, with 95% of informal MSMEs experiencing a drop in income. To support this critical sector, the government, with support from development partners, has announced a \$66 million support program for the rural sector, MSMEs, and households. This includes funding for (a) price support program for at least 10,000 coffee, cocoa, and copra farmers; (b) market improvements and small business training for rural MSMEs and households; (c) removing fees and charges on logistics and freight (managed by the Department of National Planning and Monitoring); and (d) tax and debt relief. In an effort to leverage finance and spur business activity, we are proud to inform you of the successful launch of a \$59 million loan program for MSMEs through domestic commercial banks. The package will allow MSMEs to borrow between \$2,000 - \$1,000,000 at a 4-5% interest with a term of 15–20 years. \$11 million will be directed to agriculture related businesses; \$7 million for youth, women, and micro businesses, and \$2.2 million exclusively for women-run businesses. To support the economic recovery and find gainful employment for our people, the government is committing \$88 million in a capital works program across the country. Finally, PNG's financial institutions have provided loan repayment holidays for 3 months, and some banks have offered or longer terms, estimated to cost \$177 million.

### Gender

As I noted earlier, the COVID pandemic has had specific impacts on women and vulnerable members of our communities. These impacts require a tailored response. The Government of PNG is fully cognizant of the importance of delivering a gender sensitive counter-cyclical program of support – which we believe we have outlined in the Supplementary Budget and articulated with our development partners. We remain fully committed to the gender related targets of the CPRO and will report to ADB on progress in achieving them.

### Monitoring

Progress with implementation of the CPRO program, as well as on regular reporting of results and outcomes, will be closely monitored by the Department of Treasury, in coordination with the Department of National Planning and Monitoring; and made available to the ADB. We welcome any additional consulting support to supplement our staff resources to ensure the required data

and reporting meets ADB's requirements. We express our sincere appreciation to the ADB for its consideration of this critical support under the CPRO and reiterate our full ongoing support for the reform programs being implemented by the IMF and other development partners, toward ensuring maximum development effectiveness from all assistance received.

In closing, President Asakawa, on behalf of the Government of PNG please let me communicate again our sincere thanks and strong desire to see our partnership with the ADB continue to grow in order to realise our shared development objectives for the people of PNG during this critical time.

Yours sincerely



Hon. Ian Ling-Stuckey, CMG. MP  
Minister for Treasury



Cc:

Hon. Sam Basil, Deputy Prime Minister and Minister for National Planning and Monitoring  
Mr. Dairi Vele, Secretary for Treasury  
Mr. Koney Samuel, Secretary for National Planning and Monitoring

## ASSESSMENT OF COMPLIANCE WITH THE ACCESS CRITERIA FOR THE COUNTERCYCLICAL SUPPORT FACILITY AND THE COVID-19 PANDEMIC RESPONSE OPTION

Access Criterion	Asian Development Bank Assessment
1. Adverse Impact of Exogenous Shocks	<p data-bbox="461 426 1414 590">GDP is projected to contract by 2.9% in 2020 in real terms, against 2.1% growth projected prior to the pandemic. Revenue is projected to fall by \$800 million or 3.4% of GDP, from the pre-COVID-19 target or to fall by 2.9% of GDP compared to 2019. The 2020 fiscal balance is estimated to worsen from –5% of GDP pre-COVID-19 to –8.2% of GDP post-COVID. The current account surplus is projected to reduce to 15.9% from 22.3% pre-COVID-19.</p> <p data-bbox="461 606 1414 770">The economy has been increasingly battered by the COVID-19 pandemic. The authorities have managed to contain the spread of COVID-19, to some extent, by imposing lockdowns, but these measures have depressed economic activity. Further, combined with falling export revenue as global commodity prices weaken along with external demand, and with the closure of Porgera gold mine, lockdowns have significantly undermined the fiscal position of the government. Recovery in 2021 is expected to be weak.</p> <p data-bbox="461 787 1414 1003">Several industries have been hampered by partial business closures as a result of lockdowns and restrictions on international and domestic travel: transportation, accommodation and food services, real estate, manufacturing, and construction. Agriculture and forestry have also been constrained by disruption to transportation and trade, notably by quarantine requirements on shipments, which have lengthened turnaround times. Domestic demand and household spending have weakened with curtailed business activity and associated cost-cutting measures, most notably layoffs and reduced work hours and salaries.</p> <p data-bbox="461 1020 1414 1213">The production and export of liquefied natural gas are not expected to be significantly affected by COVID-19, but mining and quarrying have been hit by the recent suspension of operations at the Ok Tedi gold and copper mine following a local outbreak of COVID-19. Beyond the Ok Tedi suspension, mining and quarrying output overall is seen to contract by 15% or more in 2020, largely reflecting closure of Porgera, following the government's decision not to renew the operator's license, and by disappointing output from the Lihir gold mine.</p> <p data-bbox="461 1230 1414 1503">The forecast for inflation in 2020 is unchanged from before the pandemic, at 3.3%, as prices track persistently weak economic activity. Recent economic developments have applied both downward and upward pressure on inflation. Downward pressures include a lower oil price, weaker domestic demand, and government interventions to mitigate the effect of COVID-19, including price regulations on selected consumer goods and a freight subsidy introduced to support shipments of local produce to the capital and ill-served offshore islands. Upward pressures include the reduced supply of goods under restrictions intended to contain COVID-19 and local currency depreciation. A lesser but still noteworthy upward pressure is accelerated increase in the money supply fueled by a quantitative easing program introduced by the BPNG, the central bank.</p> <p data-bbox="461 1520 1414 1766">The current account surplus is seen to fall to 15.9% of GDP with lower commodity prices, weaker external demand for exports, and disruption caused by transportation bottlenecks. The gold price has increased, but its positive effect will be more than offset by lost gold production from key mines. Imports have similarly slowed as businesses have become cautious and restrictions have reduced trade. Foreign exchange reserves stood at \$2.1 billion at the end of March 2020, providing cover for 5.1 months of imports. The reduction in the prices for hydrocarbons impacts PNG through the reduction in tax revenue and dividends to the state, and reduced foreign exchange transfers to the government because resource companies remit tax in US\$.</p> <p data-bbox="461 1782 1414 1890">Government revenue is expected to deteriorate significantly, with the authorities forecasting that revenue in 2020 will fall to the equivalent of 3.4% of GDP, below earlier expectations. Meanwhile, additional expenditure is needed to implement the government's response to the COVID-19 emergency.</p>

Access Criterion	Asian Development Bank Assessment
2. Countercyclical Development Expenditures	<p data-bbox="461 233 1414 369">The shortfall will be funded in part through increased financing from development partners, and the government initiated a supplementary budget to cut expenditure on other budget items. PNG's net borrowing for 2020 is projected to increase from 5% to 8.2% due to the reduction in revenue and expenditure re-appropriations for 2020. This will increase the gross domestic borrowing from a target of 40.3% to 49.8%.</p> <p data-bbox="461 386 1414 443">The pandemic has also had a significant social and economic impact, with an increase in poverty, unemployment and violence against women and children.</p> <p data-bbox="461 478 1414 722">The government, development partners and domestic institutions have prepared \$769 million of countercyclical support or 3.2% of GDP (table 3). This includes \$166 million for health and safety, \$213 million for social assistance, food security and protection to vulnerable groups, and \$390 million for MSMEs and other economic support. From the total support of \$769 million, \$444 million is directed through the budget, of which \$332 million is government funded and \$112 million is development partner financial assistance. The additional \$324 million of support is from domestic institutions, including for loan repayment holidays, though commercial banks, and support for superannuation withdrawals.</p> <p data-bbox="461 739 1414 1016">The government funded portion of \$332 million (K1.1 billion) is composed of (i) K645 million announced stimulus package, (ii) additional infrastructure stimulus of K305 million within the supplementary budget, and (iii) K200 million of support for MSMEs through commercial banks. By midyear, the government has already released 75% of the expenditures announced from the K645 package, including for water, sanitation and hygiene programs for districts (K60.0 million), medical drug and PPE procurement in the Health Sector (K67.0 million), Reinforcing security and defense border posts (K113.0 million), citizens repatriation program (K15.0 million), food distribution programs through Churches and City Authorities (K5.0 million), agriculture market development for Provinces and Districts (K111.0 million), and logistics support for MSME's and households (K44.5 million).</p> <p data-bbox="461 1033 1414 1194">In the face of falling revenues of 3.4% of GDP, the government has announced the retention of the full capital works budget for 2020. Overall share of development or capital expenditure as share of total expenditure has been increased by 3%. With budget cuts of 100% directed towards non-productive operational expenditure for 2020, the government has attempted, with the supplementary budget, to maintain a fiscal expansionary stance to stimulate the economy within its limited fiscal space.</p> <p data-bbox="461 1211 1414 1457">In May 2020, the government requested and received \$363.3 million from the IMF under the RCF made available to fund COVID-19 expenditures. The loan proceeds financed the initial emergency response in health, helped to shore up foreign exchange reserves and execute a re-prioritized capital and operational budget of the government, where emergency expenditures in health and security were brought forward. The government has committed to post details of all procurement awarded under a National State of Emergency within 1 week, present weekly reports of COVID-19 expenditures in the Budget Management Committee, and submit a consolidated report to the National Executive Council published within 3 months of the end of the emergency period.</p>
3. Pre-shock Record of Generally Sound Macroeconomic Management	<p data-bbox="461 1486 1414 1543">Growth averaged 4.2% between 2015–2019, and 0.9% in the non-mineral economy, despite being impacted by multiple shocks—falling commodity prices, drought, and an earthquake.</p> <p data-bbox="461 1560 1414 1906">In this very challenging context, fiscal policy has generally been sound, with the deficit averaging 3.9% over 2015–2019. The deficit was limited to 2.5% of GDP in 2017 and 2.6% of GDP in 2018, before a switch to a more expansionary fiscal policy in 2019, with a deficit of 4.9% of GDP, largely driven by increased capital expenditure, to stimulate growth of the economy; although, the deficit was also impacted by falling revenues associated with weak growth (revenues excluding grants fell to 14.1% of GDP in 2019 from 15.5% in 2018), and to a lesser extent revisions in nominal GDP. Additionally, the government has worked to implement fiscal reform measures, including revenue raising measures under a Medium-Term Revenue Strategy (2018–2022), guided by IMF technical assistance, and measures aimed at controlling recurrent expenditure under a Medium Term Fiscal Strategy (2018–2022), although progress has been slower than hoped for. An IMF SMP commenced in February 2020, following a request from the Government to the IMF to oversee its reform agenda.</p>

Access Criterion	Asian Development Bank Assessment
	<p>Inflation averaged 5.3% during 2015–2019 and 5.0% during 2010–2014. Key drivers of inflation were exchange rate movements, commodity price fluctuations, and demand pull associated with a large foreign direct investment, PNG LNG, a \$19 billion liquified natural gas plant constructed during 2010–2014. Inflation may also have been impacted by a program of purchasing government debt by the BPNG during 2014–2017; however, this was terminated and wound down from 2018 (BPNG holdings of Government debt increased from K766 million in December 2013, to K2.0 billion in December 2014, and to K3.9 billion in December 2016, and were steadily reduced thereafter, falling to K1.9 billion as of March 2020).</p> <p>The Kina Facility Rate is the BPNG's policy rate; it was held at 6.25% during 2015–July 2019, above the rate of inflation; however, its effectiveness has been limited, as evidenced by its weak transmission to lending rates, which remain primarily determined by credit risk appetite, and to deposit rates, which remain low as a result of ample system liquidity. The exchange rate mechanism has also limited the effectiveness of the Kina Facility Rate.</p> <p>Key factors that influence PNG's exchange rate are commodity price fluctuations and capital flows associated with foreign direct investment. The kina appreciated against the US dollar by 34.8% between June 2010 and June 2012, during a period of rising gold prices and large inflows of foreign currency associated with the construction phase of PNG LNG; central bank foreign exchange reserves grew to over \$4 billion in 2012, compared to \$2 billion in 2007. However, this trend reversed in 2013 as PNG LNG construction ended and as commodity prices began to slide. This put significant downward pressure on the kina, which depreciated by 26.3% between June 2013 and June 2014, as well as on international currency reserves, which reduced to \$2.6 billion in July 2014. The central bank intervened to stem the pace of depreciation and loss of reserves by introducing in June 2014 a trading band and a policy of rationing foreign exchange. These interventions prevented the exchange rate and currency trading from adjusting to market conditions, finally appearing as shortages of foreign exchange. A recent assessment by the IMF indicates that the currency remains overvalued by 12% to 18%. This is evidenced by a reported backlog of foreign currency orders (i.e., demand for foreign currency) with commercial banks, estimated at around \$0.5 billion. This has impeded growth and inhibited investment. In this context, the IMF SMP recommends that PNG gradually devalue its currency, which could be achieved with a real depreciation of 3% to 5% per annum over a period of 3 years, and to complement this with seeking technical assistance for an appropriate exchange rate policy. During 2020, exchange rate depreciation picked up after the commencement of the IMF SMP (the kina depreciated by 2.6% versus the US dollar, between January and September 2020). In addition, the IMF SMP recommends that an amount of at least \$60 million per month be released from reserves under the SMP, and the BPNG is broadly on track with this, having released \$330 million as of July 2020, against an annual target under the IMF SMP of \$720 million.</p>
4. Structural Reforms (including Health Response)	<p>The Department of Health released an Emergency Preparedness and Response Plan on 2 March 2020, outlining a framework for key actions needed to prepare and respond to COVID-19. On 23 March 2020, a state of emergency was declared, which resulted in a lockdown of the economy and restrictions on movements of people. An Emergency Act 2020 was passed on 24 March 2020, which was retroactively applied from 13 March, empowering authorities to respond. The Police Commissioner was appointed as the 'Emergency Controller' by the Prime Minister. The borders were closed from 26 March and the first lockdown was from 23 March to 1 April. A second lockdown was from 29 July to 14 August. The Emergency Act was superseded by the National Pandemic Act 2020, which was passed on 16 June 2020. The National Pandemic Act outlined the legal powers conferred to the Controller, including the imposition of border and quarantine controls, and financial management arrangements for the medium-term response to the pandemic. On 17 June 2020, a NCC was established to manage the response and coordinate national government agencies and development partner support. The NCC is led by the Controller, and through the whole-of-government NCC governance structure, it is currently monitoring and enforcing 11 Pandemic Measures including governing of international and domestic travel, provincial coordination, burial of deceased persons, customs duties, testing, surveillance, businesses and social events, health protocols, and public transport restrictions in the capital. At present, physical borders are closed but land and sea borders remain porous. The only formal points of entry are Port Moresby's airport for travellers, and the seaports of Port Moresby, Lae, Madang and Rabaul for cargo.</p>



Access Criterion	Asian Development Bank Assessment
5. Debt Sustainability	<p>The government has initiated a countercyclical economic package to be implemented by various agencies to support the economy and the vulnerable through support for MSMEs, food donation, freight subsidy scheme and superannuation support to those who have lost their jobs due to COVID-19 among others.</p> <p>The drastic economic and financial effects of the COVID-19 pandemic have deteriorated PNG's growth prospects. The government's limited capacity to generate sufficient revenues to fund its mounting expenditures in the face of the pandemic has widened the fiscal deficits which must then be covered by borrowing. The current deteriorating fiscal deficits will raise PNG's public debt ratio to nearly 50% of GDP in 2020, well beyond the government's 30% medium-term target. This has forced the government to request adoption of amendment to <i>Fiscal Responsibility Act</i>, raising the legal threshold level of 45%, set in 2019, to 60%. Current upward pressures come on the back of a marked trend of rising public debt during recent years. Fiscal slippage, revaluation of foreign currency debt in 2018, and a revision of public debt to include some SOE project loans taken over by the government caused public debt to rise to 39.8% in 2019 from 32.7% of GDP in 2017. Exceptionally tough circumstances this year will likely see the debt ratio jump to 49.8%, and to stabilize above 50% in the years to follow, as overall fiscal deficits are expected to more than outweigh economic growth's downward pull on the debt ratio.</p> <p>Despite the IMF classifying PNG at high risk of debt distress, the DSAs conducted by ADB (and the ones conducted by the IMF/WB), have shown that the drastic outcome of the pandemic would be presenting themselves in the short to medium term and that over the longer term, as PNG's major resource projects will continue to generate higher growth, the drastic economic effects of the pandemic would gradually dissipate. Both ADB's and IMF/WB's DSAs point to the fact that as breaches of debt services are either one-off or short lived, the longer-term sustainability of the country's external and public debt are preserved. ADB's assessment points to the gradual decline of the projected present value of the public debt-to-GDP to below 50% from 2024 and onwards (45% in IMF/WB's DSA). Both DSAs reach the conclusion that the short-term breaches of the external debt service-to-revenue ratio are expected to be financed by loans with concessional terms. ADB's proposed loan, which represents 2.5% of PNG's outstanding debt stock, is not expected to add significantly to the debt service obligations facing the government or affect PNG's debt sustainability.</p>
6. Coordination with the IMF	<p>ADB has been in close communication with the IMF on the CPRO. ADB undertook regular dialogue with the IMF on issues such as an assessment of the macroeconomic and fiscal situation, particularly related to how the increasing deficit would affect debt sustainability. ADB also sought the IMF's views on the access criteria for this CPRO. The IMF commenced a SMP in Feb 2020, and ADB has been closely coordinating with the IMF on the SOE reform program, which is a benchmark in the SMP. When the IMF prepared its RCF and undertook a review of the SMP, the IMF sought ADB's views on the economic outlook in the context of ADB's budget support in 2020 and forward pipeline. In June 2020, the IMF disbursed \$364 million to PNG, under a RCF and prepared an updated DSA. The RCF paper notes the need for additional financing support for PNG. The IMF's RCF report is provided in lieu of an assessment letter.</p>

ADB = Asian Development Bank; BPNG = Bank of Papua New Guinea; COVID-19 = coronavirus disease; CPRO = COVID-19 pandemic response option; DSA = debt sustainability analysis; GDP = gross domestic product; IMF = International Monetary Fund; K = kina; LNG = liquefied natural gas; MSME = micro, small and medium-sized enterprise; NCC = National Control Center; PHA = provincial health authority; PNG = Papua New Guinea; RCF = Rapid Credit Facility; SMP = Staff-Monitored Program; SOE = state-owned enterprise; US = United States; WB = World Bank.  
Source: Asian Development Bank.