

## Is Papua New Guinea viable?

Steven Gosarevski, Helen Hughes and Susan Windybank

Centre for Independent Studies

Evidence of stagnating living standards, crime, civil strife and corruption, and of aid's failure to help the Pacific to develop,<sup>1</sup> led to radical changes in Australia's aid policies in the Pacific in 2003. The restoration of civil order in the Solomon Islands was the initial step, but Papua New Guinea is the principal focus. The Australian Government has proposed an Enhanced Cooperation Package to place 230 Australian police and 64 legal, justice and economic advisors in Papua New Guinea to restore the rule of law and to make economic growth possible. The Somare government accepted this offer of additional aid, albeit reluctantly, although the recent suspension of the Papua New Guinea Parliament for five months to avoid a no-confidence motion that threatens the government's survival means that an indemnity law to protect Australians working on the program cannot be passed (ABC 2004a). Australia has not halted its aid program, but this must become an option if the suspension of Parliament holds up delivery of the revised aid package, which would provide a total of A\$2.4 billion of Australian taxpayers' money to Papua New Guinea during the next five years.

Australian voters will expect an accounting of the increased aid expenditures, but a revised aid program will only lead to growth if Papua New Guinea abandons the strategies and policies that have seen population grow ahead of the economy in the period since independence in 1975.<sup>2</sup> This paper discusses the reforms that are essential to putting Papua New Guinea on the road to higher standards of living and, at the same time, making Australian aid effective rather than, as in the past, allowing it to bolster Papua New Guinean élites at the expense of the majority of the population.

### 2003 economic update

On 28 March 2003, Joshua Kalinoe, Chief Secretary, the Prime Minister's Department, made a presentation to the Australian Senate Inquiry into Australia's Relations with Papua New Guinea and Pacific Island Countries to make the case for Australian aid (Kalinoe 2003).<sup>3</sup> He denied 'academic' allegations that Papua New Guinea was in crisis after long-term stagnation, topped by three years of negative economic growth, and rising crime and corruption. Mr Kalinoe's

## Policy dialogue

outline of the Somare government's program focused on further resource extraction, incentives to Japanese tourists to cease 'over flying' Papua New Guinea on their way to Australia, and some attention to agricultural exports and public sector reforms. The Senators seemed less than persuaded that this program would turn Papua New Guinea around.

Six weeks later the Treasurer, Bart Philemon, told the Business Council of Papua New Guinea that the government was 'critically short of cash'.<sup>4</sup> Philemon went on to say this was only a 'cash flow problem', because the expected drawing down of an Asian Development Bank US\$57 million loan would pay public service wages and overdue payments to business. Other sources of expected income were a World Bank loan for the timber industry and the proceeds of privatisation begun by the government of Mekere Morauta (July 1999 to July 2002), the only Papua New Guinea government since independence to have had a grasp of its country's economic problems. However, the anticipated cash flows did not eventuate, as the international finance agencies, concerned at the use of concessional loans for recurrent salaries and 'purchases' expenditures, re-examined lending to Papua New Guinea. The Morauta privatisation program was suspended.

When the Treasurer presented the 2004 Budget on 25 November 2003 the international development banks' loans were still not disbursed, there had been no income from privatisation, and none was in prospect. Mr Philemon nevertheless painted an even rosier economic picture than Mr Kalinoe, promising declining budget deficits during his government's full term to 2007 (Philemon 2004a, 2004b). The budget speech and supporting voluminous and detailed documentation are, unfortunately, no more persuasive than Mr Kalinoe's address to the Australian Senate Inquiry.

The Somare government has turned from Morauta's wide range of reforms back to the exploitation of minerals and timber to pay for an overblown political establishment and public service. This strategy, followed with the strong support of external advisors from the colonial era through independence, has failed to raise living standards in Papua New Guinea. Economic theory has long clarified the difficulties of absorbing the 'economic rents' generated by the exploitation of natural resources, particularly in developing countries (Corden 1984). The countries with the greatest development problems, in Latin America, Africa and the Middle East, have followed economic strategies of resource exploitation without offsetting policies that would enable farmers to raise productivity in agriculture and entrepreneurs to create employment in secondary and tertiary industries.

Papua New Guinea's considerable tax revenues from mining and petroleum, and the lesser taxes from timber and fishing, have not been invested in infrastructure but were used to subsidise protected industries (sugar, canning and cement) and inefficient public utility enterprises (water, power, telecommunications and air transport). The minimal education and health institutions left from colonial times have barely been improved. Sir Michael Somare, Papua New Guinea's first Prime Minister and now again the Prime Minister, has not, however, lost his faith in a resource-led development strategy for Papua New Guinea. In February 2004, Somare told Chinese and Papua New Guinean businessmen in Beijing that his vision is to 'see resource-rich Papua New Guinea become a donor to less fortunate countries'.<sup>5</sup>

Resource development does not have to lead to stagnation and corruption. With appropriate economic policies, resource rents can stimulate economic development. In Botswana, mineral revenues have contributed to a doubling of income every decade, so that

## Policy dialogue

Botswana has moved from half to more than three times Papua New Guinea's income between 1970 and 2001.<sup>6</sup> But Botswana's agriculture has not stood still; its men found jobs in South African mines (albeit at a high cost in AIDS), and labour-intensive industries have been developed for the South African customs area where Botswana has similar access to Papua New Guinea's SPARTECA (South Pacific Regional Trade and Economic Cooperation Agreement) advantages in Australia and New Zealand.

Aid revenues can have a similar economic rent impact to resource revenues. Large amounts of aid can lead to an appreciation of the exchange rate (exacerbated from 1975 in Papua New Guinea by the 'hard kina' policy), impeding agricultural and labour-intensive exports. If aid is used to subsidise public investment it creates a bias against private firms. Development clusters around government geographically, developing Port Moresby at the cost of the rest of the country. Because aid is not earned income but 'windfall' revenue, it can encourage overspending and corruption, and where large-scale corruption becomes prevalent, small criminals thrive. The negative impact of aid in Papua New Guinea has been increased by the practice of including aid flows—even concessional loans that theoretically have to be repaid—in annual budgets. The shift from budget aid to project aid has thus not made more than a cosmetic difference. Resource taxes and aid flows were used up on recurrent expenditures when Mr Philemon discovered a 'cash flow' crisis.

The cash flow problem was ultimately resolved by delaying payments to business. In addition, in the 2004 Budget consumers were hit by a 2 per cent increase in import duties and stamp duties on financial transactions were raised. Unable to borrow abroad, the Somare government, against the advice of its Reserve Bank, borrowed domestically, raising interest rates and

crowding out business borrowers. Inflation in 2003 was 10 per cent. Good rainfall and high world primary product prices thus did not have a substantial impact. Coming after three year's contraction, real growth in 2003 was only 2 per cent (Kamit 2004:5). It would have been 7 to 10 per cent in any reasonably run economy. Per capita income declined for the eighth consecutive year.<sup>7</sup> Stagnation is reflected in falling demand for imports and hence an 'improving' balance of payments.

### The rationale for stagnation

Mr Kalinoe's presentation to the Australian Senate Inquiry began with the litany of excuses that have often been used to explain the country's poor performance. Instead of seeing the benefits of exploiting Papua New Guinea's mountainous topography to generate power and foster tourism, Mr Kalinoe spoke of 'mountains, rivers and oceans that we have to negotiate' (Senate Foreign Affairs, Defence and Trade References Committee 2003:427). Historical tribal/language differences—typical of many countries at early levels of development—have been made an excuse for a (dubious) adult literacy rate in 2000 of 29 per cent for men and 42 per cent for women.<sup>8</sup> The security provided by communal land ownership in subsistence agriculture has been taken from its historical context to justify the barriers it creates to savings, investment and productivity. In rapidly growing countries, small landholders trade in their land, but do so to gain much higher incomes than those of Papua New Guinea farmers. The village (that is, male) consensus appropriate to organising a hunt or an attack on a neighbouring clan has been sanctified as the 'Melanesian Way' to bully and bribe villagers into agreement with 'big men' and to drown out minority views. The evolutionary process of moving over time to new ideas, expressed by minorities, and then to majority pressures for policy change, has been stalled. Socialist

## Policy dialogue

views—promoted by internet sites in countries that have opted for robust market capitalism because it delivers high living standards—add to traditional opposition to change. Industrial relations reform is opposed by the élite employees in the formal public and private sectors, although the present system, copied from Australia (where it has been reformed) costs thousands of potential jobs. Privatisation has been stopped by trade unions backed by managers who benefit from monopolistic and corrupt practices.

To achieve rapid growth, Papua New Guinea has to leave behind the culture of excuses and face up to policy reforms. The principal objective must be to raise rural productivity to increase incomes in villages at the same time as labour-intensive production and services take off in urban areas. The liberal reforms essential to rapid growth that will deliver higher living standards throughout the country are the subject of the remainder of this paper.

### Microeconomic reforms

The establishment of individual property rights in land, abolition of restrictions on informal business, industrial relations reform to make labour-intensive production possible, the abolition of protection, and investment in efficient, low-cost infrastructure are the key microeconomic reforms required for a change of direction in Papua New Guinea.

Communal land ownership means low agricultural productivity and small incomes. Rapid population growth is placing pressure on the communal system. Young people cannot earn incomes in rural areas and so they move to urban fringes where they cannot get jobs because over-regulation stops trading and other small business, and restrictive industrial relations prevent labour-intensive manufacturing. Some turn

to crime for employment.<sup>9</sup> Restoring some semblance of law and order is essential to the process of economic reform, but unless basic policy changes take place to enable rising incomes, a peaceful law-abiding society will remain a mirage.

### Land reform and individual property rights

Communal ownership has not permitted any country to develop. In Papua New Guinea, where 90 per cent of people live on the land, it is the principal cause of poverty. Communal ownership underlies the struggles over benefits from mineral rights and the depredations of timber exporters (Chand and Duncan 1995). Apologists point to a few examples of successful negotiation by foreign investors with local communities, but barriers to mineral exploration and excessive and damaging harvesting of forests are more typical.

Changing traditional ownership to formal 'corporate' structures does not introduce individual property rights. It has been disastrous for the indigenous communities that have tried it in Canada, the United States and Australia. Individual property rights are necessary for individual savings and as collateral for credit that is essential for the development of banking. Their absence is the underlying reason for low levels of agricultural lending in Papua New Guinea.

Individual property rights require land surveys, registration and the organisation and endorsement of individual titles by the traditional landowning communities. These cannot be imposed, but require a profound institutional change to unseat 'big men' in favour of the majority and the rule of law. Complementary development of infrastructure is essential to give greater value to land so as to create a demand for individual property rights. Appropriate leasehold arrangements may also facilitate the

## Policy dialogue

transition to individual property rights. Land reform is never easy, but it is absurd to argue, in the face of historical evidence from around the world, that it cannot or should not take place in Papua New Guinea.

Individual property rights mean that harder working and more ambitious men and women will become wealthier than others. Those with less entrepreneurial interest will ultimately become wage workers, but their incomes will also rise above present levels. Men and women have to be free to save without having the product of their labour stolen by those who do not want to work but are happy to rely on others for food and cash. Those in genuine need—such as orphans and disabled people—can be given better care as local communities become richer.

### **Obstacles to small business**

Well meaning colonial administrators gave Papua New Guinea Australia's regulatory, zoning and business frameworks that were totally inappropriate to a country at an early level of development. Such regulations persist, preventing the growth of the 'informal' trading that, by contrast, thrives in Asian villages, towns and cities.<sup>10</sup>

Regulation is also a prime cause of corruption. The Somare government's response to how excessive regulations impede small business has been to create an office to which betel nut and vegetable sellers can complain if they are 'unfairly' treated. The parliament has surely missed the point. Inappropriate regulations have to be removed if small business is to flourish. Their removal would also reduce policing requirements and police would be less able to invoke regulations to demand corrupt payments.

### **Industrial relations reform**

High unemployment and crime are closely linked. Although real wages were reduced by the 1992 Minimum Wages Board deter-

mination (Levantis 2000), awards that specify inappropriate shifts, weekends, holidays, long service and other on-costs still raise wages and salaries well above productivity levels in Papua New Guinea (Duncan 1996) so that attempts to establish internationally competitive labour-intensive export industries have failed.

Many developing economies—including Botswana—have used exports of labour-intensive goods to provide employment and move to a path of rising productivity and incomes. Papua New Guinea's trade unions, however, consistently reject reform to protect the interests of their formal sector members who benefit from elevated wages and working conditions at the cost of the thousands who are unemployed.

Papua New Guinea could start by following Singapore and Malaysia, which, to cut high unemployment, suspended industrial awards for five years for 'pioneer firms' investing in export production. In Papua New Guinea such firms would require location in secure manufacturing estates and secure dormitories for workers. The acquiescence of existing trade unions would also be required. Niche labour-intensive markets are still available. As employment and productivity increase, wages and incomes will rise, making possible radical labour market reforms tailored to Papua New Guinea's needs.

### **Reducing protection**

Protection (high tariffs and import restrictions for domestically produced goods) raises the cost of inputs, including labour costs. Papua New Guinea followed Australia's protectionist policies in the 1960s when other industrial countries were already freeing up trade in manufactures.<sup>11</sup> The small size of the Papua New Guinea market means small production runs. Costs and prices are therefore high, further limiting the already small domestic markets. Beer is the principal

|                 |
|-----------------|
| Policy dialogue |
|-----------------|

exception because it can be produced efficiently on a relatively small scale, but it too is protected. Unnecessarily high tariffs protect inefficiency, high prices and extortionate profits.

The Morauta government's 1999 tariff reform program is phasing in tariff reductions over the period to 2006. However, the retention of 'prohibitive' tariff rates means that privileged consumer and construction goods still have high import barriers (World Trade Organization 2000). Moreover, these high tariffs on consumer goods relied upon by low-income families, such as tinned fish, salt and sugar, mean that they are very regressive forms of taxes. Together with tax breaks and monopolies for favoured firms, tariffs provide effective protection rates (protection on value added in Papua New Guinea—that is, on wages and profits) of 100 per cent and more. Such high protection for local value added means that, in internationally competitive prices, much of the value added in manufacturing in Papua New Guinea is negative. Employment creation in protected industries is minimal compared to potential employment in exporting industries. Nor have protected manufacturers improved their productivity over time as they promised. The sugar, fish canning and cement manufacturing industries are all well past their infancy.<sup>12</sup> They will never grow up. As most manufactures have high import components, the effect on the balance of payments, when lost

exports are taken into account, is also negative, explaining persistent balance of payments difficulties. The principal beneficiaries are expatriate and foreign investors and their local partners.

### Increasing agricultural exports

Papua New Guinea's per capita exports are low. Botswana's exports, like Papua New Guinea's, have a substantial mineral component, but in per capita terms they are ten times that of Papua New Guinea. Mauritius and Thailand's exports are labour-intensive but represent high employment intensity that has helped those countries to grow rapidly. They have three times the value of Papua New Guinea's high mineral content exports. In addition, in Botswana, Mauritius and Thailand tourism contributes considerably through service exports. In Papua New Guinea it seems that crime, threats of civil strife, and concerns about malaria and infectious diseases have reduced tourism to a negligible trickle.

Since the 1980s, Papua New Guinea's volumes of and earnings from palm oil, coffee, cocoa, tea and copra exports have declined (Figure 1). Exports of vanilla have been boosted by typhoons and civil war in Madagascar (the largest producer), but will Papua New Guinea be able to compete as Madagascar's production recovers and world prices fall?

Palm oil exports are said to be a success story, with 11 per cent a year growth in real

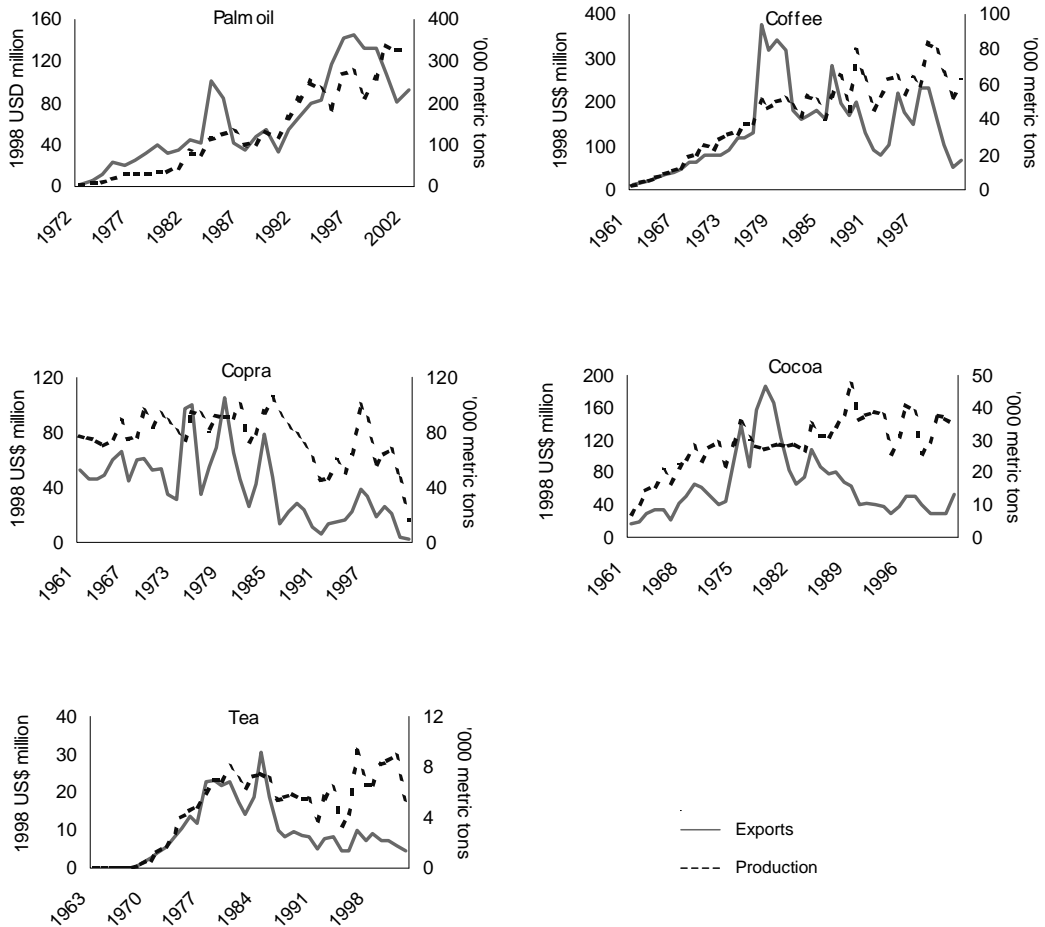
Table 1 **Merchandise exports per capita in Papua New Guinea, Botswana, Mauritius and Thailand in 2002 (US\$)**

|                  |       |
|------------------|-------|
| Papua New Guinea | 324   |
| Botswana         | 3,160 |
| Mauritius        | 1,032 |
| Thailand         | 1,056 |

Source: World Bank, 2003. *World Development Indicators*, World Bank, Washington, DC.

Policy dialogue

Figure 1 Papua New Guinea's agricultural exports, 1960s–2002 (US\$ million)



Source: Food and Agriculture Organization, n.d. *FAOSTAT—FAO Statistical Databases*, Food and Agriculture Organization, Geneva; International Monetary Fund, n.d. *International Financial Statistics*, International Monetary Fund, Washington, DC.

## Policy dialogue

earnings from the early 1970s. Papua New Guinea's climate and soils are ideal for oil palm, and the world market is growing rapidly with the economic rise of China. Wages have risen in Malaysia, the second-largest exporter with 31 per cent of world exports (after Indonesia's 56 per cent), causing it to move out of the industry.<sup>13</sup> Yet Papua New Guinea's share of the palm oil market in 2002 was still only 2 per cent. Given Papua New Guinea's geographic advantages, its exports should have grown at 30–40 per cent from the zero of the 1960s. Although several of the private nucleus estates are efficient, like all business in Papua New Guinea that does not benefit from special 'deals', they are burdened by heavy taxes. There is little government funding of social or physical infrastructure in oil palm areas, increasing the costs to business in comparison with competitors in Malaysia and Indonesia.

Communal ownership limits the expansion of nucleus estates because they cannot purchase land but have to engage in Byzantine leasehold arrangements to increase production. The smallholder palm oil sector has been crippled by communal land ownership. A US\$25 million World Bank smallholder palm oil project to be appraised and processed in 2004 (with the collaboration of the European Union) is mainly a maintenance project for five existing oil palm developments. It is to pay for the replanting of some 6,500 hectares of ageing oil palm smallholder blocks. Only 6,000 hectares of new land is to be planted by smallholders; most of the funding is for roads and other infrastructure. If the World Bank project does not eventuate, palm oil production will decline (World Bank 2003).

The Somare government's principal measure to raise agricultural production and exports has been the reduction of duties on imported agricultural machinery. For the women growing food and trying to find space and time for cash crops and transport-

ing them on rutted goat tracks, these measures will not address the deteriorating roads and rising crime that, along with communal land ownership, remain the key impediments to increased smallholder production. State-controlled export marketing organisations add bureaucratic mazes and provide opportunities for corruption. They have to be abolished.

### Reducing the high cost of infrastructure

On 14 February 2004, 19 people were killed when a truck crashed off a poorly maintained road a mere 30 kilometres from Port Moresby.<sup>14</sup> Lack of attention (local, provincial and central government) to road maintenance has interacted with civil strife and criminal attacks to make most roads in Papua New Guinea impassable. The bulk of the little maintenance that takes place is paid for by aid. The Asian Development Bank has reportedly constructed only two kilometres of road in Chimbu in the past five months. The problem is not the terrain, but over-manning, depredations, incompetence of expatriate staff, and lack of attention by Bank supervisors. A 'rehabilitation' project for the Highlands Highway, a conduit for Papua New Guinea's exports that services a third of its population, is to cost US\$113 million, mostly in aid funds, to refurbish a road allowed to become almost impassable during the past 20 years. Another new agency, the Highlands Highway Authority, is to absorb US\$5.4 million of this loan funding. The Highlands Highway is already absorbing considerable AusAID and Asian Development Bank funds. Unless substantial changes take place, this project is going to go the way of past aid spending on roads.

The situation of shipping and air facilities mirrors that of roads. Without the reorganisation of local, provincial and federal maintenance and construction priorities that will use local revenues on maintenance, little if any progress will be made.



## Policy dialogue

Colonial administrations established government-owned public utilities and many other enterprises, notably banking and superannuation for public servants. Publicly owned utilities—water, power, and telecommunications—are largely confined to urban areas. Being loss making, they maintain existing facilities poorly and have difficulty investing in infrastructure. Wages and salaries and politicians' emoluments receive priority. These enterprises have continued in the public sector, despite their extremely high costs, long after the inefficiency of public enterprises was recognised worldwide.

In Papua New Guinea, corporatisation and privatisation only seriously entered policy with the Morauta government, but even then faced strong opposition within the ruling political coalition. Most public enterprises are so run down that they have few viable assets. Private investors would be faced with large expenditures and long lead times before profits could be generated, severely limiting private sector interest. The lack of security for assets and personnel makes such investment unattractive for foreign operators with effective public utility experience. Further, because public enterprises have been the source of lucrative incomes for employees, managers and directors, their reform continues to face formidable political opposition.

### **Fostering local entrepreneurship and the role of foreign investment**

Expatriate entrepreneurs have been able to take advantage of monopolies and subsidies granted by the Papua New Guinea government, but there is no dearth of indigenous entrepreneurship. The rapid take-up of export crops from coffee to vanilla, the prevalence of women traders, and the success of a few businesses that have been able to overcome *wantok* pressures indicate that with individual private property rights, security and appropriate economic policies, Papua

New Guinea would generate as many entrepreneurs as any other growth-oriented society. At present, however, the biases against indigenous business are overwhelming.

Resource-based strategies favour foreign investment. An emphasis on foreign investment has been encouraged by aid donors. The international financial organisations—the International Monetary Fund, the World Bank and the Asian Development Bank—consider private direct foreign investment a major instrument for development, although unlike trade, foreign investment has costs as well as benefits for the firm of origin as well as for the host country. In the distorted Papua New Guinea economy, the costs of foreign private investment may well exceed the benefits. The political consequence of foreign investment in Bougainville gold and copper is a prime example. So is much of timber extraction. High costs are associated with foreign investments in salt, sugar, fish canning and cement. On balance, given the waste and corruption associated with the windfall incomes that have been generated by mining and timber, Papua New Guinea would probably have been better off had it not hastened such investments. The recent pause in mineral exploration and new projects could be beneficial if more prudent policies are introduced. Yet the first of the large-scale, new mineral projects, the Chinese Government's Ramu nickel/cobalt mine, is seeking substantial tax concessions (Australian Broadcasting Corporation 2004b).<sup>15</sup>

### **Macroeconomic reform**

Macroeconomic reform overlaps with microeconomic reform. Neither can succeed alone. Public services and enterprises have been unable to shed surplus workers because there is no alternative private employment. Without shedding surplus labour, fiscal and hence monetary policies cannot be reformed.

---

Policy dialogue

---

The failure to match expenditures to revenues has been a major factor in Papua New Guinea's stagnation (Chand 2002). Restructuring budgets is the key to macro-economic reform. Prime Minister Somare's first reaction to making Australian taxpayers' aid contributions accountable was to assert that Papua New Guinea did not need Australia's aid. Sir Michael was correct. But doing without aid would mean dramatic economic, social and political reforms. The government would have to take immediate steps to bring budget expenditure under control. The 10 per cent of public service employees who are 'ghosts' (who receive salaries but do not come to work) and perhaps another 10 per cent whose productivity is negligible would have to be dismissed. The International Monetary Fund has financed a technical assistance computerisation project (at a cost of more than US\$13 million<sup>16</sup>) that would enable excess staff to be fired. All that is needed is the political will to act. Overseas high commissions, embassies, consulates and travel to meetings, conferences and seminars are extravagantly funded. An 80-strong delegation accompanied Sir Michael Somare on a recent trip to Beijing (Australian Broadcasting Corporation 2004c). Such numbers could be cut sharply.

Accountability for public equipment purchases could reduce waste and corruption. Expenditures on expatriate advice could be cut to the bone without affecting the quality of policies. Papua New Guinea's economic performance indicates that this advice has largely been wasted money. The Morauta Government has calculated the millions that would be saved by privatising public enterprises that are bleeding money. Simplifying taxation laws and eliminating 'tax incentives' (tax holidays) would require less tax staff and increase revenues. Low and uniform tariffs would reduce numbers of customs officials.

Every traveller, whether on business, journalist or tourist, is irritated by the complexities involved in obtaining an entry visa to Papua New Guinea. Every country must, of course, protect its borders from drug traffickers, arms smugglers and terrorists. Border security is an essential component of national sovereignty. But Papua New Guinea wishes to encourage business visitors and tourists as well as enabling visiting journalists and scholars to report on its progress. Papua New Guinea's present migration regulations do not achieve these objectives. Potential visitors are discouraged by fumbling visa issuing and work-permit procedures that follow from the complexity of visa regulations. Slowly moving queues greet arrivals and hold up departures. Simplifying migration regulations and streamlining entry and exit procedures would substantially reduce the public payroll while increasing the efficiency of border security.

Papua New Guinea revenues would then meet recurrent expenditure requirements, with enough left over for investment programs. These measures would be followed by rapid increases in agricultural production and employment, so that Papua New Guinea would join those rapidly growing economies with rapidly expanding revenues.

To simplify and stabilise fiscal and monetary policy and hence lower inflation and reduce kina fluctuations, aid inflows must be separated from domestic revenues. Only then will the government know the value of its revenues and where its expenditures are going. It is essential to establish what has happened to past revenues from minerals, timber and fish and on what aid inflows have been spent. International financial organisations have been irresponsible in allowing the spending of concessional loans on recurrent expenditures. Some Papua New Guinean politicians evidently believe that these loans—like those

---

**Policy dialogue**

---

of other developing economies—will be ‘forgiven’ or repaid by the International Monetary Fund and the World Bank under its ‘heavily indebted poor countries’ (HIPC) scheme, to which Australia contributes, although its aid is mostly in grant form (Harper et al. 1999).

Domestic revenues must over time cover recurrent expenditures and contribute to investment to a level that is at least equal to, and for rapid growth considerably higher than, aid inflows. Domestic and foreign borrowing should be a last resort for adjustment to climatic disasters or falling export prices because it raises interest rates for private borrowers and encourages inflation. Papua New Guinea must recognise that increasing worldwide productivity is leading to long-term primary (and secondary and tertiary) price declines, so that its export productivity must rise if it is to be competitive. In times of high primary product prices, debt should be retired, not increased.

Current policies and proposals do not indicate that Mr Philemon’s target of a balanced budget by 2007 will be met. The 2003 Budget depended on good weather and rising primary product prices. A proposed export tax on cocoa is not likely to be a major revenue earner and will reduce cocoa exports. Another proposed tax on savings withdrawals would undermine domestic investment. Otherwise, the policy cupboard is bare. Inflation could again increase rapidly if loose monetary policy is adopted to balance the 2004 Budget.

### **Social reform**

Thanks to the work of women, only a very few Papua New Guineans go hungry, but other indicators—housing, sewerage, water, power and telephones—show very low standards of living. Those few Papua New Guineans who can watch television are

deeply frustrated when they see how other people live.

Education, particularly for women, is key to income earning, health and social regard. Only 64 per cent of boys and 53 per cent of girls completed primary school in 2001 (World Bank, various issues). Half the children are taught in church schools where salaries are paid and some school materials are available. Many female state school teachers cannot work in villages and many girls cannot walk to school because of the danger of rape. In villages, accommodation for teachers is generally inadequate, and pay cheques cannot be cashed. They often have to take two days’ leave to get to the nearest bank once a fortnight. Where schools operate, fees are a considerable proportion of women’s incomes. Secondary education is largely confined to the children of élites in urban areas. Some are sent to schools in Australia to prepare for tertiary studies.

Infant mortality, child mortality and maternal mortality rates are high. Papua New Guineans can only expect to live 57 years, and AIDS threatens to lower this figure. Medicines are frequently hard to obtain even in the vicinity of Port Moresby.

The multinational non-government organisations and their Australian subsidiaries, pointing out that aid was not reaching low-income groups, pressed for direct aid for education and health for poor people. The non-government organisations have become so influential that social targets now dominate bilateral and multilateral aid. But the deflection of aid from production to social distribution has not only undermined the creation of productive capacity and employment but also not been effective in the social sectors. ‘Direct aid’ has become ‘band aid’ with no long-term impact. Once aid funding ends, schools and health centres fall apart. Emergency generators and other hospital equipment vanish.

## Policy dialogue

'Empowering rural women' is a particular favourite of 'soft' aid. But how can women be empowered if they do not own land, have negligible schooling, lack roads to take their goods to market and are constantly threatened by domestic violence? Consultants come, seminars, workshops and training sessions are held, consultants return home to bank their 'boomerang aid' fees, and the women go back to work in the gardens, carry water up steep hillsides, see their children die, and die in childbirth.

In Papua New Guinea, as in other developing countries, 'hard hat' funding for water supply, electric power and telecommunications was easier to control than funding for social projects. 'Soft' aid encourages corruption because it is easier to steal.

### Can aid help Papua New Guinea to achieve growth?

Australia's determination to use its taxpayers' funds to promote growth has, not surprisingly, met with serious opposition in Papua New Guinea. Opening up the economy to rapid growth would deprive elite politicians and bureaucrats of their privileges and perquisites. Opposition will increase as those already indicted by corruption investigations are tried and sentenced and other civil transgressors and criminals are caught. Australian and Papua New Guinean police and legal staff will face considerable danger.

But without a Papua New Guinea commitment to the rule of law and to economic reform, Australian aid will continue to be wasted. Papua New Guineans have to make the choice between growth and stagnation, and it is in Papua New Guinea that the economic and political debates and institutional changes have to take place. Australian taxpayers would be foolish to support societies that do not want to change

and grow but want to remain aid dependent.

Australia could provide resources for land surveys and land reform consultative processes as well as the physical and social infrastructure necessary to make land reform work. Such projects could be negotiated directly with provincial governors rather than with the Port Moresby government. Each allotment of funds should have clearly specified quantitative targets. Disbursement should only follow mutually agreed monitoring, for example, so many kilometres of road completed to standard, so many metres of pipes laid or so many households connected to power in a given time. Unexplained shortfalls would lead to the suspension of aid flows. Not only roads, water, power and other infrastructural aid, but also taxpayer-supported non-government organisation projects must be subject to strict monitoring, accountability and independent evaluation.

The Australian government's aid program must have the power as well as the responsibility to enforce such targets in the context of civil peace, strict policing of crime, and central government fulfilment of its responsibilities to provinces. As several Australian government departments are now concerned with aid to Papua New Guinea, collaboration on the analysis of Papua New Guinea's problems and development possibilities is essential to underpin the Australian side of a 'mutual obligation' aid program.

### Notes

<sup>1</sup> This paper follows Windybank and Manning (2003) and Hughes (2003), who document economic and social stagnation in the Pacific since independence. Wainwright (2003) indicates the depth of civil strife, while Alpers and Twyford (2003) follow Pitts (2002) in delineating violence in the Pacific.

## Policy dialogue

- <sup>2</sup> Between 1973 and 2000, the average annual growth of the Papua New Guinea population was 3.7 per cent, while real GNP grew by 4.0 per cent a year; thus, real per capita income only grew by 0.3 per cent a year (Hughes 2003:4).
- <sup>3</sup> Mr Kalinoe was supported by His Excellency, Mr Renagi R. Lohia, High Commissioner for Papua New Guinea and Mr Kenneth Peter Baxter, Policy Adviser to Mr Kalinoe in the preparation of the program to revive Papua New Guinea's economy. The 'recovery' program was launched in Papua New Guinea's Parliament as 'The Road to Recovery: the way forward for Papua New Guinea', a Statement to Parliament by the Prime Minister, the Right Honourable Sir Michael Somare, GCMG.
- <sup>4</sup> *Australian Financial Review*, 23/05/2003, 'PNG short of cash, mired in recession'.
- <sup>5</sup> *Post Courier*, 12/02/2004, 'PM blows own trumpet'.
- <sup>6</sup> While Papua New Guinea's per capita income has stagnated at US\$3,500 in purchasing power in constant US dollars since 1970, Botswana's has risen from about US\$1,750 to nearly US\$10,000 (World Bank, various issues).
- <sup>7</sup> The *World Development Indicators* for the years 1998–2003 give negative growth rates for Papua New Guinea per capita income from 1995–96 to 2000–01, except for 1997–98, when per capita growth was zero. The World Bank used the extremely low population growth rate of 2.2 per cent to obtain these per capita growth rate figures. Even using these low population growth rates, according to the Reserve Bank of Papua New Guinea, per capita income growth was again negative in 2002 and 2003 (Kamit 2004:5).
- <sup>8</sup> These figures, as with all Papua New Guinea's social statistics, cannot be taken seriously. Education participation for girls is notoriously lower than for boys (World Bank 2003; Tables 2.12 and 2.14 are contradictory.)
- <sup>9</sup> Levantis (2000) documents the Harris–Todaro rural–urban migration process, with evidence of high criminal occupations for young people and their low participation in unskilled employment.
- <sup>10</sup> The International Labour Office's *Employment, Incomes and Inequality: a strategy for increasing productive employment in Kenya* (ILO 1972) was the seminal study that showed how inappropriate regulations impede the informal sector and job creation.
- <sup>11</sup> Australia drastically reduced protection and floated its exchange rate in the 1980s. Further microeconomic and macroeconomic reforms, notably the reining in of budgets, have made it one of the best economic performers in the OECD.
- <sup>12</sup> These issues were explored by Hughes in *Industrialization, Growth and Development in Papua New Guinea* (1986), which predicted that none of the 'infants' would become adults.
- <sup>13</sup> Published Food and Agriculture Organization data (<http://apps.fao.org>) underestimate Indonesian exports. They do not include the palm oil smuggled because of Indonesian export restrictions out of Sumatra to Singapore. Singapore does not include this trade in its published statistics.
- <sup>14</sup> *Post Courier*, quoted in *Sydney Morning Herald*, 17/02/2004, 'Truck roll claims 19 in PNG'.
- <sup>15</sup> The Australian Broadcasting Corporation (2004b) reported that the Papua New Guinea owners of the nickel/cobalt project were Highlands Pacific and the Mineral Resources Development Corporation, and that China was to acquire 65 per cent of the enterprise but to supply 100 per cent of the US\$650 million needed for the project. Mining Minister Sam Akotai was quoted as saying, 'Now if there is someone who is willing to give 100 per cent financing on a project like Ramu Nickel, I see no problem in government giving concessions to such companies.' Akotai added, 'According to our discussions, I don't think the Chinese are depending on concessions being given by the government' ABC (2004b:np). On 16 February 2004, the *Post Courier* reported that the project was subject to tax concessions.
- <sup>16</sup> *Sydney Morning Herald*, 26/09/2002, 'Concept Systems wins PNG government payroll deal' (<http://www.smh.com.au/articles/2002/09/26/1032734265347.html>)—this article reported that Concept Systems International Ltd had won a four to five-year contract worth \$A13–\$A20 million to computerise and clean up Papua New Guinea's 65,000-person government payroll.

## Policy dialogue

## References

- Australian Broadcasting Corporation (ABC), 2004a. 'PNG: Parliament adjourned for half a year', *Go Asia Pacific on Location Pacific*, 23/01/2004, ABC Radio Australia, Melbourne, 28/01/2004. Available online at [http://www.goasiapacific.com/location/pacific/GAPLocPacificStories\\_1029913.htm](http://www.goasiapacific.com/location/pacific/GAPLocPacificStories_1029913.htm).
- , 2004b. 'PNG nickel project seeks further tax breaks', *Go Asia Pacific Breaking News Pacific*, 04/02/2004, ABC Radio Australia, Melbourne. Available online at [http://www.goasiapacific.com/news/GoAsiaPacificBNP\\_1037340.htm](http://www.goasiapacific.com/news/GoAsiaPacificBNP_1037340.htm).
- , 2004c. 'PNG reassures China over its dealings with Taiwan', *Go Asia Pacific Breaking News Pacific*, 10/02/2004, ABC Radio Australia, Melbourne. Available online at [http://www.goasiapacific.com/news/GoAsiaPacificBNP\\_1041482.htm](http://www.goasiapacific.com/news/GoAsiaPacificBNP_1041482.htm).
- Alpers, P. and Twyford, C., 2003. *Small Arms in the Pacific*, Occasional Paper No. 8, Small Arms Survey, Geneva.
- Chand, S., 2002. Deficit bias, debt accumulation, and economic crisis in Papua New Guinea, The Australian National University, Canberra (unpublished).
- Chand, S. and Duncan, R., 1995. 'Resolving property issues as a precondition for growth: access to land in the Pacific islands', in P. Larmour (ed.), *The Governance of Common Property in the Pacific Region*, Pacific Policy Paper No. 19, National Centre for Development Studies, The Australian National University, Canberra:33–46.
- Corden, W.M., 1984. 'Booming sector and Dutch disease economics: survey and consolidation', *Oxford Economic Papers*, 36(3):359–80.
- Duncan, R., 1996. 'Unit labour costs in manufacturing in Fiji and Papua New Guinea', *Pacific Economic Bulletin*, 2(1):39–47.
- Food and Agriculture Organization, n.d. *FAOSTAT—FAO Statistical Databases*, Food and Agriculture Organization, Geneva. Available online at <http://apps.fao.org>.
- Garnaut, R. and Baxter, P., 1984. *Exchange Rate and Macro-economic Policy in Independent Papua New Guinea*, Report to the Government of Papua New Guinea, Reprinted as Pacific Research Monograph No. 10, National Centre for Development Studies, The Australian National University, Canberra.
- Harper, I., Hughes, H. and Gregg, S., 1999. 'Noble ends flawed means: the case against debt forgiveness', *Issue Analysis*, No. 8, 28 September, Centre for Independent Studies, Sydney.
- Hughes, H., 1986. *Industrialization, Growth and Development in Papua New Guinea*, Institute of National Affairs, Port Moresby.
- , 2003. 'Aid has failed the Pacific', *Issue Analysis*, No. 33, 7 May, Centre for Independent Studies, Sydney.
- International Labour Office, 1972. *Employment, Incomes and Inequality: a strategy for increasing productive employment in Kenya*, International Labour Office, Geneva.
- International Monetary Fund, n.d. *International Financial Statistics*, Washington, DC. Available online at <http://ifs.apdi.net/imf/logon.aspx>.
- Kalinoe, J., 2003. Submission by the Chief Secretary to Government of the Independent State of Papua New Guinea to the Australian Senate and Foreign Affairs, Defence and Trade Committee, Submission No. 63, Inquiry into Australia's Relations with Papua

## Policy dialogue

- New Guinea and the Island States of the Southwest Pacific, Australian Senate and Foreign Affairs, Defence and Trade Committee, Canberra, 28 March. Available online at [http://www.aph.gov.au/Senate/committee/fadt\\_ctte/png/submissions/sub63.doc](http://www.aph.gov.au/Senate/committee/fadt_ctte/png/submissions/sub63.doc).
- Kamit, L.W., 2004. *Monetary Policy Statement by the Governor of the Bank of Papua New Guinea, Mr L. Wilson Kamit, CBE*, Bank of Papua New Guinea, Port Moresby, 30 January. Available online at [http://www.bankpng.gov.pg/monetary-policy/Jan04\\_mps.pdf](http://www.bankpng.gov.pg/monetary-policy/Jan04_mps.pdf).
- Levantis, T., 2000. *Papua New Guinea: employment, wages and economic development*, Asia Pacific Press, The Australian National University, Canberra.
- Philemon, B., 2004a. *Budget Speech—Restructuring for Recovery and Development*, 2004 National Budget, Department of Finance and Treasury, Port Moresby, 25 November. Available online at <http://www.treasury.gov.pg/budget2004/>
- , 2004b. *Economic and Development Policies*, Volume 1, 2004 National Budget, Departments of Finance and Treasury, Port Moresby. Available online at <http://www.treasury.gov.pg/budget2004>.
- Pitts, M., 2002. *Crime, Corruption and Capacity in Papua New Guinea*, Asia Pacific Press, The Australian National University, Canberra.
- Senate Foreign Affairs, Defence and Trade References Committee, 2003. Official Committee Hansard, Reference: Australia's relationship with Papua New Guinea and Pacific island nations, Commonwealth of Australia, Canberra, 28 March. Available online at <http://www.aph.gov.au/hansard/senate/commtee/S6282.pdf>.
- Wainwright, E., 2003. *Our Failing Neighbour: Australia and the future of Solomons Islands*, Australian Strategic Policy Institute, Canberra.
- Windybank, S. and Manning, M., 2003. 'Papua New Guinea on the brink', *Issue Analysis*, No. 30, 12 March 2003, Centre for Independent Studies, Sydney.
- World Bank, 2003. *New Guinea—Smallholder Agriculture Development Project*, Project Information Document, Report No. AB161, World Bank, Washington, DC, November, Available online at <http://www-wds.worldbank.org>.
- World Bank, 2003. *World Development Indicators*, World Bank, Washington, DC.
- World Bank, various issues. *World Development Indicators*, World Bank, Washington, DC.
- World Trade Organization, 2000. *Trade Policy Review: Papua New Guinea 1999*, World Trade Organization, Geneva.

International disputes: Papua New Guinea relies on assistance from Australia to keep out illegal cross-border activities from primarily Indonesia, including goods smuggling, illegal narcotics trafficking, and squatters and secessionists. Major sources and definitions. Next. Index. Papua New Guinea Profile. History. Geography. Papua New Guinea occupies the eastern half of the island of New Guinea, just north of Australia, and many outlying islands. The Indonesian province of West Papua (Irian Jaya) is to the west. To the north and east are the islands of Manus, New Britain, New Ireland, and Bou Papua New Guinea, officially the Independent State of Papua New Guinea, is a country in Oceania, occupying the eastern half of the island of New Guinea and numerous offshore islands (the western portion of the island is a part of Indonesian provinces of Papua and West Papua). It is located in the southwestern Pacific Ocean, in a region defined since the early 19th century as Melanesia. Its capital, and one of its few major cities, is Port Moresby. It is one of the most diverse countries on Earth, with Papua New Guinea consists of eastern New Guinea along with New Britain, New Ireland, Bougainville, and six hundred small islands and archipelagoes. The land area is over 178,000 square miles (462,000 square kilometer), with the mainland accounting for 80 percent. The western half of the island is the Indonesian province of Irian Jaya.