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## POTENTIAL STRATEGY TO BOOST AGGREGATE DEMAND FOR GOODS AND SERVICES IN PAPUA NEW GUINEA DURING THE COVID-19 PANDEMIC

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### Key Points

- COVID-19 pandemic, which is currently impacting on the economy of nations, is resulting in the loss of lives and livelihoods.
- In order to minimise the spread of COVID-19, Papua New Guinea (PNG) adopted the lockdown measure.
- The lockdown measure restricted the supply and demand for goods and services across the country.
- The total quantity of goods and services bought by people (aggregate demand) must be stimulated to prevent the PNG economy from going into recession.
- The Economic stimulus package must be implemented in an effective and efficient manner to boost aggregate demand.
- Bail out firms hit hardest by the impact of COVID-19, and provide long-term loans at low interest rates to micro, small and medium enterprises to also boost aggregate demand.

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# POTENTIAL STRATEGY TO BOOST AGGREGATE DEMAND FOR GOODS AND SERVICES IN PAPUA NEW GUINEA DURING THE COVID-19 PANDEMIC

By Eugene E. Ezebilo

**L**ockdown measure has been implemented in several countries including Papua New Guinea (PNG) as a way to minimise the spread of the COVID-19 pandemic. However, the lockdown has the potential to have different impact on various sectors of the economy. People need to earn an income in order to be able to pay for goods and services. However, during the lockdown most people find it difficult to earn an income and to buy goods and services they need. This is either because the goods and services are not available or that people do not have money to pay for them as a result of restricted access to opportunities to earn an income.

This paper focuses on the strategy to boost aggregate demand (AD) for goods and services as a way to mitigate the adverse impact of COVID-19 pandemic on the PNG economy. The pandemic can impact the economy in several ways such as an increase in government's expenditure, a decrease in household consumption, a decline in investment and a decrease in the export of goods and services. The decrease in consumption, investment and export of goods and services contribute to the decline in AD whereas an increase in government expenditure can be used to trigger an increase in AD. In order to mitigate the impact of COVID-19, we can implement an effective and efficient economic stimulus package, bail out firms that belong to sectors that have been hit harder, business owners should be allowed to pay tax on instalment basis until such a time that normalcy in economic activities returns. The informal sector and Micro, Small and Medium Enterprises (MSMEs) should be considered in the economic stimulus package because they play an important role in providing livelihoods for most people in PNG.

## Aggregate Demand and its components

AD is the total amount of goods and services that people buy in a country over a period of time at a given price level (Gravelle and Rees, 2004). All things being equal, AD should be equal to the amount of goods and services produced in a country over a period of time (Gross Domestic Product, GDP) especially in the long term after adjusting for

price level. However, if goods have been produced and AD suddenly declines, GDP will become greater than the AD within that period of time. Furthermore, if there is a decrease in AD over a long period of time, producers will have less economic incentive to produce goods and services which results in a decrease in GDP and consequently a reduced government revenue. AD has the potential to impact on government revenue. An increase in AD will increase the revenue from taxes on goods and services bought by consumers, which can stimulate growth of PNG economy. AD is made up of several components as the following:

- **Consumption.** This includes households' expenditure on goods and services that are used at home; that is, expenditure on final goods and services that will not be resold or used for production. If households' future income is guaranteed, then lowering interest rates will ensure that they have less debt; hence they are likely to increase their consumption. An increase in households' consumption of goods and services results in an increase in AD.
- **Investment.** It entails expenditure made by firms in the production of goods and services. An increase in investment often results in an increase in AD. A decrease in interest rates, an increase in business confidence about future growth of the economy and provision of incentives such as tax holidays, subsidies and loans at lower interest rates would likely increase investment. An increase in investment will provide more jobs and an increase in government revenue.
- **Government expenditure.** This includes expenditure made by the government on pensions, unemployment benefits, roads, schools, hospitals, electricity and pipe-borne potable water. An increase in government expenditure contributes to the redistribution of income, which can also increase AD.
- **Net exports.** This is the difference between the value of goods and services exported and those imported. An increase in net export results in an increase in AD.

## Potential impact of COVID-19 pandemic on aggregate demand in PNG

The COVID-19 pandemic impact on aggregate demand in several ways as the following:

- Diminishing household consumption. The 14-days lockdown of PNG that was declared by the Government of PNG (GoPNG) on 24 March 2020 and later extended for two months by the Parliament on 2 April 2020 resulted in the restriction of movement of people and makes consumers to spend mainly on essential goods and services. The uncertainty surrounding future income especially for short-term contract workers and those in the informal sector who depend on daily income make it difficult for them to spend money on non-essential goods and services. In fact, some people that work in the private sector either lost their job or are not paid salaries, which decreases their consumption for goods and services. It is important to note that in the GoPNG's 2020 National budget, it was estimated that K11.2 billion will come from tax revenue (Department of Treasury, 2019). However, the fall in AD as a result of COVID-19 pandemic makes it difficult to achieve that expectation. The fall in AD will also have an adverse effect on the country's GDP for 2020. For instance, before the onset of COVID-19 pandemic, the World Bank (2020) reported that PNG's GDP growth for 2020 would be around three percent. However, the impact of COVID-19 on AD might make it difficult to achieve the growth of that magnitude.
- Decline in investment. Even before the COVID-19 pandemic, PNG has been struggling to provide an enabling environment to attract investment. COVID-19 is exacerbating this problem in that the uncertainty associated with future stability of the country's economy and low expectations of making profit in the future are likely to discourage potential firms from investing in PNG. Decline in investment will result in a decrease in job opportunities which in turn will reduce AD.
- Increase in government expenditure. To minimise the spread of COVID-19 in PNG, the GoPNG increased expenditure of the health sector, defence sector and has also announced a K5.6 billion economic stimulus package (Ling-Stuckey, 2020).

The package was later increased by K100 million, making it a total package of K5.7 billion (Business Advantage PNG, 2020). According to the 2020 budget, the government expenditure was estimated as K18.7 billion, however, there is tendency that this estimate will be surpassed.

- A decline in net export. The lockdown of PNG means that non-essential goods and services cannot be exported and imported. Crude oil has been one of the important exports of PNG. However, the price of oil crashed as a result of the diminishing demand caused by COVID-19 pandemic. For instance, on 30 December 2019, the price of a barrel of Brent crude oil was US\$68.60 whereas it was US\$29.63 on 11 May 2020 (Markets Insider, 2020). This corresponds to a decrease of 57 percent.

## Interventions used by Government of PNG to boost aggregate demand

In the 2020 National Budget, GoPNG increased expenditure to K18.7 billion from K16.1 billion in 2019 with the hope of stimulating AD in the country (Sanida, 2020). However, the COVID-19 pandemic triggered the need for more expenditure. The following interventions have been used by the Government to boost AD:

- Economic stimulus package. GoPNG has earmarked K5.7 billion (US\$1.63 billion) as the economic stimulus package. If implemented properly, the stimulus package has the potential to stimulate aggregate demand. The package should be managed properly by using an effective and efficient mechanism to avoid using it for other purposes. In fact, effective monitoring and evaluation mechanisms should be put in place for checks and balances and accountability concerning how the economic stimulus package is being distributed among sectors of the economy and utilised.
- As a result of the adverse impact of COVID-19 pandemic on businesses, the Internal Revenue Commission (IRC) has provided opportunity for potential extension for lodgement of corporate income tax (KMPG, 2020). There is also the opportunity for business owners to pay corporate income tax and personal income tax in instalments until 30 June 2020. Although it is a good development, the window for this opportunity is too short. It is important for IRC to continue the arrangement until such a time that a solution is found to the COVID-19 pandemic and the economy stabilises again.

### Other potential interventions that can be used to boost aggregate demand

- Bailout firms in sectors that have been hit by the impact of COVID-19. GoPNG should consider providing financial assistance to firms that have been hit hardest by the impact of COVID-19, especially those in the tourism, hospitality, manufacturing, and transportation sectors of the economy. This has the potential to sustain production of goods and services, sustain jobs of employees and save the firms from shutting down. The goods and services are bought by consumers whereas incomes received by employees are also used to buy other goods and services, which boosts AD. Furthermore, government gets revenue from taxes paid by firms, employees and consumers through goods and services tax. This has the potential to stimulate the economy. The economic stimulus package states that K320 million or US\$91.43 million (Ling-Stuckey, 2020) will be used to support agriculture, businesses and households. It is not clear whether it would be in the form of bail out of firms in the sectors that were hit hardest by COVID-19.
- Promote employment and income support. The economic stimulus package should be used to support MSME operators to create more jobs and income for people. Part of the fund from the package can be given to commercial banks for on-lending to MSME operators at low interest rates such as three percent. This has the potential to boost AD and revenue for the government. For instance, as people earn income they pay for goods and services and at the same time pay tax, which contribute to boosting of the economy. This has the potential to reduce supply shocks and demand shocks associated with workers' productivity capacity and suppression of households' consumption.
- The economic stimulus package should consider people who work in the informal sector. Some households depend on informal activities for their livelihoods. However, these households were hit harder by the impact of COVID-19 because they were restricted from the activities during the period of lockdown in PNG (Kopel, 2020). Currently, it is not clear how the economic stimulus package would be used to assist informal sector operators. For the stimulus package to work well, the welfare of

informal operators should be considered in planning interventions that the package should be used for. GoPNG should consider providing food rations or cash transfers to informal sector operators or both. If only food is provided, it will not boost AD; cash is required to increase the purchasing power of the operators and their employees. However, the challenge is that some people who engage in informal economy may miss out because they do not have a bank account. Further, it is difficult to identify people who are involved in informal businesses because of lack of registration. In fact, the current situation may provide the government with the opportunity to begin the registration of informal businesses. This will provide the needed information for planning future interventions in the informal sector of PNG's economy. In the nearest future, GoPNG should consider initiating social insurance for households that depend on informal activities for livelihoods.

- Fund research on the socioeconomic impact of COVID-19 pandemic on the PNG economy. The findings from the research will provide a clearer picture concerning how various sectors of the economy and households have been impacted and potential strategy to address the impact. This information will be very useful for planning and making informed decisions during post-COVID-19 period.

### Concluding Remarks

If the situation in other countries around the world is anything to go by, then the future after COVID-19 pandemic is bleak. At the time of writing this paper, PNG has successfully prevented an outbreak of COVID-19 in the country. Only eight confirmed cases of COVID-19 infections without any death have been reported in the country (Worldometers, 2020). However, the trade-off of the success has resulted in the hardship faced by businesses especially those associated with MSMEs and informal economy. It is challenging to minimise the spread of virus and at the same time minimise its impact on the country's economy.

While the virus triggered a downward spiral of economic activities, AD can be stimulated to reduce the tendency of the economy slipping into recession. To do this, it is necessary to implement the economic stimulus package in an effective and efficient manner. Bailing out firms hit hardest by the impact of COVID-19 and allowing business owners to continue paying tax in instalments until such a time that IRC ascertains that the businesses have stabilised should be considered as important ingredients for stimulating the consumption of goods and services around

the country. MSMEs and informal business operators should also be considered in the distribution of the economic stimulus package. For instance, GoPNG should consider providing food rations to households that depend on informal activities for their livelihoods and MSME operators should be provided loans at low interest rates. To assist planners and policymakers in making informed decisions, further research on socioeconomic impact analysis of COVID-19 on PNG economy is necessary. The research findings will provide planners and policymakers more understanding of the potential strategy to better stimulate AD during post COVID-19 to move the country's economy forward to the next level.

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