



# The Papua New Guinean malaise: from redistributive politics to a failing state

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Do the current governance problems in Papua New Guinea have a political, cultural or economic basis? While politics and culture have no doubt been important, it is argued that the economic policies adopted at independence are responsible for many of the governance problems that are proving so difficult to overcome. In particular, the adoption of the recommendations of the Faber Report of 1973, with their emphasis on localisation and redistributive policies rather than policies that would have supported economic growth, led to predatory behaviour by the political élite that undermined the process of legitimisation of economic, political and administrative institutions.

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There is much to be said for the widely held belief that Papua New Guinea's current governance problems originate in politics: the weakness of the party system, rapid turnover of parliamentarians, candidates being elected by a small proportion of votes, notoriously weak parties unable to prevent their members from crossing the floor and unstable governments ousted by recurrent motions of no confidence. This unstable environment, the argument goes, gears incentives heavily in favour of short-term

benefit maximisation by politicians and the provision of particularistic benefits to political followers and to corruption. Governance, thought to include 'public sector management, accountability, the legal framework, and transparency and information' (Larmour 1998:1), suffers as a consequence. This interest-based explanation contrasts with cultural accounts wherein weak governance is believed to derive from political culture. A lack of 'national identity and purpose', reflected in relatively strong primordial



attachments, induces politicians to use their positions of power for their own benefit and that of the primordial public—a behaviour that generates political instability and factionalism as well as governance problems (May 2001).

Defective governance, in turn, is generally considered to constitute a major handicap for economic growth. Law and order problems, corruption, infrastructure collapse, unreliable service provision, to which now macro-economic instability has to be added, have all increased operating costs and business risks and reduced investment spending and economic growth.

However, it is by no means obvious that governance problems have been responsible for the anaemic growth experienced by Papua New Guinea. Indeed, there is credence to the theory that deficient governance has been at least partially brought about by the redistributive policies that were pursued immediately after independence. These policies damaged employment growth and opened the door for predatory behaviour. Increasing unemployment, inequality, and misuse of political power undermined the process of legitimisation of economic, political and administrative institutions. Economic failures might be as much a cause of the current governance problems as its consequence.

The timing of events at least intimates such an interpretation. As Donald Denoon has pointed out '[t]he fact is that Papua New Guinea's governance was widely admired for more than a decade [after independence]' (2005:195). In those early years, public administration was functioning reasonably effectively. The 'visible deterioration of roads, schools, aid posts' (May 2001:313) had not yet set in, and corruption had not become endemic.<sup>1</sup> Law and order problems did surface in the 1970s (Denoon 2005) but reached new heights only in the 1980s 'when the first of several states of emergency was

declared in the national capital, Port Moresby in 1984' (May 2001:313). This relatively credible performance in terms of governance in the first ten years after independence contrasts with an economic one that 'has not been good' (Goodman, Lepani and Morawetz 1987:51), as 'GDP has been growing more slowly than population', output per person has been declining<sup>2</sup> and formal employment in the non-mining private sector has remained stagnant.<sup>3</sup>

This article explores the thesis that economic policy—neither reducible to political instability nor to 'primordial attachments'—was responsible for Papua New Guinea's economic stagnation and contributed markedly to the current governance problems.

### A lost cause?

Why was Papua New Guinea's economic performance in the first ten years after independence so unsatisfactory? What were the economic prospects at independence?

These questions are looked at exclusively in terms of economic growth, that is, the increase of the economic capacity of a country as measured by output produced. Economic growth is generally thought to be different from economic development. The latter has been defined in many ways, but whatever the definition, economic growth is a prerequisite for sustained development. Without expanding production there will be no additional resources for social improvement, for public infrastructure, education, sanitation and health services. It is true that purely redistributive measures can lead to development if 'development' includes an element of 'equity' in its definition. The bounds to such 'development through redistribution' are narrow, however, particularly for a poor country like Papua New Guinea. Indeed, this country did go

through a painful experience where the neglect of growth opportunities contributed to its impoverishment and, as will be argued, added to its political woes as well.

There are two broad strands of reasoning that explain economic performance generally and economic failures specifically. They might be labelled 'external' and 'internal', depending on their relationship to domestic politics. The external category includes two elements: unfavourable initial conditions at the time of independence and the development of the external environment since then. The initial conditions are made up on the one hand by 'the colonial legacy', the initial endowment of human and physical capital, and on the other by the physical conditions such as climate, terrain, natural resources, population density, and geographical location. Of importance in the external environment are changes in the world economy, particularly the terms of trade. Since exogenous factors are outside domestic political influence, a finding that they have caused the current economic malaise absolves the government of Papua New Guinea and their advisers from any responsibility and it is hardly surprising, therefore, that the debate on the relative importance of 'external' versus 'internal' causes of economic failures is, in Papua New Guinea as elsewhere, highly contentious.

The claim that Papua New Guinea's economy failed because of the nature of the initial conditions, that Papua New Guinea was 'a lost cause' from the beginning because of its physical make-up and endowment with human and physical capital, is fraught with the danger of rationalisation with the benefit of hindsight. The fact that Papua New Guinea, like all countries before they industrialised, was capital poor—both in terms of human and physical capital—does not in itself constitute a barrier to development. It is only the capacity to increase them at a rate that is sufficient to

improve the standard of living that is relevant.

To avoid the bias of hindsight, it is useful to look at the forecasts of observers (at the time of independence) who, after all, were well aware of the characteristics of the country. One of these concludes that purely in terms of its growth rate 'there would be cause for satisfaction' (Shand 1971:54). The Faber report anticipated national product growing at a rate (in constant prices) of 7–9 per cent' (Overseas Development Group 1973:18). The report was written before the oil price shock of 1973 and the world recession that followed—an event that might have muted the optimism of its authors. However, one year later the Asian Development Bank came to the same upbeat conclusion 'PNG has good chances of achieving a reasonable degree of development and stability' (Asian Development Bank 1976:7). A 1976 World Bank mission focusing on the question 'whether Papua New Guinea's successful transition into self-government and independence can eventually be matched by economic self-reliance', and on its ability to finance the budget and the current account without Australian aid, found that

...the prospects for self-reliance were promising and that there were good grounds for believing that the country would eventually be able to 'earn its own living' without grant assistance (World Bank 1978:8, xiii).<sup>4</sup>

This optimism was supported by the exceptionally rapid economic growth in the ten years before 1973—the year of self-government—, with 'an average real growth of gross national product (GNP) of over 10 per cent' (Goodman, Lepani and Morawetz 1987:28). Although these numbers are distorted by the rapid increase in government spending and the opening of the Panguna copper mine,<sup>5</sup> the performance is impressive by any standard.



Weak initial endowments had not prevented this remarkable performance. Human capital constraints did not operate because of the rapid expansion of the education system and because skills could be imported until Papua New Guineans were available to take over positions that required extensive education, training and experience. This is an expensive way of compensating for the lack of local skills, but considering that the Somare government expanded government employment by one third in the first four years after achieving self-government<sup>6</sup>—at rapidly increasing rates of pay<sup>7</sup>—and that the speeding up of localisation was driven by political and not financial considerations, funding does not seem to have constrained the importation of skills unduly. Despite the rapid expansion of the education system, scarcity of personnel with skills and experience persisted, but already by the mid 1970s the problem of ‘underemployed’ secondary school graduates had emerged (Asian Development Bank 1976:40).

There are few indications that capital constraints did not allow a rate of growth sufficient to improve the standard of living. With the exception of the road network, Papua New Guinea was thought to have a relatively good infrastructure facilities and services (World Bank 1978:30). The private sector had access to financial capital through a well-functioning banking system. Government finances were stabilised by the massive Australian aid flows and the revenue from the Panguna copper mine that allowed levels of government spending on investment and services at roughly the rate of pre-independence days initially; public finance became precarious mainly because the economy failed to take off and the additional tax revenues that come with rising levels of income did not materialise.

Nor is there much evidence that the physical endowments were an effective

barrier to development. Papua New Guinea does have a major market at its doorstep and its location in relation to other markets is not significantly different from countries like Malaysia that have managed to increase greatly their living standard. Parallels to Malaysia go further. The land-abundance Papua New Guinea is blessed with would have allowed a similar massive expansion in agricultural exports. Although the low population density increases the cost of infrastructure, this is simply the reverse side of land abundance. The most severe physical handicaps are the rugged terrain and the many islands that make transport and communication difficult and expensive and lead to the fragmentation of the domestic market. Such fragmentation, however, cannot explain the development failure in places where infrastructure has been established. Papua New Guinea would be a very different place if the region along the highland highway had prospered and provided a growth pole.

Thus, the initial conditions in Papua New Guinea were fairly favourable for a take-off. No macroeconomic disturbances imposed restraints on growth; the government budget and the current account were balanced and inflation was low. Public administration functioned and financial institutions were sound. Papua New Guinea had an education sector that was producing human capital at a rate sufficient to feed an expanding economy and the government had enough resources to continue to expand public infrastructure. The country could count on a strong agricultural and natural resource base as a springboard for growth. The optimism of the early observers was hardly misconceived.

Still, the economic failure of independent Papua New Guinea could have been the result of external conditions, in particular, a massive deterioration of the terms of trade. In fact, the external environment was not unfavourable in those early years.

Commodity prices of tree crops rose to lofty heights—the prices of coffee and cocoa quintupled within a few years during the mid 1970s<sup>8</sup>—and commodity prices generally settled at a historically high average level for the rest of the decade.<sup>9</sup>

### The new world of development

In the absence of external factors able to account for the economic failure of the first decade, internal factors come to the fore. As has been widely observed, the time of independence coincided with a sea-change in policy analysis and policymaking, a break that is captured by the difference in outlook between the 1965 World Bank report and the 1973 Faber report. The obvious suspicion arises that the declining growth rate is related to this change in outlook.

The World Bank report is strongly growth oriented '[t]he mission believes that major emphasis in the development program should be given to the stimulation of production and the advancement of the indigenous people' (International Bank for Reconstruction and Development 1965:27). The Bank suggested a strategy of export-led growth based on agriculture and forestry—mining hadn't appeared on the horizon then—with foreign investment taking a leading role in both sectors. This growth orientation was maintained when it came to the 'advancement of the indigenous people' (1965:27). It is pursued not through a process of redistribution but by increasing the productivity of indigenous labour. Education would open employment opportunities in government and commerce, new production methods and crops in agriculture were to increase subsistence production and income from smallholder cash cropping, and better credit facilities<sup>10</sup> and advisory services<sup>11</sup> were to provide an entry into plantation agriculture and business generally.

The World Bank report has a coherent vision of how to generate a rate of growth capable of increasing the standard of living and to provide the necessary tax revenue for the government to become self-sufficient in the long run. Rural incomes were to rise through additional subsistence output and cash cropping. Smallholder production, logging and plantation agriculture would earn enough from exports to pay the import bill that was bound to increase with raising income levels and the limited scope for import substitution that a small and fragmented market such as Papua New Guinea allows. Employment growth capable of absorbing a growing number of young school leavers in search of wage employment in the formal sector was to come from the localisation of positions in government and additional employment in the manufacturing and the service sectors. This vision guided much of the planning process of the territory until self-government arrived (Territory of Papua and New Guinea 1968; Downs 1980).

In the eyes of its critics this 'orthodox' development strategy had one major disadvantage. By primarily stimulating output growth it was forced to rely heavily on foreign investors providing both capital and know-how, the economic dominance of foreigners was to continue, or, as it was put by these critics, the plan was deficient in local 'participation' (Schaffer 1965; Kaputin 1969, Crocombe 1969; Curtin 1968). As Voutas put it in the House of Assembly

[t]he basis of our [Pangu's] opposition to this plan is our concern that at the conclusion of five years much of the business will be in the hands of Europeans, and only a little in the hands of Papuans and New Guineans (House of Assembly Debates, 26 November, 1968:707).<sup>12</sup>

These criticisms were fully accommodated by the Faber report, the new vision that



displaced orthodox thinking, shifting attention from growth to redistribution in a dramatic way. 'We believe', it said, 'that the emphasis of the next plan should be on localisation/indigenisation, rather than growth' (Overseas Development Group 1973:4). 'The main emphasis of development in the past has been upon aggregate growth...But development goals are now to be more concerned with equalising the distribution of benefits, with increasing indigenous participation and with reducing the rural-urban gap' (1973:97). The Faber report was adopted by the Pangu Pati out of which grew the Eight Point Plan, the official government development strategy (Hegarty 1979; Downs 1980). The new strategy was 'the product of a happy conjunction: an advisory team offering an alternative charter for development and a new, reformist government looking for one' (Fitzpatrick 1985:22).

The eight aims faithfully followed the Faber report in their concern with redistribution. Indeed, there is no mention of economic growth at all. The aim with the most significant impact was the first one: '[a] rapid increase in the proportion of the economy under control of Papua New Guinean individuals and groups and in the proportion of personal property income that goes to Papua New Guineans' (Papua New Guinea 1974:x). It was 'the aim that overwhelmingly concerned members of the first national government' that had approved them (Fitzpatrick 1985:22, 27). Indeed, for most members of the Coalition, 'participation', the localisation of employment and the acquisition of equity by Papua New Guineans, was only one key aim (Connell 1997:28).

It will be argued in the next section that the adoption of the Faber report in the form of the eight aims, coupled with the failure to deal with the problem of access to land and to reverse the decision of the Minimum Wages Board to double urban wages, closed off the avenues for the growth of the formal sector.

## Development policies and their consequences

The strong emphasis on redistribution by the new vision did not usher in a complete reversal of economic policies (Reilly 2001). There was continuity: the priority of rural development with its focus on subsistence agriculture and smallholder cash-cropping, the emphasis on foreign investment in mining, forestry and fisheries, and the need for Papua New Guineans to play a larger role both in the public and the private sector through accelerated localisation of public employment and through their increased involvement in private business. There were significant differences, though. The redistributive bent, with its hostility towards foreign investment, led to a downgrading of the plantation economy and the manufacturing and services sector, all of which could expand only with the help of foreign capital.

The widespread reservations towards foreign investment led to a severe curtailment of its scope. Large areas of business activity were restricted to nationals.<sup>13</sup> In those areas that remained open to foreigners, the generous fiscal treatment of the Territory Administration was discontinued; the tax holidays, low rates of taxation, generous infrastructure provision and immediate write offs of new investment expenditure in agriculture were all abolished. Up until 1977 there were essentially no fiscal incentives for investors that applied across all sectors of the economy. The policy began to shift gradually thereafter, as some 'selective incentives' and some changes in the tax regime were introduced.<sup>14</sup> Thus by the mid 1980s the *status quo ante* had been restored to some degree, at least in terms of the fiscal incentives offered to attract new foreign investment.

Changes in the fiscal regime were not followed by regulative relaxation. Particularly cumbersome was the procedure of approval of every new foreign enterprise<sup>15</sup> through the National Investment Development

Authority (NIDA). An approval had to be sought not only for the initial registration but also for any change in an enterprise's activity. The procedure was complicated even more by the fact that the Authority was not a one-stop-shop agency, but permissions had to be sought by other concerned agencies as well—such as the ministry of labour for expatriate employment or the central bank for loan approvals. The estimated time for the registration process to run its course was excessively long—taking one and a half years on average. This long and costly process was made even more onerous by the uncertainty it entailed: National Investment Development Authority approvals proved largely arbitrary and inconsistent, depending heavily on the proclivities of the minister who happened to be in charge at the time and ultimately approved all those decisions. Thus the Authority was a major element in an over regulated environment that seriously delayed and hampered investment spending (Daniel and Sims 1986; Connell 1997; Stein 1991).

Fiscal and regulatory policies were also a handicap in the evolution of a competitive manufacturing sector; another was the doubling of urban real wages between 1973 and 1975 and their subsequent entrenchment through wage indexation. These wage increases, it is generally agreed, raised the wage costs of unskilled urban labour to a level much above those of countries with which Papua New Guinea had to compete.<sup>16</sup> The option to establish a competitive manufacturing sector of any significance—whether of the import substitution or export orientation kind—had been effectively closed. With wage costs a factor of two or three times higher than those of comparable locations, the conclusion was unavoidable that '[u]nless there is a dramatic change in economic policies, in particular those related to wages, the prospects for employment growth are not good' (Goodman, Lepani and Morawetz 1987:49).

It is hardly surprising that manufacturing essentially stagnated during this lost decade,

employment increased only insignificantly (McGavin 1993:75), and private sector investment fell (Connell 1997:204).

The minimum wage decision was not directly related to the Faber report, where it was made clear that 'needs of employment creation in the long-term require policies of wage restraint at the lower levels' (Overseas Development Group 1973:21). It was a result rather of the industrial relations system bequeathed by the Australian administration. Nevertheless, in a more roundabout way it reflected the redistributive tenets at the time (Colclough and Daniel 1982), as did the government's failure to use its influence to reverse the decision until the structural reforms in the 1990s.

Manufacturing industry was not the only casualty of government policy; tourism was another victim of the redistributive bent. A World Bank report (1965) had recognised the potential of mass tourism and both the World Bank and the Territory administration undertook the first steps in its promotion (Territory of Papua and New Guinea 1968, 1971).<sup>17</sup>

The Faber report had acknowledged as 'unquestionable' that the 'growth potential of the tourist industry in Papua New Guinea is very great'. Unfortunately, tourism was 'a form of exploitation' associated with severe disadvantages: 'facilities (i.e. beaches) are denied to local people' and because of the tourists' wealth 'a feeling of resentment against tourists...begins to manifest itself' (Overseas Development Group 1973:85). On these grounds, measures to increase the number of tourists who 'are certain to increase even without government promotion' are less important than actions that increase the benefit of tourism to the localities' by empowering 'local authorities to impose a licence fee or tax upon tourists' (1973:86). The story is the familiar one: growth will occur unaided; tourism is bound to expand; what is needed is to distribute the (expected) benefits.



The attitudes found in the Faber report are reflected in government policy, influenced by apprehensions over foreign domination, cultural impact and the desire to channel it towards the 'encouragement of indigenous industries catering for the tourist market' and 'village level participation' (Papua New Guinea 1973b:89).<sup>18</sup> The first two concerns meant that tourism was 'never a priority for any government, despite intermittent market pushes in response to problems in other sectors' (Connell 1997:207). Indeed, at some stage it was made clear that '[l]arge scale tourism development will not be encouraged in non-urban areas with the exception perhaps of special areas where other economic opportunities are scarce' (World Bank 1978:169).<sup>19</sup>

Concern over 'participation' and economic nationalism excluded that form of tourism that has the greatest effect on employment: mass tourism, organised around an international airport and a string of large resorts—of sufficient capacity to warrant regular air services—within easy travelling distance from that airport. Such perspectives were totally at odds with government policy, although mass tourism is complementary to other forms of tourism—all attracted by cheap airfares and the infrastructure developed around the resorts—that would have greatly stimulated the 'indigenous industries' and 'village level participation' that the Coalition government aimed for.

Tourism development fell foul to a further handicap. Finding and arranging secure property rights for resorts is even more intricate than it is for manufacturing and service industries in towns where this issue had developed into a major cause for complaint.

Needless to say, the brazen optimism of the Faber report turned out to be misplaced. The number of pleasure tourists declined from a peak of 22,000 in 1974 (Connell 1997) to stagnate through the 1980s at around 10,000 holidaymakers a year (Stein 1991:51). In the words of one observer 'no country in

the Pacific region has so much tourist potential and gained so little from it' (Connell 1997:207).

For the mobilisation of land, the conventional wisdom of the 1960s had relied heavily on plantation agriculture. It was thought that substantial output gains could be achieved on existing plantations, and it was considered essential that additional land be made available for foreign investment. Such plantations 'should be located where there is no serious land pressure' (International Bank for Reconstruction and Development 1965:33), and, the World Bank believed, they could be established without undue infringement on subsistence and cash crop production of local inhabitants.

The view that guided the Territory administration was to change dramatically with the Faber report where it was assumed that 'after Independence it will not be acceptable to have half the marketed output of the agricultural sector...owned and controlled by expatriate enterprises' (Overseas Development Group 1973:5). Thus 'means should be found and measures should be introduced...to encourage transfer of ownership and control of substantial parts' of this sector to local interests (1973:5). This was not the only change of outlook, however. The Faber team expected most of the plantation sector to wither on the vine. After noting that 'new investment has reached a very low level in the plantation industry due to a state of uncertainty about the future' they continue that

...we do not see the gradual decline of the plantation sector as a serious disadvantage for those crops—such as coffee, cocoa, coconuts, rubber and tea—for which production can be efficiently organised by small-scale or co-operative producers (Overseas Development Group 1973:116).

Estate agriculture of tree crops and tea had outlived its usefulness and was to be replaced by smallholder production.<sup>20</sup>

From the Faber report and its offshoot, the Eight Point Plan, two policy measures emanated: the effective prohibition of the sale of plantations to foreigners<sup>21</sup> and the Plantation Redistribution Scheme. Their purpose was dual: to alleviate land shortages (Papua New Guinea 1973a) in heavily populated areas, and, as the Minister for Lands made clear, a means 'to bring all aspects of plantation production under the ownership of Papua New Guinean individuals and groups' (House of Assembly Debates 1974:3,536).

The program was of an incredible complexity<sup>22</sup> and never worked as anticipated. Of the approximately 1,200 plantations that existed at the time Papua New Guinea became self-governing, some 70–80<sup>23</sup> coconut, cocoa, coffee and rubber plantations were purchased under the scheme. Despite this modest effect on redistribution, the economic consequences were major.

Already in the pre-independence period many foreign-owned plantations were run down in anticipation of expropriation or sale to Papua New Guineans. The dual onslaught of the inability to sell plantations to non-nationals and the threat from expropriation under the Plantation Redistribution Scheme, coupled with uncertainties surrounding the valuation of the plantations, made it—in the drastic language of one commentator—'foolhardy for existing holders to upgrade' (Stein 1991:39-40). By the early 1980s, the plantation sector was considered to be 'in a seriously deteriorated situation' largely because of the uncertain property rights (Committee of Review 1981:33).<sup>24</sup> Cocoa was particularly strongly affected; it was estimated that cocoa plantations produced at 'less than 20 per cent of the potentiality' (Bridgland 1981:14).<sup>25</sup> To the declining productivity of the foreign owned plantation were added problems of the often subdivided, badly managed and hence poorly performing nationalised plantations (Committee of Review 1981).

Exempt from the policy shift were tea and oil palm. According to the World Bank recommendation the Australian administration had set up nucleus estates for tea. A nucleus estate consists of a plantation and a processing plant and provides planting material, transport, processing facilities, research, and advisory and marketing services to the smallholders surrounding the estates. The tea estates rapidly reverted to conventional plantations as the smallholders abandoned tea for more remunerative crops (Territory of Papua and New Guinea 1971). According the same principle, a successful oil palm sector was developed, the Territory government set up two estates, a third one was added in the first decade after independence, and a further one had completed the planning phase in 1985.<sup>26</sup>

For the traditional estate tree-crop sector, government policy proved destructive; only in the palm oil sector did growth reach levels that, if it had not been limited to one sector but been much more broadly based, would have made a noticeable difference in overall economic performance.<sup>27</sup> Thus, government did little to promote the development of a viable plantation sector that could have mobilised underutilised resources efficiently.<sup>28</sup>

In the account of the disappointing performance of the three sectors, the difficulty of mobilising land for productive purposes played its part everywhere. It was part of the conventional wisdom that 'traditional land tenure, with its heavy emphasis on clan or community ownership' inhibited 'investment and effort' of local producers (Territory of Papua and New Guinea 1968:111) and put obstacles in the way of investors who 'have some difficulties of identifying available land' and 'must await negotiations with landowners leading to government acquisition, and then the issue of a lease' (1968:34, 35). Thus the issue transcends the



narrow boundaries of the discussion of formal employment that has been pursued in this paper, but includes the whole subsistence and cash-cropping sector.

The Australian Government attempted to solve the problem by introducing a series of Land Bills in the House of Assembly in 1971. One of those Bills was to provide for all land to be registered and would have meant that the owners of native land, once registered, would be free to transfer their land or to mortgage it. The proposal was rejected by the House and the Bill was subsequently dropped (Downs 1980; Hegarty 1998a). When the Coalition Government took office after the elections in February 1972 it shied away from major reforms (Papua New Guinea 1973a). The discussion on a transformation of traditional land rights resurfaced from time to time (see, for example, Papua New Guinea 1976), without drawing nearer to a solution as to how to utilise land more effectively.

A successful growth strategy must be oriented around the resources that are relatively abundant—in the case of Papua New Guinea these are unskilled labour, land and natural resources. At the time of independence, it was evident that rural self-employment would remain the main employer for a long time, with the formal sector of the economy becoming increasingly important. Mining, fishing, and forestry are enclave activities that employ relatively little labour; thus plantation agriculture, and labour intensive manufacturing and services (particularly tourism) were those parts of the economy that offered the best prospects for employment. The economic policies pursued blocked the development of these three sectors on which an employment-oriented growth strategy, using the abundantly available factors of production, would have had to be based.

## Implications for governance

The economic policies influenced governance in a number of ways. The most obvious connection is the contribution of the missing new employment opportunities and the rising levels of crime. In addition, the economic policies of the 1970s affected attitudes to the rules and procedures that buttress a functioning modern polity. Even when such institutions are unrelated to custom and tradition they are able to gain legitimacy through their success—when they are seen to ‘work’. If they are manifestly unsuccessful, they will fail to attain the degree of acceptance on which compliance must ultimately rest. Government policy has contributed to this failure.

The consequences of the sluggish income growth were hidden for a time by the process of localisation, as nationals took over the well-paid positions of departing expatriates: thus, there was some ‘development without growth’. The process of legitimisation suffered, however, by the increasing difficulties in finding employment and the economic stagnation, and increasingly the deterioration of public services and infrastructure, which must at least be partly<sup>29</sup> attributed to funding problems.

The development policies and the associated government failure put an enormous strain on the job allocation mechanism in the public sector. The high wage levels, combined with the lack of employment opportunities in the private sector, put a high premium on government employment. The resulting strain on the system of allocating public employment is one contributing factor to the breakdown of administrative rules in the allocation of public employment that became over time ‘substantially influenced by *wantok* ties’ (Connell 1997:197).

The free reign given to ‘participation’ was another factor damaging the process of



legitimation. The acquisition of businesses by Papua New Guineans, what 'participation' amounted to in practice, was caught up in a tension that was unwittingly expressed by one of the founding members of Pangu, Cecil Abel who, according to Somare, told the House of Assembly that '[w]e must aim for a reasonable equality of wealth between black and white, or rather, between haves and have nots' (Somare 1975: 60). Although acquiring businesses by nationals reduces the wealth and income gap between foreigners and nationals, it adds to that between the 'haves' and 'have nots': inequality within the Papua New Guineans society increases. Whether this growing inequality will have repercussions on the legitimacy of political institutions will depend on attitudes towards inequality generally, but crucially too on whether the wealth thus acquired is 'merited' according to some accepted standard.

As the events unfolded, politicians 'quickly grasped the opportunities available through their privileged access to the resources of the state'; it became 'a rare politician who had not enhanced his material well-being by independence' (Hegarty 1979:199). This was by no means limited to urban areas; by the mid 1970s even the government admitted that 'there are signs that a distinct rural business 'elite' is emerging' (Papua New Guinea 1976:9). The instruments of 'participation' were in the first place privileged access to concessional finance<sup>30</sup> used to buy rental property and existing businesses. Such opportunities were enhanced by the National Investment Development Authority's requiring that certain levels of equity be held in new investments by Papua New Guinean citizens (Daniel and Sims 1986:33). The National Investment Development Authority process, the combination of pervasive red tape but poor enforcement, gave rise to a further type of 'front' people who minimised detection of

violations of NIDA Act (37–39). Further business opportunities ranged from exploiting political connections to attracting contracts from public institutions,<sup>31</sup> to profits from cut-price releases of residential land,<sup>32</sup> quite apart from lucrative positions that were to be had on boards of private and public companies. Thus the wealth that gave rise to inequality was acquired largely through the use of political power.

The wealth so acquired under the mantle of 'participation' generated an inequality unrelated to merit, and sanctioned neither by traditional nor Western norms and customs. It is an inequality that is particularly grating because, unlike the inequality with expatriates, it occurs within people's reference group; it is an inequality among peers. Institutions that create such types of inequality are unlikely to be held in high esteem and that they succumb to the untrammelled scramble for wealth and income ought not come as a surprise.

## Conclusion

The battle for the development of a vibrant, non-enclave, formal sector of the economy was lost through a set of economic policy decisions in the 1970s. The resulting stagnation in employment opportunities and government services, together with the new type of inequalities that were emerging, militated against the legitimisation of the vital institutions of state and helped to bring about the governance problems that became increasingly pronounced in the 1980s. Thus, economic growth was not only a function of governance; governance was equally influenced by economic factors. Needless to say, Papua New Guinea would have governance problems even without these policies,<sup>33</sup> but the vital institutions of the state would have borne less strain.

In this account, the formal sector of the economy has taken centre stage. It is an



indispensable part of an economic transformation; no successful transformation of an economy is conceivable that relies exclusively on small-scale production and natural resource extraction. Its importance and the damage inflicted on it have been implicitly acknowledged by reforms in recent decades: the abolition of the urban minimum wage, the reform of the regulations governing foreign investments (Fallon 1992), the changes to the tax system (Fairbairn 1993), and the revamp of the tourism promotion agency (Stein 1991). Only the system of landed property has been resistant to reform. It is somewhat ironic it has taken over a quarter of a century to come back to the main recommendation of the World Bank of 1965. Tragically, these microeconomic reforms are much less effective now than they would have been a quarter century ago because the governance problems that have built up meanwhile constitute a high hurdle for investment, foreign and national alike.

This still leaves the question of why policies that stifled economic growth have been pursued. There is little doubt that 'participation' was in the material interest of the politicians and cultural factors might explain the absence of inhibitions to the use of political power for private gain. But it is less clear why it was in the political interest of the incumbents to embrace these policies. The economic policies of the 1970s might well have conformed to the preferences of the voters at the time; there are few convincing reasons why they continue to support politicians and parties that have systematically impoverished them. Thus, in the background lurks the much larger question of the conditions under which democracy and economic development are compatible.

## Notes

- <sup>1</sup> Although corruption has been seen as a major problem in the timber and fishing industries since at least the early eighties (King 1989).
- <sup>2</sup> Both Garnaut (2000) and Reilly (1997) argue that economic performance during these years was satisfactory. However, falling incomes per head are the mark of economic failure by most standards.
- <sup>3</sup> At 130,000 from 1973 to 1982 (McGavin 1993).
- <sup>4</sup> Shand (1971) came to the same conclusion.
- <sup>5</sup> Gross fixed capital formation roughly trebled between 1969 and 1972 (McGavin and Millett 1992).
- <sup>6</sup> From 37,452 to 49,759 between 1972 and 1976 (McGavin 1993:74; Asian Development Bank 1976:62, 37).
- <sup>7</sup> Partly reflecting the increase in minimum wages (see below).
- <sup>8</sup> The price index for coffee increased from 100 in 1972/3 to 498 in 1977; for cocoa from 100 to 563.7. The index for both commodities fell back to around 320 in 1980 and averaged around that level for the rest of the 1980s (Bank of Papua New Guinea, September 1983, December 1989). The boom produced a veritable bonanza in the Highlands (Hegarty 1998b).
- <sup>9</sup> Terms of trade fell in the 1980s below the level of 1975/76 (Goodman, Lepani and Morawetz 1987; Fallon 1992). This can mislead if it is not taken into account that 1975/76 were years of a pronounced commodity boom.
- <sup>10</sup> The World Bank proposals (1965) led to the establishment of the Papua New Guinea Development Bank in 1967. It was charged with easing access to funds for 'development projects'.
- <sup>11</sup> The Department of Business Development with its Business Advisory Service was to take on this role (Territory 1968, 1971).
- <sup>12</sup> In the House of Assembly, the opposition to foreign investment united the retired missionary Percy Chatterton and the speakers of the Pangu Pati. But whereas Chatterton feared 'economic colonialism' and a 'banana republic', the speakers of Pangu

- Pati (Voutas, Somare and Abel) were concerned with 'participation' (Territory; House of Assembly Debates II/3 1968). Some of their arguments strongly resemble the 'lump of labour fallacy': there is a fixed number of business opportunities, hence more businesses owned by foreigners means less are available to locals.
- <sup>13</sup> Contained in National Investment Priorities Schedule (World Bank 1978).
- <sup>14</sup> The Budget 1978 introduced the Export Incentive Scheme, the Infant Industry Loan Scheme, and the Feasibilities Studies Contribution Scheme.
- <sup>15</sup> Defined broadly at that stage as one where '26 per cent or more of the voting power is held or controlled by persons who are not citizens' (Daniel and Sims 1986:31).
- <sup>16</sup> See, for example, Goodman, Lepani and Morawetz (1987); Colclough and Daniel (1982); and McGavin and Millet (1992).
- <sup>17</sup> By setting up the Papua New Guinea Tourist Board.
- <sup>18</sup> The antipathy toward mass tourism was shared by much of the academic community; it was 'antithetical' to a development that was truly concerned with raising levels of life, sustenance, human dignity and freedom (Lea 1980).
- <sup>19</sup> The frame of mind of the government is illustrated too by reluctance to grant landing rights to airlines in the 1980s—especially from Asia—with the potential to bring tourists into the country (Connell 1997).
- <sup>20</sup> A view not without influence (see, for example, Fingleton 1981).
- <sup>21</sup> In 1974, the National Executive Council adopted the policy of withholding the approval of plantation sales to expatriates (Committee of Review 1981).
- <sup>22</sup> 'The government was to acquire the plantations under the Lands Acquisition Act and then redistribute them in accordance with the provisions of the Land Redistribution Act to the groups formed under the Land Groups Act.' The scheme proved unworkable and no plantations were transferred as envisaged (Au 1981:67).
- <sup>23</sup> As is often the case with statistics in Papua New Guinea, there is disagreement on the precise numbers. Eaton (1984) talks of 81 plantations, Daniel and Sims (1976) count 68.
- <sup>24</sup> As always, other factors such as wage costs and commodity prices played their part too, but property rights were generally thought to be the main reason for the dismal state of the plantations.
- <sup>25</sup> Output in the plantation sector had decreased from 22,396 tons to 8,215 tonnes between 1974 and 1983 (Daniel and Sims 1986) and increased in the smallholder sector by roughly 50 per cent in the same period.
- <sup>26</sup> Establishment dates are Hoskins 1967; Biala 1972, although it suffered years of delay until production started; Popondetta 1976, and Milne Bay 1985 (Koczberski, Curry and Gibson 2005).
- <sup>27</sup> Annual growth rates are estimated to be around 10 per cent (Bourke 2005).
- <sup>28</sup> To complete the record, the Ramu Sugar project has to be added. It was the only large-scale foreign investment in import replacement agriculture but entailed a tripling of the price of sugar. It illustrates the failure of import-substitution in a small economy such as Papua New Guinea (Daniel and Sims 1986).
- <sup>29</sup> Quite apart from the inefficient use of resources from sheer mismanagement (Trebilcock 1982).
- <sup>30</sup> For example, through the Development Bank and the Village Economic Development Funds (for the latter see King 1998).
- <sup>31</sup> The best-known case is Pangu's business arm operating as financial broker for the Public Service Association's construction activities (Hegarty 1998b).
- <sup>32</sup> For example, the release of a large parcel of enormously scarce and valuable Port Moresby residential land to a who's who of bureaucratic, political and business notables in June 1982 (King 1998; *Times* 19 February 1982).
- <sup>33</sup> Indeed, corruption (most notably in forestry as documented in the Vanimo project) and mismanagement (for example, in public enterprises) were well advanced in the 1980s (King 1998).



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