Papua New Guinea: enduring problems, radical solutions

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Papua New Guinea’s Medium Term Development Strategy (MTDS) and the national budget are both characterised by the strict demarcation between state and market. This demarcation is implicit in the orthodox policy paradigm: the private sector is the engine of growth, and for it to roar the government needs only to create a market-friendly environment and then not interfere. Contrast this with the World Bank’s assessment of its half-century of global experience in development.

Governments play a vital role in development, but there is no simple set of rules that tells them what to do...a deeper understanding of development involves a recognition that sweeping beliefs are often incomplete, that layers of complexity are buried not far beneath the surface, and that wisdom is often contingent on the particular conditions of time and place...experience and intellectual insight have pushed development thinking away from debates over the role of states and markets, and the search for a single, overarching policy prescription (World Bank 2000:2, 13 [author’s emphasis]).

For Papua New Guinea, the ‘one-size-fits-all’ approach to restructuring the economy, dominant in the 1980s and 1990s, should be supplanted by a pragmatic approach. This pragmatism better suits Papua New Guinea’s particular conditions, such as labour force participation rates that are too low in the private sector and too high in the public sector. The informal private sector dominates, comprising 85 per cent of the population and 97 per cent of the land, and its institutions conflict with those assumed in orthodox policy. The effective labour participation rate (at constant productivity) in agricultural export production (excluding palm oil) has halved since 1980 as a result of rigidities in rural land and labour markets. The public sector, non-market by definition, accounts for half of domestic credit and more than half of the formal sector payroll. That only a minor proportion of economic activity can be realistically classified as market-oriented readily explains why market-based price-signalling policy has failed so spectacularly to date. More than a decade after wage rates were deregulated and the exchange rate floated—big growth policy levers—large
tracts of agricultural land and large and growing numbers of people, mainly male, remain stubbornly outside the productive economy. These men do not suffer the exclusion passively; it is arguably the primary cause of crime and land-compensation claims—both well-known growth inhibitors. Over that period, households experienced three-fold increases in prices. When implementation of growth policies heralds an extended period of stagflation, strategists ought to ask why. The MTDS’s silence in this regard condemns it to being as ineffective as it claims its predecessor was. The inability of markets to allocate resources for broad-based growth, despite accommodative policy, means a more complex role for fiscal policy.

Fiscal policy

Aggregate primary expenditure needs to be reduced in order to achieve budget balance and put a cap on debt. Although the 2003 budget acknowledged this fact and established a task force to identify where best to make the cuts, it seems unlikely that the 2006 budget will reflect them. Whereas the 2004 surplus—reflecting high world commodity prices and low domestic interest rates—has reduced the urgency of the task, the issue still needs to be addressed. History cautions us against assuming commodity prices will not revert to trend, and, consequently, the budget to deficit. The government’s claim that it has spending under control is weak.

The revenue mix

As well as balancing the budget, the government must raise the proportion of foreign-sourced tax receipts to achieve external balance. There is a trade-off here: the higher the foreign-sourced proportion of revenue, the larger a balanced budget can be and still maintain external balance. One kina of foreign-sourced revenue will finance more than one kina of expenditure, only a part, albeit a substantial part, of which would be spent ultimately on imports. A balanced budget needs a minimum of 40 per cent foreign-sourced revenue (taxes and dividends derived from the mining and oil sectors, taxes on log exports, and foreign grants) to maintain external balance. From the mid 1980s until recently, the proportion has been well below this level. The national goal to reduce dependency on foreign grants underscores the importance of export-based taxes in the revenue mix. Tax rates on export industries, however, must be internationally competitive in order to attract foreign direct investment.

Could the government maintain expenditure levels and achieve external balance by increasing tax rates on sectors producing for home consumption? This depends on whether such taxation suppresses import demand more than spending stimulates it. If tax is defined as foregone expenditure, the question comes down to whether foregone expenditure has the same import propensity as actual expenditure in magnitude. Conventional economic theory assumes that it does. But what if the theory is only approximate? Then, equating taxation and spending would not necessarily have a neutral impact on the balance of payments. Moreover, the imbalance is more likely to be structural than cyclical and negative rather than positive—in the very early stages of development, latent demand for foreign exchange is virtually infinite. Furthermore, however small the structural deficit, being cumulative it would in time drain reserves. This is what happened from 1984, when, not coincidentally, the level of reserves peaked and government ceased borrowing overseas, until mid 1994 when exhaustion of reserves caused the floatation of the kina. On average during the fixed exchange rate regime,
government expenditure induced foreign exchange demand at the rate of 80 toea in the kina compared with taxation dampening it at the rate of 67 toea per kina, with changes in taxation and government spending explaining 87 per cent of changes in the level of foreign reserves. Limiting expenditure commensurate with foreign-sourced revenue is the only means open to fiscal policy to achieve external balance.

Operational efficiency

The structure of departmental budgets needs adjusting from wages and salaries to goods and services. For some time now, public servants have not had the equipment, supplies or services they need to do their jobs effectively all of the time. Waste and its counterpart, poor service delivery, result. For members of parliament, this provides justification for the electoral funds under their direct control outside the public service system, not all of which is spent wisely or fairly. There are internal consequences as well. Well-motivated people who lack the resources to do their jobs properly can easily become frustrated and, in time, either apathetic or corrupt, further eroding standards of service delivery. Individual descent into corruption is more likely if it is perceived to succeed, or to be condoned and practised amongst the leadership, or if real incomes are under stress—conditions all too familiar in recent times. This vicious downward spiral can be turned virtuous and upward by hiring a more appropriate number of people. A smaller, better-equipped public service would be better insulated from corrupting influences. It would be one in which the public could have confidence, and their servants great pride. Policymakers might also consider strategic approaches to public sector retrenchment, presenting it as an opportunity for career re-orientation to be embraced by employees. It can be an opportunity for redeployment of educated personnel from the public sector at the national level, via orientation and training programs, to entrepreneurs in the private sector to make the economy as productive as it needs to be to provide broad-based rising household incomes and a growing government tax base.

Resource allocation

The structure of aggregate expenditure needs to be adjusted temporarily from social to economic goods so that social programs can be funded over the long term without recourse to debt. The big increase in consumer prices since 1990 and the current high level of public debt are the results of policies that ‘put the social cart before the economic horse’. Government has been able to reduce total debt in recent times, not by reversing this order but by courtesy of windfall revenue resulting from high world commodity prices.

Government economic expenditure needs to include investment in agricultural export production on customary land. The issue here is risk. Relying on private financing of foreign-owned, ‘high impact’ projects following tenure conversion—the main strategy pursued to date—ignores the fact that tenure conversion will remain voluntary and slow. Meanwhile, customary land law increases risk prohibitively for private financiers. The proposed ‘green revolution’ tax breaks cannot deal with this type of risk. Policymakers might consider a strategic choice: continue with policies that seek to reduce this risk to commercial levels, which has resulted in rural exports per capita halving since 1980; or find a financier who can accept the level of risk, namely, the state. Taking this risk mitigates a greater one—social decay or upheaval as the ongoing decline in the participation rate in
productive activity is matched by its growth in the unlawful kind. The ill-fated Enhanced Cooperation Package recognised the urgent need to arrest the descent into lawlessness, unfortunately choosing a politically-expedient but economically infeasible enforcement strategy alone to do it. Australia’s legitimate interest in the well-being of its neighbour and protégé would be well served by heeding the World Bank’s distilled wisdom and focusing on the ‘particular conditions of time and place’ that have so confounded orthodox policy and left the country struggling.

Self-fulfilling fear

Keeping land out of the modernising process and retaining it as a safety net against the process’s failure has contributed to that failure—a self-fulfilling fear. Land kept out of production holds employment, foreign exchange supply, and the tax base below what they could be and slows the rate of development. A rate of progress below potential would matter less if those excluded from the development process were happy to remain passively in subsistence mode. Their rejection of this notion manifests as the law and order and land compensation problems.

Do we treat rising crime by employing more policemen, magistrates, judges and correctional officers and by imposing harsher penalties? Or do we treat the root causes of rising crime by creating more male employment? The answer is, of course, not a simple either/or one. The enforcement agencies need to be better provisioned than they are. But more policemen will not help much when existing ones lack the operational vehicles to do their work (Why aren’t the police properly provisioned? Partly because excluding land and labour from production constrains the tax base). But no longer can law and order be seen mainly as enforcement. Only by creating legal income-earning opportunities to replace the troublesome illegal ones can crime be brought back to manageable levels. Numerous talk-fests over many years have concluded that these opportunities must be created in the informal, rural sector.

Policymakers responded by attempting first to create private property rights in land by marking boundaries, identifying ownership and issuing formal title. This has proved impractical. Nor, crucially, is it necessary: most of the nation’s coffee is grown on customary land. Moreover, plantations—land alienated from customary ownership where private property rights exist in law but not in practice, owing to weak enforcement—produce less and less coffee. Just as policymakers need to broaden their thinking about how to reduce crime, they need also to consider how more land and more people can be brought into legal economic activity.

A good starting point is to recall the spectacular flowering of smallholder coffee production in the 1960s and 1970s, when it grew three times as fast as the population, providing a quantum leap in living standards. And then to puzzle why, since about 1980, quite abruptly, it has grown more slowly than population. Conventional economic analysis looks immediately to prices for the explanation. Certainly prices boomed in the latter half of the 1970s, but the production boom preceded the price boom. Moreover, prices have boomed at times since 1980 without a noticeable effect on production. Furthermore, the huge realignment of the kina since 1994 has given smallholders much higher prices, but they have not responded by growing more coffee. After prices, conventional analysis looks to government failure for the explanation: failure in providing law and order, infrastructure, extension services, and research and
development. But government in 1980 was mostly still in good shape in these regards. When conventional analysis turned to land and labour market structures for explanations of agricultural under-performance, it did so from a plantation perspective and focused on formal property rights, wages and the exchange rate. Wage rates were liberalised in 1992 and the exchange rate was floated two years later, neither policy much affecting agricultural performance. Indeed, to repeat, plantation coffee production is declining.

The effects on rural productivity of the structure of informal land and labour markets are yet to receive serious attention. It seems likely that the abrupt change in 1980 in the rate of growth in smallholder coffee production reflected changes in the supply of female labour. Before 1980, the high growth rate in production was using up a labour supply that was surplus to subsistence requirements. By 1980, that surplus had been fully utilised. Since 1980, production growth has been limited by growth in the fully-employed female workforce. On the other hand, the male labour force remained seriously underemployed because plantations, which employed them, could not expand fast enough owing to the lack of formal property rights.

In summary, customary attitudes to land and to the gender division of labour are the binding constraints on the rural sector. They also constrain the urban private sector, for factories will not produce more than households (85 per cent of which are rural) can buy. With a severely constrained tax base, government, too, is limited in what it can do without going into debt, which governments in the 1990s did with alacrity. Moreover, the long-standing strategy of relying on enclave resource development to fund government is looking increasingly risky. That strategy was always incomplete. Enabling people to enter the workforce and contribute to the nation's development, which agriculture can do more cost-effectively than mining, is surely more developmentally beneficial than funding government activity, much of which, the record shows, has been of dubious value. If governments since 1975 had invested in agriculture what they invested in resource enclaves, the country's prospects today would be far better than they are. Liquidating these investments to pay off mounting debt underscores the point, particularly since debt nevertheless continued to grow. The only way for governments to permanently reduce debt is to run budget surpluses. Budget papers routinely recognise this reality—but only in the out-years!

The centre and foundation of low-risk modernisation

PlesPlus, rather than regarding customary land as insurance against modernisation's failure, makes it the centre and foundation of modernisation.

PlesPlus, where strange things happen. More than a place, it's an idea for transforming villages, featuring: the school as its focal institution, which is also a communications centre, an agricultural export production unit and a community hall; solar power and satellite communications; producing land areas designated for financing social expenditures (health, education, and water supply); and a mix of traditional and modern housing.

Public investment in agriculture is necessary for Papua New Guinea's survival as a viable state and for raising living standards, simply because the lack of property rights inhibits private agricultural investment. Since, as we have seen, government must soon move its budget into permanent surplus, public investment in agriculture must displace some existing
expenditures. On first thoughts, given that non-priority expenditures exceed priority ones, this is where the savings should come from. But in PlesPlus they come from priority expenditures as public and private roles are partially reversed in a public–private partnership that puts the economic horse where it belongs: in front of the social cart. Savings in non-priority expenditures, according to PlesPlus players, go to debt reduction. These players, the national government and the clan leaders, are the modern and the traditional economic managers. Both know that surplus production must precede social expenditures for them to be sustainable. They know also that, because social expenditures rely heavily on imported inputs, the surplus must be in foreign exchange. PlesPlus, then, is an integration on customary land of export production, primary education and health care and utilities (solar power and satellite communications). These improvements, like the land on which they stand, are owned by nobody in particular but by the community—by everybody in general—and are managed in perpetuity by clan leaders, whose membership changes over time.

With the benefit of hindsight, it could be fairly said that the colonial administration made a strategic error in not formally recognising the autonomous, resource-rich institution of clan leadership, creating instead the local government system. It should not be too difficult to remedy the error. Local government has not taken root: the mid-1990s attempt to revive it has not worked. Compiling a register of members of clan leadership, as an association or a cooperative under existing law, might be sufficient to incorporate the institution into the system of governance. The system would have to provide for clan groupings from the perspective of financial viability (here we are moving towards the district concept that resurfaced in the 2005 Budget). The clan leaders’ first task in creating PlesPlus would be to allocate usufructuary rights to land for development of export production and social infrastructure. Clan leaders would also employ primary health and education staff, as national institutions relinquished this responsibility under the subsidiarity principle. To complete the mobilisation of resources to get PlesPlus off the ground, clan leaders would need to recall their unemployed sons—by paying for work completed—to turn idle land into the necessary foreign exchange receipts to finance the import component of social expenditures. The national parliament’s complementary task would be to transfer funds from consolidated revenue to registered clan leaders for primary health and education and local infrastructure and administration, which would need modifications to the current fiscal system. Owing to the fiscal constraints outlined above, these funds would have to be stretched to include payment of land labour until export receipts began to flow.

The second phase of PlesPlus envisages investment in water supply, solar power and satellite communications. With an established cash flow, clan leaders could issue long bonds to finance the investment in these long-lived assets. With intermediation by the national government, Papua New Guinea’s bilateral and multilateral friends might be attracted by these bonds. Of course, in specific cases there may be better power and communication solutions.

Reference