Economic survey

Developments in Papua New Guinea—1997

Mike Manning

Papua New Guinea has had a very eventful year in 1997. It has had a constitutional crisis involving the military, an election and is now beset by a severe drought. But its macroeconomic indicators look good, with low inflation, adequate foreign reserves, moderately low interest rates and a liquid banking system. The one sticking point has been employment, which has not increased significantly for the last ten years. Apart from its economic record Papua New Guinea's social indicators rate poorly on the international scale and this will also impact future growth.

Papua New Guinea's extraordinary mineral and petroleum wealth provides a cushion which can be used to redirect resources away from wasteful expenditure toward productive activities. But it will require strong and determined political leadership to achieve this.

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Political and social developments

Major civil unrest involving the military, general elections, the ongoing problems of Bougainville and the effects of Cyclone Justine, followed by a very severe drought have all had an impact.

Any single one of these events would have put pressure on less robust societies with dire consequences. It is to Papua New Guinea's credit that its democracy continues to survive and maintain the rules of coalition government.

Military unrest

During 1996 the government secretly negotiated with a group of British and South African companies to provide mercenaries to assist it with the resolution of the ongoing Bougainville crisis. At first this was kept uncharacteristically secret within Papua New Guinea.

The arrival of giant Russian Turpolev transport planes in January and February began questions and an Australian journalist eventually broke the story on 21 February. The government's reaction was to admit the presence of foreign troops but to claim that they were only in the country to assist with the training of PNG troops for another attempt at the final 'surgical' strike at the rebel Bougainville Revolutionary Army. During 1996 the PNG Defence Force, on the promise that it could finish the war with 'one final push', had been allocated an extra K10 million. It was not able to do so and an increasingly frustrated

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government decided to look outside for help.

On 17 March 1997, the Commander of the Defence Force, Brigadier General Jerry Singirok, surprised the government and the country by appearing at the National Broadcasting Commission, declaring his open opposition to the use of the Sandline mercenaries and calling on Prime Minister Chan and Deputy Prime Minister Haiveta to resign. He and a number of other officers launched *Operation Rausim Kwik* (get rid of them quickly) and the mercenaries were quickly and unceremoniously terminated and sent home. Their leader was kept in the country until after he appeared in front of an inquiry eventually established by the government.

The government's reaction to Singirok was first to dismiss him and suspend his actions. During this time the real task of the mercenaries and their *modus operandi* unfolded. It became clear that they were importing relatively sophisticated (if secondhand) equipment and they were to be involved in, at least, securing the Panguna mine site on Bougainville. The Defence Force was deeply divided about the use of the mercenaries and the sacking of Singirok. At first there was conflict between the troops themselves and then support for Singirok and the call for the resignation of Sir Julius Chan and the government. A small riot erupted on 19 March when some troops, supported by non-government organisations, incited the public. Tensions remained high within the barracks for several weeks after these happenings.

Localised looting occurred at a shopping centre opposite Murray Barracks but this, as well as further threats, was ably contained by the Police Force which had failed to link up with the troops in a full-scale uprising. Regrettably overseas media, particularly commercial Australian television, vastly exaggerated these events.

The troops loyal to Singirok issued an ultimatum to the government. Sir Julius Chan refused to hear them on the grounds that the military was subverting the Constitution and the rule of the Parliament. The military then blockaded the National Parliament overnight. Sir Julius Chan, the Minister for Finance and the Minister for Defence then 'stepped aside' (as opposed to resigning) on 29 March pending the results of a Commission of Inquiry which was set up.

The inquiry was duly held, exonerating the Prime Minister and his Ministers in respect of the terms of reference. After strong public pressure the new government has established another inquiry to examine if there has been any culpability.

There were a number of basic issues exposed during this crisis.

- Could there have been a solution to Bougainville and would the people of Papua New Guinea have stomached the levels of force being proposed?
- The role and leadership of the Defence Force following subsequent revelations about Singirok's acceptance of a secret commission.
- The price charged by Sandline and the apparent huge discrepancies between the price being paid for military hardware and market prices.
- The importance of the Panguna Copper mine, and secret negotiations to purchase it, including unexplained movements on the Sydney stock exchange.

The main mercenary contractor was a UK-based company, Sandline International. The contracted price for the operation was US$36 million (K51.5 million).[1] This was unbudgetted but should have been absorbable in the total size of the PNG Budget.

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General elections

The 1997 general election was held in July, following a campaign that was sometimes violent. The election was relatively smooth although there were isolated reports of disruptions, particularly in the Highlands.[2]

A total of 2,371 candidates contested the 109 seats with an average of 21.8 candidates per electorate. In some electorates it took less than 5 per cent of the eligible number of voters, and less than 7 per cent of the total number of votes cast, to be elected. There were 3.4 million people on the electoral rolls against a projected population of voting-age people of about 2.2 million. The New Guinea Islands region had approximately the same numbers enrolled as the projected population whereas some Highlands provinces had more than 3 times the projected population of voting age on the electoral roll.

The implication is that there was massive distortion of the rolls. If not, the population projection of 2.3 per cent population growth has been seriously underestimated and the population of Papua New Guinea is in the order of 6–7 million. This has profound implications for planning and government provision of services. It shows the urgent need for the census due to be held in 2000.

Of the 109 members of the old Parliament, only 51 or 48 per cent were re-elected, this was higher than the 40 per cent who retained their seats in 1992 election. Amongst the casualties were Prime Minister Sir Julius Chan and former Prime Minister Paias Wingti, along with nine other Ministers of the previous government.

During the period between the declaration of the polls and the formation of the new government there was a great deal of optimism and excitement. Opinion was that the voters had clearly shown they were fed up with the corruption and mismanagement of the previous government. A number of the new members were known for their public repudiation of these policies and some had been prominent citizens in other areas before entering politics. Three of the winners of regional seats in the Highlands took advertisements in the press explaining their stance against corruption, which was widely believed to have been aimed at the previous government.

The fact that there were 36 independents elected showed the disenchantment with existing political parties and the previous government.

Papua New Guinea has always had an intense period of horse-trading between the declaration of the polls and the formation of the new government. New members are lobbied vigorously, rumours fly about the amounts of money that are allegedly offered and paid for members to join the various camps. One leader was quoted in the press as saying that his party would have to reimburse the electoral expenses of any independent member who joined his group.

The lobbying centred around two camps, one headed by the nation's founding Prime Minister, Sir Michael Somare, and the other around the former Prime Ministers Chan and Wingti. Reports were sketchy and highly speculative with a number of names being put forward about possible Prime Ministers. In the end, Mr Bill Skate emerged victorious with a coalition of his own small People's National Congress Party (6 members), the People's Progress Party of Sir Julius Chan (16), the People's Democratic Party of Mr Paias Wingti (8), Pangu Pati led by previous Deputy Prime Minister Chris Haiveta (15) and the Melsol group which contained a number of independents. The majority of candidates who stood as Independents aligned themselves to this group, including the three Highlands members who had previously been so vocal about the former government and its coalition members.

The new coalition was in trouble during the second sitting of Parliament, leading to the dismissal of Finance Minister Roy Yaki and intense speculation that this would lead to more serious repercussions. There was no official reason for the removal of Mr Yaki but it involved an appointment to the Public Officers Superannuation Fund and a visit to Taiwan.

Corruption

The Sandline crisis, the elections and the debate during the formation of the new government have all focused attention on corruption. In mid-1996 the Business Council of Papua New Guinea and the Institute of National Affairs organised a seminar on 'Ethics in Business' in order to get Papua New Guineans talking about the issues of corruption. This seminar was strongly supported and widely publicised and brought together speakers from Papua New Guinea and overseas to discuss the issues.

As a result of the seminar, a chapter of Transparency International was formed with a view to providing a rallying point against corruption. Most of the existing private sector, civil society and church groups have publicly supported the formation of Transparency International. Some members of Parliament, including the present Prime Minister, have publicly signed a pledge but interestingly the majority of those who are vocal about corruption have not.

A further step in the fight against corruption will be the formation of the Independent Commission Against Corruption. This body is currently under consideration by the government and is expected to be given the powers to investigate large-scale government corruption in a way that existing bodies do not have the powers or resources to do.

Corruption of its own is debilitating and leads to misallocation of resources. The associated failure to take good advice, follow tender procedures and be aware of all the alternatives means that the political culture no longer thinks in terms of good value for expenditure. In this way millions of kina have been frittered away in Papua New Guinea.[3]

Bougainville

The civil war in Bougainville has been going on since 1989. In a flurry of diplomatic activity brokered by the New Zealand government, hope for peace has been rekindled.

At a conference at Burnham in New Zealand the Bougainville Revolutionary Army (BRA), the Bougainville Transitional Government and the government took steps towards a tentative peace. A follow-up conference at the same place in early October is reported to have made substantial further progress. This is to be followed by a negotiating meeting at the political level to be attended by Prime Minister Skate. The key to this meeting will be whether BRA leader Francis Ona will agree to attend.

The significance of Bougainville is both social and economic. The social effects include the complete lack of services in most of the province, increased deaths and illness and nearly a generation of children denied access to schooling. More importantly it has sapped the energy of the national government and diverted attention from other serious problems in the country.

The economic effects include the cost of maintaining the military operation, budgeted at K21 million in 1997, the loss of income from the Panguna mine and the loss of cocoa and copra income.

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Bougainville produced more than half of the nation's cocoa and copra prior to the civil war. Some of this was from Buka where growers are again able to market their produce, but the main island of Bougainville remains virtually inaccessible.

If the peace process is successful there will be a short-term drain on the national budget to restore essential infrastructure. The main priorities will be roads, schools and health centres. International funds are available for this purpose and the European Union and AusAID are already funding parts of the restoration programs.

There will need to be a major push to restore food and cash crops on the island. This will restore the economy and encourage a return to normality.

Drought and weather

In the early part of 1997 Cyclone Justine was centred off the Queensland coast. It had a very strong effect on coastal areas of Papua New Guinea, especially the New Guinea Islands. The effect of the strong winds was to destroy young cocoa pods which will affect coconut production in early 1998.

The second half of 1997 saw the normal dry season turn to drought. This has been attributed to the El Nino effect, which has caused severe problems in the Pacific and Southeast Asia.

The drought in Papua New Guinea has been felt in all regions except the Sepik. It has brought on frosts in the higher altitudes of the Highlands. In late September 1997, the Papua New Guinea and Australian governments began an assessment of the effects of the drought through the use of rapid appraisal techniques. There have been alarmist reactions to the drought with estimates of food requirements reaching K300 million.

The major effects of the drought will be a reduction in revenue and increased expenditure. On the revenue side, the Ok Tedi Mine was forced to close on 11 August 1997. This is costing the National Government about K200,000 a day in lost company tax and dividends. This will impact the 1998 Budget due to the timing of tax payments. Porgera has not been as badly affected because it does not depend on river transport. It scaled back production but good rain in late September has enabled it to reopen; although not before significant production had been lost.

Fortunately, Lihir and the smaller mines have not been affected but they could be, if good rain is delayed for too long.

There are no official estimates available for the effects on tree crop production. Coffee will not be badly affected if it rains soon but every month without rain will cause a drop of about 10 per cent in the crop. The estimated potential drop in production in 1998 ranges from 10–40 per cent. The current estimate is a decline of 26 per cent, costing K70 million (*The National* 8 October 1997).

Cocoa has been severely affected on the Gazelle peninsula, Madang and Karkar Island. The Sepik, and Baining area of New Britain have not been affected. The El Nino has caused an increase in world prices, which have exceeded K2,000 per tonne for the first time in more than 10 years. But most farmers in Papua New Guinea will not have the cocoa to be able to take advantage of these prices. It is estimated that there will be a 22 per cent decline in exports which will cost about K16 million in 1997 but if the drought continues, production for the 1997/98 crop year could fall to 20,000 tonnes which would cost more than K30 million (*The Independent* 17 October 1997).

Oil palm production is not expected to be affected in 1997 or 1998 with the possible exception of Poliamba estate in New Ireland. However if there is not good rain before the end of the year the 1999 crop will be severely affected.

Copra production in 1998 will be affected by the combined effects of the cyclone and the drought. There are no estimates available but it is thought that production will be down by at least 30 per cent. Based on 1996 prices this would cost around K30 million.

The expenditure effects will be caused by the need to feed people whose food crops have been destroyed or replacement crops have not grown. Papua New Guinea staples (except for yams) are not readily storable. Hence food consumption relies on continual production although there are often shortages known as *taim hangre* (hungry time) which, traditionally, people knew how to cope with.

Over the last 30 years the tendency of government to overreact with food hand-outs has meant that people are no longer as able to cope. The immediate reaction is to demand government assistance as soon as a time of stress begins. This is probably exacerbated by the stress that rapid population growth is placing on traditional social and economic systems.

The government has reacted by an initial allocation of K4 million for drought relief. This is to be spread amongst all electorates and distributed by members of Parliament. It has foreshadowed another K30 million to be funded, with K20 million from the money earned by the sale of Orogen shares and K10 million to come from a specially established fund to which the public has been invited to subscribe. To date the main contributors have been government instrumentalities.

Further planning and disbursement will depend on the result of the rapid rural assessment. The government has already appealed to the international community and Australia has pledged an initial A$500,000, with the amount to be reviewed when the result of the assessment is known. It is to be hoped that all potential international aid sources for disaster relief are examined. The worst-case scenario is having to feed 750,000 people for six months, which would cost about K100 million, based on a ration of 2 kilograms of rice and 2 tins of fish for 8 people per day. Recent rain may have marked the breaking of the drought but it is still too early to tell. Whatever happens, the logistical problems will severely test available PNG resources and skills.

If the drought develops into a major disaster, there is a good case for the government to run a substantial deficit in the 1998 Budget. This would be justifiable so long as it was strictly controlled and did not create any long term implications, that is, if it was recognised to be a 'one-off situation.'

Recent economic performance

In 1997 Papua New Guinea has posted a number of very encouraging macro-economic indicators which should earn it top marks from the World Bank and the IMF. However these indicators do not show that there has been an adjustment as a result of the Structural Adjustment Programme (SAP) and this should give cause to a degree of alarm for the future.

Earlier in the year GDP was predicted to be growing at an annual rate of 6.6 per cent in the non-mining sector and 5.6 per cent overall, higher than predicted in the 1997 Budget (Papua New Guinea Department of Finance 1997); however, a more recent estimate has drastically adjusted this rate downwards to about 0.8 per cent for non-mining GDP. The faster rates of growth were thought to have been fuelled by an increase in the construction industry especially the major oil and mineral projects at Lihir and Gobe as well as the Poraporeina Freeway and Jacksons Airport projects in Port Moresby.

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Table 1 **Papua New Guinea: employment trends, 1989–97** (per cent change)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Agriculture	5.7	-11.3	-10.0	0.3	4.9	-1.1	7.8	-5.7	5.2
Mining	-20.1	-32.1	13.9	-.07	3.3	1.0	5.8	7.0	5.4
Construction	-20.2	-0.8	2.3	-15.8	-14.0	2.5	63.8	105.0	-34.7
Manufacturing	7.8	-4.8	-3.6	-5.2	0.2	3.2	-5.0	0.01	1.9
Other sectors	-4.4	-6.9	-6.5	-1.0	-2.7	0.8	-0.8	4.4	2.8
All sectors	-1.7	-11.2	-4.8	-2.0	-3.0	0.8	3.4	5.0	-0.03

Source: Employers Federation of Papua New Guinea, 1997. *Employment Survey June 1997*, Port Moresby:6.

This compares with recent performance of -1 per cent for non-mining and -2.9 per cent overall in 1995 and 4.2 per cent for non-mining and 1.9 per cent overall in 1996.

The Bank of Papua New Guinea reported that the economy was expanding in the first half of the year, with imports up by 10.5 per cent, government had posted a K138 million surplus and increases in credit levels.

Inflation growth continues to slow, with a June CPI increase of 3.7 per cent for the twelve months. The June quarterly increase was 1.3 per cent which was slightly higher than the previous quarterly increase of 1 per cent. Papua New Guinea's inflation has returned to lower levels following a large jump due to the currency devaluations of 1994 and 1995. Papua New Guinea appears to have its inflation rate under control.

Population continues to grow at around 2.2–5 per cent, and there are approximately 50,000 school leavers pushed out every year. The Bank of Papua New Guinea estimates that employment declined by 1.3 per cent in the March quarter of 1997 and the decline was in all sectors except retail and transport. Employment in 1997 is less than 1 per cent higher than in 1989, revealing a serious problem.

The Employers Federation estimated that employment grew by 3.6 per cent in the first six months of 1997 but will fall in the next six months to record a slight decline in employment of -0.03 per cent. The growth in the first 6 months was fuelled by seasonal growth in agriculture, which recorded an increase of 18.6 per cent but that is expected to fall away in the second half of the year.

The only significantly potential avenue to increase employment is in agriculture and there are a number of major constraints to this expansion, with the main one being collapsing rural infrastructure.

The balance of payments is in a very healthy state with a small deficit in the first quarter of K22 million as compared with a surplus in the same period in 1996 of K45 million. The deficit was a result of a lower trade surplus, lower net transfers, lower capital inflows, and lower net drawdowns from offshore accounts. Nevertheless, the level of foreign reserves stood at K768 million, sufficient to cover 4.6 months of imports and 5.8 months of non-mineral imports.

In the period 1994–95 the PNG exchange rate was devalued by more than 35 per cent and now stands at 0.9534 against the Australian dollar and 0.70

against the US dollar. There has been a slight improvement against the Australian currency which had fallen to around 0.92 and the kina has lost 4.1 per cent against the US dollar since January 1997. The kina has remained stable against a trade-weighted basket fluctuating between 88–90 index points since December 1996.

For a number of reasons the response to the devaluation has been disappointing in terms of stimulating growth in agricultural, other export and import replacement industries. The Institute of National Affairs, in conjunction with the Australian National University, is currently carrying out a study into the reasons for this. There are a number of structural problems which will have to be addressed before there will be a significant increase in employment, production and investment.

A key variable in the decision to devalue the kina was wages policy. The 1992 Minimum Wages decision pegged wages at the then minimum rural wage of K45.92 per fortnight or K1,194 per annum. More importantly, it broke with the establishment of indexation of wages and argued for wage increases on the basis of productivity and capacity to pay, with enterprise bargaining as the vehicle for negotiation. Despite heavy pressure from workers, the government has remained firm on this issue and has resisted pressures to convene a new Minimum Wages Board.

McGavin (1993) and Duncan and Lawson (1997) have shown that the main problem with PNG labour is that its wage productivity is lower than a number of other countries in the region. This means that a combined policy of increasing productivity and holding wages will be necessary to encourage significant growth in non-farm employment.

The Budget

The 1997 PNG expenditure appropriation was K2001 million (excluding K175 million of AusAID project grants) with a deficit of K119 million, or 1.8 per cent of projected GDP.

The 1996 fiscal outturn showed a small budget surplus of 0.6 per cent of GDP as against an initial estimate of a deficit of 1.1 per cent. Both revenue (K1,898 million, up K112 million) and expenditure (K1,861 million, up K5 million) exceeded estimates. Despite this the government borrowed some K82 million from the banking system, which had the effect of increasing outstanding domestic debt which had grown over previous years and severely restricting domestic credit.

The 1997 Budget saw the reintroduction of a Medium Term Development Strategy[4] which was aimed at improving the longer term allocation of resources toward the priority areas of health, education, transport and law and order. As a longer-term planning exercise, the government appointed a committee to make recommendations on the subject of a ‘Vision 2020’or where the country should be heading by the year 2020. This Committee has had extensive consultations with the community at large and made a preliminary report to government with a view to presenting its final report before the end of 1997.

The government has achieved a surplus of K138.8 million or 2 per cent of GDP in the first six months of 1997. This was achieved by revenue and grant income of K939.2 million (45.7 per cent of estimate). Tax revenue of K797.4 million performed well with income tax, Mineral Resource Stabilisation Fund taxes and import duties accounting for 71.25 per cent of total tax revenue and 63.4 per cent of total receipts. Non-tax revenue performed badly and the drawdown of project aid from Australia had not yet been recorded.

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Table 2 **Papua New Guinea: budgetary indicators, 1993–97** (kina million)

	1993	1994	1995	1996[P]	1997[a]
Total internal revenue + budget grants	1,316	1,446	1,772	1,898	1,882
Surplus/deficit	-273	-125	-34	37	-119
Appropriations	1,589	1,571	1,775	1,861	2,001
Borrowed funds	458	420	355	364	446
GDP (current prices)	5,016	5531	6,442	6,533	6,787
Appropriations/GDP (per cent)	31.7	28.4	27.2	28.5	29.5
Total internal revenue/GDP (per cent)	26.2	26.1	26.7	29.0	27.7
Deficit/GDP (per cent)	5.4	2.3	0.5	(0.6)	1.8
Borrowed funds/GDP (per cent)	9.1	7.6	5.5	5.6	6.6

[P] Preliminary
[a] For comparison purposes, excludes AusAID project grants of K175 million from grants and appropriations.
Source: Bank of Papua New Guinea, 1996. *Quarterly Economic Bulletin*, December, Port Moresby.

The Deputy Prime Minister and Minister for Planning and Implementation reported to the Parliament recently that the Development Budget was substantially underspent. At the end of August K130 million had been recorded (the implication being that there had been unrecorded spending of development funds) which represented only 32 per cent of the appropriation (Haiveta 1997). The main reason for this appears to be due to technical reasons such as failure to issue warrants, failure to present cash flows, and failure to record accurately the drawdown of grant funds. A further inhibiting factor has been the imposition of cash ceilings by the Department of Finance, which is hard to understand given the fact that revenues have been so bullish.

This is an ongoing trend which successive governments have tried to come to grips with. Until Papua New Guinea can devise systems that fully utilise the funds available, it cannot expect to achieve its targets. Many of these constraints are relatively easily fixed but it requires the political will to do so—involving hard decisions within the central government agencies.

Value-added tax

As part of its commitments to the World Bank and the IMF as well as its commitments to the World Trade Organisation and APEC, Papua New Guinea has long pledged to introduce a value-added tax in January 1998. A series of events have made the introduction of the tax very unlikely. The draft bill was supposed to have been approved by the National Executive Council and then the Parliament in March 1997. This would have triggered an education and publicity campaign to prepare the public for the tax.

Unfortunately, the government was occupied with the Sandline crisis during this time and the bill could not be adopted. This was followed by the elections and the formation of the new government, all of which meant that the necessary legislation was not approved.

The government now faces a dilemma. It has reduced a number of import tariffs on the supposition that the value-added tax would supersede them. At the same time it faces falling gold prices and oil production, falling agricultural production due to the drought and falling import duty due to the completion of most of the construction of the Lihir mine. It is not clear what the shortfall from these areas will be but it could be as high as K100 million.

The shortfall will have to be found within the system. It is unfortunate that the government has not made this public, so that the community is aware that there will have to be other revenue measures introduced. If the government had done so, there may have been a different attitude from some of the sectors that have so vociferously opposed the introduction of the value-added tax in 1998.

As it is, the government must make an almost impossible decision—it has to reverse previous tariff decisions, giving the wrong signals to the international bodies and investors. At the same time it has to devise new revenue measures to cover the shortfall and there are very few options available that will not equally give wrong signals to resource and other investors.

In the long term the value-added tax will almost certainly be implemented. Opposition to it is generally at the margin, some interest groups are concerned about how it will affect them, but most of these objections can be accommodated by the government without losing the simplicity of the tax. The value-added tax is being introduced to enlarge the tax net in Papua New Guinea, and inevitably some people will have to pay more tax as a result. The key issue is to avoid, as far as possible, undesirable distortions to the economy. These can be negotiated and can continue to be negotiated after the tax is introduced. It may have been better to go ahead with introduction of the tax on this understanding.

Interest rates

As a result of the maintenance of a very tight monetary policy, interest rates in Papua New Guinea rose sharply during 1995. Official commercial bank lending rates rose to 15.4 per cent in December 1995 before starting to fall in February 1996 to 10.5 per cent in June 1997. During the same period Treasury Bills rose to 21.5 per cent and have since fallen to 9 per cent. The Minimum Liquid Asset Ratio was raised above 32 per cent in mid-1995 before falling to 20 per cent in March 1997. The result was an almost complete standstill in lending and, by corollary, investment.

Social indicators

Despite its recent growth in wealth, Papua New Guinea has performed relatively poorly in terms of social indicators. According to the UNDP Human Development Index, Papua New Guinea’s ranking slipped back from 126 in 1996 to 128 in 1997 (UNDP 1997). This indicator measures life expectancy, adult literacy and school enrolments. On a number of other indicators such as infant mortality (65 per 1000, placing it in the worst off countries in the world, Gani 1997) and life expectancy (52 years in 1993, Chand 1997) Papua New Guinea has performed badly and there still seem to be serious problems in getting essential health and education services to the people. This is partially due to the introduction of the new provincial government system, which has left many people confused about the source of social services, with all levels of government blaming each other. There does not appear to be a clear plan in place to overcome these problems.

Structural adjustment

Papua New Guinea has had two Structural Adjustment Programmes (SAPs); the first was implemented after the closure of the Bougainville mine in early 1990 and the second after the chronic failure to control government expenditure in 1994. The SAPs were dealt with in the last edition of the *Pacific Economic Bulletin* (Chand and Stewart 1997) however the main points in the 1994 program are shown here in a slightly different form

- restore and maintain a sound macroeconomic environment by lowering fiscal deficits and maintaining relative prices to make Papua New Guinea more competitive.
- implement a series of structural reforms to improve competitiveness and business confidence, bringing about a recovery in private investment, especially in the non-mining sector, including agriculture.
- create a basis for sustainable and equitable development of renewable and natural resources through a sustainable forestry policy.
- increase the provision of essential services by better management and budgeting and introduce new methods of providing services to complement the public service.
- improve public service delivery by focusing government on the provision of basic services in education, health, agriculture, support services and infrastructure to support private sector-led growth.
- ensure a more equitable allocation of public funds across regions, maximising basic services and infrastructure across the country.

The key measure of the success of the SAP is whether economic activity has improved and whether the structure of the economy has changed fundamentally so that it will be better able to cope with future crises. Whilst it may be too early to make a definitive statement on the subject, it does not look as if there has been much change. Employment has not responded to the devaluation, while free banking reserves stand at around K742 million, so there is little investment occurring with borrowed funds. Agricultural exports have grown slowly despite record prices for coffee and copra.

Cocoa production has declined over the last 8 years but this is due to two effects, the loss of Bougainville and the poor performance of new hybrids. Coffee has also declined over the last 8 years despite the price being at more than K7,000 per tonne in early 1997—a record.

Copra and copra oil have shown an increase in 1996 reflecting high prices and full utilisation of existing nuts, however, high freight rates have restricted production in outlying atolls and there has been a reduction due to the Bougainville crisis. There has been virtually no replanting of nuts and it is becoming harder and harder to recruit copra cutters. It is highly likely that the industry will collapse when the inevitable next price fall occurs, unless a mechanical cutter is devised.

Palm oil has been the one success story, however, the long lead times to bring investment into production mean that the large increases in production of this crop have not occurred because of structural adjustment but because of other factors. There has been no new investment in this industry for more than ten years.

In terms of longer-term adjustment, Papua New Guinea is trying to improve the efficiency of its tree crops. Cocoa, copra, coffee and oil palm all have their own research institutes, which are partially funded by industry and partly by government. These are working on obtaining greater production at lower costs thereby

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Table 3 **Papua New Guinea: agricultural export volume indices, 1989–96** (1980=100)

	Cocoa	Coffee	Copra	Copra oil	Palm oil
1989	161.8	167.3	66.8	101.8	396.7
1990	117.7	124.1	60.9	102.2	429.2
1991	124.3	82.5	46.1	87.9	465.7
1992	131.3	100.2	40.7	103.1	550.3
1993	126.8	117.9	48.4	127.8	729.3
1994	90.5	126.9	55.3	101.5	692.1
1995	105.9	108.1	70.7	96.9	542.3
1996	142.7	122.3	145.2	145.2	800.6

Source: Bank of Papua New Guinea, 1997. *Quarterly Review*, March, Port Moresby.

improving the international competitiveness of the crops and their ability to survive periods of lower prices.

By far the largest obstacles to growth are poor physical infrastructure and the serious law and order problem. Poor physical infrastructure affects all crops either through lack of roads, bridges, wharves or expensive coastal shipping. Over the last few years, expenditure on the maintenance of this infrastructure has virtually ceased.

Coffee has been traditionally sold by farmers at the roadside. The collapse of the feeder road system and the dangers of armed hold-ups of slow-moving trucks has meant that probably more than 30 per cent of the nation's crop was not marketed in 1996 or 1997. The main arterial highway to the Highlands is barely passable due to lack of maintenance, which impacts freight rates for coffee, and also the prices of trade goods travelling up the road. The SAP will have to divert substantial funds into this area to enable farmers to market their produce at lower cost.

The recent formation of the National Agricultural Research Institute (NARI) shows that Papua New Guinea has recognised the need to develop crops other than traditional tree crops. The Institute will look at two separate areas—traditional food crops and new cash crops—some of which are indigenous, but have never been commercially exploited. This will allow cash crop diversification as well as increased food production. Initial funding for NARI is expected to come from overseas but the government will have to make a commitment to long-term funding of this instrumentality which will be vitally important in achieving any significant structural adjustment in agriculture.

Forestry

An important part of the SAP was to ensure that Papua New Guinea achieved a sustainable forest policy. The government and the World Bank carried out a sometimes heated debate on the program to be adopted, the main bone of contention being the composition of the Board of the proposed Forest Authority. Arguments on this issue held up release of the first tranche from the Bank for several months. Eventually the government accepted that its agreement with the Bank was binding and acceded to the requirements.

The logging industry in Papua New Guinea is currently feeling the effects of the setbacks in the Thai, Malaysian and Japanese economies and is arguing strongly for relief from export taxes. A number of logging companies have suspended operations due to the collapse of these markets. The industry continues to argue that it is unrealistic to expect it to move toward downstream processing in these circumstances and the Minister recently made a statement in which the government appeared to back away from its previous stance that no unprocessed logs would be exported after 2000 (Pok 1997).

There is a dispute over proposed tax regimes for logs to be processed within Papua New Guinea. The government proposes to tax input logs at the same rate as logs for export and the industry argues that this will cripple the processing industry before it starts.

It is still unclear whether there has been a significant and lasting move toward downstream processing and sustainable harvesting which would constitute a real structural adjustment.

Fisheries

The government has made a number of changes that have altered the composition of the fishing industry in Papua New Guinea. Papua New Guinea has a potential fisheries catch of greater than K1 billion per annum. This includes barramundi, prawns, crayfish and deepwater resources. Prior to 1995 virtually none of the catch was harvested by domestically-based vessels. Papua New Guinea received a licence fee from foreign fishing boats as its share. The government has made a number of changes that have led to the start of a domestically-based fishery, including the establishment of a cannery in Madang. There are a number of reported negotiations with canning companies, and they may result in more canneries being established in Papua New Guinea in the next 12 months.

The number of domestically licensed fishing boats based in Papua New Guinea has risen from 45 to nearly 130 in the last three years. The value of fish products has risen from a stagnant K10 million from 1982–95 to around K80 million in 1997 with an industry target of K200 million by 2000. Direct employment has increased from around 350 to 1,200 in 1997 with the potential to grow to 3–4,000 (Brownjohn 1997). The main factors in encouraging growth have been reduction in the duty on inputs, removal of 5 per cent export tax and introduction of a fuel rebate. As a result the industry has undertaken a major structural adjustment and looks set to provide significant employment and export income growth.

Manufacturing

There are no indicators available on growth or changes in the level of activity in the manufacturing industry. There are a number of projects under discussion such as oil refineries, an industrial centre at Kokopo, a fish cannery at Wewak and some timber processing plants. None have come to fruition except for a cannery at Madang. It does not appear that the devaluation has brought forward significant investment in this industry.

Service industries

Tourism in Papua New Guinea has grown steadily from around 5,000 in 1993 to 20,000 in 1996 (PNG Tourism Promotion Authority 1997), but there has been a decline in the first two quarters of 1997. The number of beds of all sorts available in Papua New Guinea has risen to around 5,000 and is expected to continue growing.

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Given its rich natural resources, diversity and beauty, Papua New Guinea should be one of the foremost tourist attractions in the region. Devaluation should have significantly increased our competitive position with other countries in the region, particularly Fiji which receives around 350,000 tourists each year, earning around K250–400 million (Duncan and Lawson 1997). High air fares, high accommodation costs and continuing bad press about law and order problems all inhibit growth in this market despite the proliferation of eco-tourism destinations and the efforts of the Tourism Promotion Authority.

There are no indicators available for other service industries.

Structural rigidities

A number of authors have recently identified the structural rigidities that inhibit investment and structural adjustment in the PNG economy. Duncan and Lawson (1997) as well as Chand and Stewart (1997) have discussed them in detail. The inhibiting rigidities are

- poor infrastructure including utilities
- law and order problems, estimated to cost the average investor about 3 per cent of direct production costs (Duncan and Lawson 1997) and the nation 4.66 per cent of GDP in direct costs (Levantis and Chand 1997). Each reports these to be understatements of costs
- little land available for private investment
- high employment and labour costs, especially lack of supervisory-level staff
- high unit labour costs.

These rigidities still exist and are powerful influences against investment. To achieve widespread structural adjustment they will need to be addressed.

Prospects

The World Bank is predicting good economic growth over the next ten years, particularly for developing economies (World Bank 1997). This will be led by the 'big five' developing economies of China, Indonesia, Russia, India and Brazil. Papua New Guinea should be in a position to capitalise on this with its mineral, gas and petroleum reserves and, to some extent, agricultural exports. The degree that it is able to compete will depend on maintaining a sensible exchange rate and remaining competitive in its export markets.

Despite some setbacks in the last year, especially the drought, Papua New Guinea still has enormous potential. Lihir mine began production on 1 May and production estimates for 1998 have been revised upward from 400,000 ounces to 650,000 and some 30 per cent has been hedged at a price in excess of K400 per ounce.

Mineral reserves include the Freida River deposit, which has recently been upgraded to 333,000 ounces of gold and 220,000 tonnes of copper (*The National* 16 October 1997), the Ramu cobalt and nickel deposit, the 'Morobe gold' prospects around Wau, Wafi, Simberi and Woodlark island gold deposits. Additional oil resources include Gobe of about 93 million barrels scheduled to come on-stream in March 1998 and Moran, with 80–130 million barrels and scheduled to come on-stream in 2000 (*The Post-Courier* 15 October 1997). There is ongoing negotiation about a potential natural gas pipeline to North Queensland from Kutubu, Gobe and Moran and a giant natural gas reserve at Hides in the Southern Highlands which may be processed into Liquefied Natural Gas (LNG) in Papua New Guinea (PNG Chamber of Mines and Petroleum 1997) for sale into the South East Asian market.

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Potential income from these reserves gives Papua New Guinea a cushion from other serious structural deficiencies. Nevertheless the future will depend on a willingness to take hard decisions regarding the rigidities which are inhibiting investment. Health and education services are continuing to decline, infrastructure has to be rebuilt and then maintained, the public service has to be overhauled and remotivated and the law and order problems have to be addressed.

Firm and clear investment policies and a framework conducive to investment need to be maintained. Special deals with favoured investors have to cease and trust has to be built up that rules and conditions will not continually change. Having announced long-term policies on issues such as taxation and tariffs, the government must stick with them rather than bowing to individual pressure groups.

A major push is necessary to get agricultural production of traditional tree crops, food crops and new cash crops (including livestock) moving. Papua New Guinea has the potential to double agricultural growth and maintain an exponential level of growth if it concentrates on setting the right conditions in place. This means a commitment to research and development, provision of infrastructure and training and extension. This will have to be provided within the new provincial government system, which seeks to decentralise decision-making and provision of services to local-level government.

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This paper has benefited greatly from the comments of Chris Manning.

Notes

1 Exchange rate K1=US$0.6985, 8/10/97

2 Some reports linked renegade defence force elements to these troubles.

3 For example, helicopters bought under the Sandline contract were reported to have been valued at K8 million. Several different sources have confirmed that they could have been bought on the open market for less thanUS$1 million.

4 Papua New Guinea had an earlier version of this in 1985, but it lapsed over time.

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