Export processing zone policy in Papua New Guinea

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In 1991 the government of Papua New Guinea began a new development strategy which focuses on the creation of industrial centres. Unlike export processing zones, industrial centres will not be restricted to export-oriented activities. Both concepts, however, specify a particular zone for industrial activities. While the Papua New Guinea government will take the initiative in the areas of incentives, reducing high costs and the provision of institutional 'support', it is hoped that the private sector will take up the challenge to create a strong, viable and competitive industrial base.

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The government of Papua New Guinea is taking advantage of the large increases in revenue from the mining sector to diversify the structure of output so that the economy will not be dependent on a mining boom that may end at some future date. It is taking deliberate steps to promote and encourage other sectors of the economy, particularly agriculture and industry. Various initiatives and programs, most of which have been highlighted in the 1993 budget, represent direct and indirect channelling of the government's revenue from the mining boom into these sectors.

The strategies, policies and programs aimed at creating a viable and competitive manufacturing industry and promoting export production are contained in the government's 1991 *Medium Term Industry and Trade Development Action Plan.* While there is no specific policy or program to establish export processing zones, a similar but more general concept of industrial centres has been adopted.

An export processing zone is a location where all processing activity undertaken is for the export market. Once a geographical area is designated as an export processing zone, infrastructure, services and incentives must be provided in order to attract the appropriate clientele. Certain criteria and guidelines also need to be developed in order to make the zone work. Numerous developing countries have adopted this development strategy. Some of their experiences are described in other articles in this issue of the *Bulletin*.

Whereas export processing zones exclude all, or most types of non-export manufacturing activity, Papua New Guinea's industrial centres include all types of manufacturing activity, irrespective of the destination of the product. A strong similarity lies in the identification of a zone for the purpose of manufacturing activity.

The rationale for industrial development policy

In recognising the important role of industry in development, the government, through its *Medium Term Industry and Trade Development Action Plan*, has initiated strategy, policy and programs for the development of manufacturing. This development is seen as an important step towards economic diversification and as an attractive way to create a more dynamic economy capable of providing jobs and income earning opportunities.

The Action Plan takes a broad based approach and addresses most of the influences on industry. In addition to the use of conventional instruments such as incentives, areas of influence such as macroeconomic policy, financial sector performance, tax structure, labour markets and infrastructure are also reviewed so that negative influences can be adjusted. In taking this approach, the government is trying to encourage the private sector to take the lead in industrial development. If the government can create a conducive environment for investment, the private sector is likely to respond and opportunities for employment, income and growth will be created.

Structure and performance of the industrial sector

At present, industry accounts for only 13 per cent of GDP and 8 per cent of formal employment. Manufacturing is the most important component of industry and is the primary target of the industrial centre strategy. Manufacturing is concentrated in food, beverage and tobacco production, and in 1986 these commodities accounted for 53 per cent of the value added in manufacturing. Other activities include metal and metal products, timber and wood products, chemicals, textiles, wearing apparel, leather products, soap and detergents, paints and enamels, industrial gases, paper and paper products, and jewellry.

The manufacturing sector has had limited growth since 1980, rising from 12 per cent of GDP to its current share of 13 per cent. Rapid expansion in the mining activities that have dominated growth in GDP have caused the relative shares of sectors like manufacturing to remain constant, even though there has been a relatively small increase in their output. The lack of new private sector investment in manufacturing may also partly explain its unchanging share of total output.

Most of current manufactured output is sold on the domestic market. Much of the activity is capital intensive and largely foreign owned and managed. This is particularly true for large-scale manufacturing activities like food, beverages and tobacco. The sector's contribution to export production is small at 5 per cent of total exports. Given its present heavy reliance on imported raw materials, net foreign exchange receipts from manufacturing are not substantial. This also means that backward linkage effects are small.

The number of factories engaged in manufacturing has declined from 508 in 1980 to 443 in 1992 (SRI/ECFA 1992). The factories are geographically concentrated with 55 per cent located in the two main urban centres of Port Moresby and Lae. Employment in manufacturing has increased slightly from 20,000 in 1980 to 22,000 in 1993. Men account for over 90 per cent of the workforce in manufacturing, a proportion that is quite different from that of other developing countries, particularly in Southeast Asia.

It is often argued that manufacturing in Papua New Guinea is characterised by a high cost structure, caused by heavy reliance on imported inputs and high labour costs. A diversification of output would provide an opportunity to be less dependent on imported inputs. Wage costs, originally based on Australia's industrial relations system are, in some cases, a multiple of those in neighbouring countries. The deregulation of wages should contribute to a reduction of relatively high labour costs. The high costs of power, telecommunications and transport are also areas of concern. The broad based approach mentioned earlier is intended to reduce or constrain them.

Strategy and objectives of industrial centres

The government sees itself as a minor player in the process of industrial development and looks to the private sector to take the initiative in achieving higher levels of output. The government's responsibility is to create an environment conducive to industrial development through various policy and incentive programs.

The government's strategy identifies three important problem areas requiring intervention: lack of incentives, high cost and lack of institutional support.

The current incentives regime is seen to be weak and uncoordinated. Greater and better coordinated incentive programs are needed to encourage new investment and export production. The newly established Investment Promotion Authority has been set up specifically to perform this function.

An important component of the government's broad based approach to industrial development is the need to address the high cost problem. The cost of services and utilities such as electricity, telecommunications, transport and rentals is estimated to be 50 per cent higher than those of Papua New Guinea's competitors. Substantial reductions in all these costs are needed if Papua New Guinea is to have any hope of achieving international competitiveness. The SRI/ECFA study recommends the use of off-peak pricing, industrial discounts and private provision of utilities.

Policy intervention is also seen as a necessary feature of this new approach. Wages, particularly minimum wages, have been kept artificially high by legislation and administrative manipulation. It has often been argued that this has resulted in the promotion of capital-intensive modes of production in sectors of the economy that are traditionally dependent on labour. There is now a tendency towards deregulation. For the labour market, a market-determined wage structure has been proposed. The 1992 Minimum Wages Board determination, which effectively reduces the urban minimum wage to rural levels and argues for deregulation, represents this new trend.

Changes in exchange rate and trade policy are also required. A competitive and flexible rather than a strong exchange rate is to be adopted. The kina has already been devalued in several small steps since 1976. At present, it is maintained at a high level by the 'Dutch Disease' effect of mineral (now including petroleum) export receipts. For the near future the exchange rate should be based on a policy envisioning an increase in the Bank of Papua New Guinea's reserves. At present these reserves are augmented by mineral receipts, which results in an appreciation of the kina above a level that would be appropriate for an economy based on non-mineral production.

It is non-mineral production that provides a long-term opportunity for income creation and employment not only in traditional activities but in other activities that would be competitive in a non-protectionist world. The success of mineral production should not create a barrier for income creation and the employment of the majority of Papua New Guinea's people. Quantitative controls and a protectionist trade policy are to be abandoned. Instead, free trade and the use of common tariffs are likely to be encouraged.

Institutional support has been a common problem for industry in the past. Private sector organisations such as the Chamber of Commerce and the National Institute of Standards and Industrial Technology have played a supportive role. Under this new approach, existing government institutions will be strengthened and streamlined and new ones established. For example, the Department of Trade and Industry, with a new structure and a role more clearly defined by the Action Plan, is now better coordinated and focused. New statutory bodies have been established, such as the Investment Promotion Authority, the Small Business Development Corporation, the Chamber of Manufacturing and the Industrial Centres Development Corporation, to provide government institutional support that has been lacking in the past. Of these, the Industrial Centres Development Corporation, although not fully operational, is the organisation responsible for the establishment of industrial centres. The problem now is not one of creating new institutions, but of implementing the plans already made.

Industrial centres

The concept of industrial centres was adopted as a strategy for the promotion of industrial development in Papua New Guinea in 1990 when parliament passed the Industrial Centres Development Corporation Act. This act specifies the following functions for the corporation

- to plan and implement the industrial centres development program
- to prepare feasibility studies to identify appropriate forms of industrial development and to identify industrial centre sites
- to acquire land for industrial centres
- to coordinate finance for the development of industrial centres
- to manage and coordinate all projects, from site development to commissioning
- to promote industrial centres internally and externally
- to manage industrial centres.

As of June 1993, the Industrial Centres Development Corporation was not fully operational because matters relating to personnel, structure and budget were being finalised. Meanwhile, work on the establishment of industrial centres is currently being performed by the Industrial Division of the Department of Trade and Industry.

The Lae industrial centre is the first project to be developed. A feasibility study undertaken in 1989 established its viability. A loan of US$8.4 million from the Asian Development Bank was approved in 1990 and development work commenced the same year. The total land area of the centre is 26.95 hectares. This will be subdivided into plots of approximately 4,000 m^2 and each plot will house a standard factory building capable of accommodating 4 to 16 tenant enterprises. Smaller plots are also planned for micro-scale industries. Land is expected to be leased over a 30 year period at a maximum rate of K10/m^2/year, while buildings will be leased at a maximum rate of K40/m^2/year. These rates are slightly lower than the existing commercial rates. A land dispute between the state and a traditional group, however, has delayed this project by an estimated 10 months. Industry officials are confident that the dispute will be settled soon so that the final phase of the project can get underway.

Although no selection guidelines and procedures are currently available, official indications are that preference in industrial centres will be accorded to activities

- that are nationally owned and operated
- that are export oriented
- that are environmentally friendly.

Possible tenants identified in the feasibility study included enterprises engaged in food processing, metal works, wood works (furniture and building material), repairs, automotive spare parts and garment manufacture.

Despite the delay in the development of the Lae industrial centre, plans are underway to establish industrial centres in other parts of the country as well. Goroka and the Eastern Highlands and a location in Central Province just outside Port Moresby have been identified as possible sites. It is envisaged that each province will have its own industrial centre by the time this program is fully operational.

A good start

The government has taken the initiative to promote industrial development in Papua New Guinea. A broad based approach designed to address problem areas has been adopted. It involves strengthening and broadening the incentive structure, reformulating and reorienting policy in all related areas and creating the necessary institutional structure. The private sector appears to be the prime target of this approach. Industrial centres represent the extent of government involvement in this process. The ultimate goal is to create a 'dynamic and diversified industrial base providing self-sustaining growth, income and employment opportunities, as well as improved standards of living' (Mai 1993). The next step should be to implement these objectives.

References

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