A Private Sector Assessment for Papua New Guinea
Foundation for the Future

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Abbreviations

ADB  Asian Development Bank
BPNG  Bank of Papua New Guinea
CTC  Coastal Trading Committee
GDP  gross domestic product
ha  hectare
ICCC  Independent Consumer and Competition Commission
ICT  information and communication technology
IPBC  Independent Public Business Corporation
ISP  Internet service provider
MW  megawatt
PML  PNG Microfinance Ltd.
PNG  Papua New Guinea
SOE  state-owned enterprise

Note: In this report, “$” refers to US dollars unless otherwise stated.
I. Summary and Recommendations

The Issues

The performance of the Papua New Guinea (PNG) economy over most of the past 30 years has been disappointing. It has suffered from periods of macroeconomic instability, low and widely fluctuating growth, and low investment.

Investment rates show that it has been a difficult country in which to do business. As a result, it remains one of the poorest countries in the region, with more than 80% of its population engaging in semi-subsistence activities. Education and health indicators are similarly weak. While the recent commodities boom has had a strong positive impact on growth, experience from other countries suggests that relying on natural resources alone is insufficient to create the foundation for sustained economic expansion that will bring widespread prosperity.

Inevitably, commodity booms eventually diminish, and if reform has not occurred, growth will decline. The current round of high commodity prices provides the opportunity to remove many of the binding constraints to growth and to set the economy on a strong, sustainable growth path.

PNG’s natural assets of oil, natural gas, minerals, and fertile soil constitute advantages that many other more prosperous countries have not had. Set against this is the challenging topography that makes the provision of infrastructure and services difficult and costly.

Reasons for Low Growth

The most important factors explaining the low growth rates in the past are that PNG is a high-risk country in which to invest and do business and that transactions costs in the country are very high—with only part of these costs being a result of geographic challenges.

Inconsistent government policies, macroeconomic instability, fluctuations in the price of commodities, and a high crime rate have resulted in high risk. Meanwhile, weak property rights, poor infrastructure, lack of competition, and the dominant role of the state in the economy—which limits competition—have resulted in high
transactions costs. The crime rate has also added substantial costs to doing business, which can be likened to a tax on development. There are well-founded reasons to conclude that the risk-adjusted rate of return on investment is low, although a chronic lack of data makes firm calculations difficult. Foreign investment data support the low rate of return hypothesis—the ratio of foreign direct investment to gross domestic product (GDP) is low and has been declining.

Financial markets do not support investment and entrepreneurship. Despite a low ratio of private sector credit to GDP, financial institutions have substantial liquidity, illustrating the risks of lending. Even though lending has expanded rapidly in the past 2 years (because of the economic stimuli and opportunities that high commodity prices have provided), financial markets remain shallow and underdeveloped, and will remain so without further reform.

The rural economy is typically remote and poorly served by infrastructure and other services. Getting market information and transporting goods to market is often an insuperable challenge, making the transition from subsistence to a market economy difficult.

Some factors offer grounds for optimism, however. Political stability has improved, with the current government having been reelected after distinguishing itself by having been the first government since independence to serve a full 5-year term. The macroeconomic situation has stabilized, and the government has committed publicly to strengthening the role of the private sector in the economy. The continuing high prices of commodities benefit the economy and the national budget.

Constraints to Growth

Constraints to growth arise from the factors that increase risks and transactions costs, and the inability of financial markets to finance investment opportunities—particularly smaller businesses.
High risks and transactions costs are the result of:

- Perceptions of country risk, which have been improving, but remain high. The private sector has a strong perception of lack of transparency and accountability in the public sector. In addition, PNG fares poorly in international corruption and governance ratings.
- Political and macroeconomic instability, which in the past has fueled uncertainty for the private sector, reducing the confidence of both small and large investors. This has left a legacy of uncertainty that raises perceived risks in the present. A recent survey of business in PNG shows that perceptions are still affected by past uncertainties arising from changes in governments and policies.
- Unpredictable changes in government policies for the private sector, which raise uncertainties in investment.
- The high crime rate, which adds to the costs of doing business.
- The government intruding in every area of the economy through ownership and regulation, which raises costs and weakens competitiveness. Ambivalence toward competition within the government results in a number of highly inefficient monopolies. For example, the monopoly on internet connection results in costs that are several times higher than the world average and access that has grown at far lower rates than in countries where there is competition. This raises the cost to business of a communications tool and deprives the more remote rural areas of an indispensable source of information.
- Poor infrastructure, especially road infrastructure, which has been described as a massive and pervasive problem in PNG. Inefficient state-owned enterprises (SOEs) provide poor, high-cost services and crowd out the private sector. Massive investment in all infrastructure areas is needed.
- An underdeveloped legal system, which makes reliable contracting difficult and costly. Perceptions of inconsistent court decisions, especially in the lower courts, and unreliable enforcement reduce the effectiveness of the law as a foundation for business activity.
- A complicated and uncertain leasing system for land. Acquiring long-term property leases for investment is costly, difficult, and time consuming. Moreover, landowners attempt to renegotiate lease terms frequently.
- Weak property rights over movable assets, which make the pledging of collateral for loans difficult, unreliable, and expensive.

Financial markets are undeveloped. Historically, PNG has one of the lowest ratios of private sector credit to GDP in the Pacific, and interest rates and interest spreads are high.

Constraints that inhibit access to finance are:

- A weak collateral framework that makes it difficult and costly to pledge assets as security;
- Lack of credit information on prospective borrowers; and
- A large majority of the population having very limited access to formal financial services.

**Policy Reform**

To promote private sector development and raise the long-term growth rate, we recommend:

- Vigorously promoting competition by eliminating SOE monopolies. The dramatic reduction in calling costs and expansion of services as a result of the partial opening up of the mobile telephony market to competition illustrates...
the benefits of having new entrants in sectors that have been monopolized. Generally, policies should be directed at reducing costs and improving service, instead of protecting incumbent SOEs. While the value of SOEs might fall in the near term, this will be far outweighed by lower costs and better service for consumers. Concerns over a reduced value of SOEs may well prove to be misplaced. As competition improves the efficiency of SOEs, their value could also rise.

- Promoting competition by supporting PNG’s Independent Consumer and Competition Commission (ICCC).
- Promoting public–private partnerships to increase investment and improve productivity in infrastructure and service provision.
- Modernizing the legal system to better meet the needs of modern commerce and reflect the realities of PNG. Initially, the Companies Act and the companies registry require reform, and should accommodate rural and community organizations.
- Simplifying the system of licenses, regulations, and taxes which raises the costs of doing business. This will especially help small- and medium-sized enterprises.
- Promoting financial market development by reforming the collateral framework, establishing a system for credit information, and promoting access to financial services in rural areas.
- Formalizing private and public sector consultation mechanisms to arrive jointly at a consensus regarding reform initiatives and priorities. This will entail strengthening the ability of representative private sector organizations to analyze policy options.
- Promoting agriculture by viewing it as a fundamental component of the private sector—with all the problems that the private sector faces. In particular, issues of infrastructure and removing state intervention are paramount. Combining this with agriculture-oriented rural and microfinance initiatives has the potential of increasing substantially the contribution of agriculture to GDP and raising cash incomes in rural areas.
The government has stated that growth through private sector development is one of the pillars of its policies.

However, PNG remains one of the most difficult countries in the world in which to do business. Public goods such as a sound legal system, well-defined and protected property rights, and a financial system that funds investment and entrepreneurship, which provide the foundation of private sector activity, are poorly developed in PNG. Law and order is fragile. The crime rate is high. And companies, large and small, are forced to invest substantial amounts in security services. This results in a significant tax increase for businesses. In addition, the legal system underpinning commercial activity is weak and the small, formal financial system provides services only to relatively few firms, reflecting the high risks of lending. Infrastructure is inadequate and hampers development of rural areas. While PNG has a modern competition law, recent controversies and policy reversals over telecommunications competition have sent mixed signals to investors. SOEs still account for a substantial amount of the capital stock and, in some cases, crowd out private sector activity. The country is endowed with substantial natural resources, including vast supplies of oil, natural gas, and extensive mineral deposits. Although construction of the natural gas pipeline to Australia has been shelved, alternatives are being planned so that prospects for substantial exports appear to be better than any time in the past 10 years. Indeed, a private consortium has recently entered into the front end engineering design phase for a liquefied natural gas project, which could result in gas exports from around 2014. From this perspective, the economic outlook has improved. Nevertheless, only a bold observer would suggest that these developments herald a sharp break with the past and signal future prosperity for the country. In particular, unless the growth in the minerals sector results in accompanying investment and growth in other sectors of the economy, the incomes of the majority of Papua New Guineans will unlikely improve. Examples from many resource-rich developing countries...
with large mineral deposits provide a sobering reminder that natural resource abundance does not necessarily lead to prosperity. Only cultivating an environment conducive to business will break the cycle of poverty and subsistence and result in sustained economic growth.

The long-run determinant of the degree to which the commodity boom will be sustained is the supply response of the private sector. With the world’s agricultural commodity prices at unprecedented levels, increased agriculture output would be expected. Anecdotal evidence indicates that although output has risen because of more intensive farming, investment in agriculture has yet to happen ( Warner and Omuru 2008). This is perhaps because of the lengthy lead times required to expand capacity.

Poor economic performance in the past stems from a number of factors. Extractive rents, mainly from the mining and forestry sectors, are channeled into a public sector that expanded significantly in the decade prior to 1994 without improving public services. This lack of improvement is one of the main causes of the urban–rural income gap. The lack of infrastructure to physically integrate the country’s rugged terrain remains a major impediment to development. The insecurity and high costs generated by criminal activity amplify these problems. These aspects combined make PNG one of the highest cost countries in the world in which to do business, and this has obvious implications in investment, productivity, and growth performance.

Encouraging private sector development in PNG is especially challenging. An active formal sector operating primarily in the country’s urban centers and natural resource enclaves coexists with a large informal sector that comprises the majority of the population living in rural areas, where the topography often makes contact with urban centers difficult.

Any policy directed at encouraging private business activity entails accommodating PNG’s traditional social structure, which includes

- A semi-subsistence and/or subsistence economy involving 85% of the population engaged in agriculture;
- Strong bonds of kinship, with obligations extending beyond the immediate family group, which often supersede perceived duties to employers, including government employment;
- Generally egalitarian relationships, with an emphasis on acquired rather than inherited status; and
- A strong attachment of the people to the land (most Papua New Guineans still adhere strongly to this traditional social structure, which has its roots in village life).

PNG’s economy is highly dualistic. It is composed of an informal sector that supports the majority of the population through subsistence agriculture and smallholder cash cropping, and a formal sector that generates comparatively high incomes. Foreign investors dominate the latter, especially in relation to the minerals, timber, and fisheries sectors. Manufacturing is limited, and the service sector is small. Consequently, the formal labor sector is also limited. PNG is richly endowed with

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3 This phenomenon is known as the “resource curse.” Most prosperous countries in the world have limited or no natural resources.
natural resources, but the rugged terrain and the high cost of developing infrastructure have hampered optimal use. Mineral deposits, including oil, copper, and gold, account for 72% of export earnings. Agriculture provides a subsistence livelihood and small cash incomes for 85% of the population. Agriculture, forestry, and fishing accounts for 37% of GDP. Government revenues and foreign exchange earnings depend heavily on oil mineral exports. In 2006, oil, gas, and mineral production was estimated to have accounted for 27% of GDP. The gas resources, currently estimated at 15–20 trillion cubic feet, are equivalent to about eight times the remaining recoverable oil reserves of 340 million barrels. Natural gas exploration continues at a strong pace.

The economy is open, with imports and exports amounting to more than 100% of GDP. Gold and copper are the main export earners, each accounting for 27% of total exports, while oil accounts for another 23%. Australia, the European Union, and Japan are PNG’s key export markets. Most manufactured goods are imported.

While the private sector in PNG is made up of very small and informal enterprises, with many of them based on family units in village communities, it nonetheless accounts for 80% of consumption and fixed investment, 95% of gross domestic savings, and more than 90% of employment (including self-employment). More than 90% of private enterprises are micro and informal enterprises, with their main economic activity being subsistence and smallholder, market-based agriculture. These enterprises supply almost all domestically produced food—about 70% of coffee, 65% of cocoa and copra, and 35% of palm oil. They also dominate the livestock sector (mainly pigs and chickens).

The formal private sector in PNG can be divided into two main parts:

• Large, mainly foreign-owned natural resource firms that operate on an enclave basis in the mining, petroleum, and forestry sectors; and

• A nonmining private sector that consists mainly of plantations, fish canneries, and small enterprises. Most small enterprises are engaged in manufacturing, construction, and trade in urban areas.

Historically, growth in formal sector wage employment has been lethargic and highly variable. Recently, strong growth has been recorded, with formal sector employment increasing by an estimated 19% in the 2 years to December 2007. Nonetheless, formal sector employment only accounts for a small proportion of the overall workforce in PNG, and growth rates have fallen substantially short of that required to absorb the increasing number of Papua New Guineans who are of working age. As a consequence, the majority of new entrants to the workforce have to secure their livelihoods in the informal sector, such as through smallholder cash cropping.

The extractive sectors and rural enterprises that produce cash crops are export oriented. The cash crop sector has a well-organized private supply and marketing chain. Outside the cash crop sector, rural production is oriented exclusively toward meeting household and local demand.

Identifying and removing the binding constraints to growth and investment are therefore vital to ensuring the sustainability of the impact of the commodity boom on the economy.

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*For instance, in the agriculture, forestry, and fisheries sector, formal wage employment has grown by less than 1% per annum over the past 15 years.*
through barter and sales at the local markets. Both interisland and interprovincial trades in nonexport agriculture are limited, with the betel nut trade being the exception.

Foreign ownership is extensive among medium-sized and large private firms, and is fairly widespread across all economic sectors. Most minerals, logging, manufacturing, wholesale, transport and distribution activities, and many plantations are managed by foreign-owned enterprises. Large-scale retailing is also dominated by foreign enterprises. Traditionally, Australia has been the dominant source of foreign direct investment, but investment from East Asian countries is well established in logging, canneries, and retail activities.

Productivity in PNG has been disappointing. Table 2 shows the contributions to growth from capital, labor, and a residual known as total factor productivity, which measures, among other things, the contribution to productivity of institutional changes. From 1996 to 2004, this contribution was negative, likely indicating both supply shocks from the decline in commodity prices over this period and the drought in 1997, as well as institutional instability resulting from political upheaval and the deterioration in the security situation. Real GDP growth averaged only 0.8% per year over this period.

These measures can be used to estimate the implications for productivity and future growth. Assuming that the mineral boom continues and that the liquefied natural gas project proceeds, using a high growth scenario of 5% per year would imply that total factor productivity will need to increase by 3% per year for the growth rate to be sustained. Implicit in these calculations is an implied investment to GDP ratio of 27%. Since the investment ratio averaged only 13% of GDP in 1996–2004, sustaining high growth will require a very large increase in investment. The current high growth that the economy is experiencing will therefore need to be sustained by a prolonged period during which investment will have to rise by more than two thirds.

<table>
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<th>Table 2: Productivity in Papua New Guinea</th>
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<tr>
<td>Capital</td>
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<td>Labor</td>
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<tr>
<td>Total Factor Productivity</td>
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<tr>
<td>Potential GDP Growth</td>
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<td>Investment to GDP Ratio (%)</td>
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GDP = gross domestic product
Source: Faal 2006.

The dynamics of this process could change, however, if there is widespread investment in infrastructure. In rural areas, there are currently limited opportunities to spend on consumer goods. Lack of electricity, for example, rules out expenditures on any items that require power to operate. As a result, many observers suggest that rural activity should be income driven. Once sufficient cash has been earned to purchase the limited range of consumer goods available, however, there is little incentive to work. Furthermore, the supply of health and education services is limited and poor. Upgrading infrastructure and social services, for which a modest fee could be charged, may well increase the incentive to earn cash, and result in a corresponding increase in the supply of labor engaged in cash cropping and other income-earning activities.

Identifying and removing the binding constraints to growth and investment are therefore vital to ensuring the sustainability of the impact of the commodity boom on the economy. The chapters that follow identify the binding constraints and suggest reforms in the areas of the role of the state, the commercial legal framework, property rights, competition, access to finance, security, infrastructure, and SOEs.
III. Binding Constraints and Foundations for Growth

This chapter examines the business environment in PNG from the perspective of identifying binding constraints to growth. It looks at the role of the state, the commercial legal framework, property rights, competition, access to finance, security, infrastructure, and SOEs—all of which impinge on investment and entrepreneurship, and eventually sustainable growth.

The Role of the State

Promoting a good environment for private sector development involves a wide range of policies related to ensuring sound formal and informal institutions, strong property rights, infrastructure, communication, basic services, the rural economy, and economic governance. To maximize efficiency, it also involves promoting a business environment in which competition is vigorous.

Many of these factors involve actions by the state. It is a paradox that promoting private sector development on the one hand necessitates limiting the direct involvement of the state in the economy, but at the same time requires actions by the state to establish a strong commercial legal framework and a reliable system for enforcing contracts, good infrastructure, basic service provision, effective regulation, and competition.

These actions generally involve reducing transactions costs in the economy and improving productivity. Incentives, risks, and transactions costs determine the private sector’s way of organizing business activity, structuring contracts, and investing. These, in many cases, are determined by the laws, rules, and practices of the government.

Characteristics of a Well-Functioning State

A well-functioning state helps private sector development by providing public goods and institutions that minimize transactions costs and hence, promote investment and specialization. Typically, these are macroeconomic stability, provision of basic services (e.g., education, health, and law and order), an open trade policy, stable political institutions, policies, and a structure for private sector business activity that supports investment and entrepreneurship without the state’s direct involvement. An investment-friendly environment is supported by the state through providing the institutional foundation for doing business. More specifically, this requires that the state

- Establish and protect property rights, providing a mechanism for the resolution of property disputes;
- Provide law and order and a safe environment in which to invest and conduct business;
- Establish an environment in which contracting can be undertaken with confidence—this requires a sound framework of commercial law, a mechanism for adjudicating contract disputes, and a mechanism for enforcing legal judgments;
- Ensure that transactions costs, the costs of doing business, are kept to a minimum;
- Promote access to finance by providing mechanisms for lenders to reduce their risks and ensuring that the laws regarding the pledging of collateral promote lending effectively and at low cost;
• Promote competition by ensuring that markets are competitive, minimizing intervention (which includes preventing SOEs from crowding out private sector activity and effectively regulating natural monopolies);5

• Ensure that the infrastructure framework supports the development of the economy, not directly by state-owned businesses, but rather by opening infrastructure provision through public-private partnerships, contracting out, and outright privatization where appropriate; and

• Ensure that the public sector exists to provide services to the whole population, not to entrench the interests of the employees of government or SOEs.

The Business Environment in Papua New Guinea

Many basic elements required for a good business environment in PNG are poorly developed. Nevertheless, the government has expressed commitment to improving the business environment. In the 2008 budget speech, for example, the minister of finance said:

The favorable rate of growth of the economy needs to be sustained through further structural reforms. The government will continue to remove the impediments to businesses and investments, thus creating opportunities for further competition in key sectors of the economy, and to promote private sector growth.

It is costly to start a business, with procedures and regulations adding to the cost. Members of the business community interviewed for this report stated that either a lawyer or an accountant is essential to start a business, making the process expensive and protracted.

Running businesses is similarly costly with difficult regulation. For example, members of the private sector complained about the discretionary and inconsistent application of incentives, arbitrary border procedures, and policies on industry reservation, pricing,6 and tariffs. Uncertain and unpredictable government policies and their discretionary application have discouraged business and led the private sector to look for short-term profits and seek special deals and monopoly privileges from the government. All these factors affirm that the business environment in PNG is difficult.

Effective governance to promote private sector development requires policy stability and credibility

Governance

Effective governance to promote private sector development requires policy stability and credibility. This, in turn, means addressing three core challenges. The first challenge is to implement stable policies with sufficient credible commitment to assure private investors that policies will not undergo sudden reversals or that a government policy, which has led to particular investments, will not unexpectedly change, and that rules governing business will be transparently implemented. A central problem of governance, particularly in countries with a history of state interference and policy instability, is how to bind future governments to current commitments.

The second challenge is how to encourage the delivery of high-quality public goods while eschewing the production of private goods

5 Institutions such as state marketing boards, which interfere with the price mechanism, frequently introduce inefficiencies.
6 Price controls exist on many basic commodities.
through the public sector. This implies both recognizing the importance of public goods for doing business and identifying current weaknesses that adversely impact property rights, legal systems, and the business regulatory framework.

The third major challenge is how to improve the government’s technical and administrative capacity in

- Administration of fiscal, budgetary, and monetary programs;
- Regulatory bureaucracy to administer the laws that deal with market failures;
- Technical bureaucracy to administer the legal framework in registries, licensing, and financial regulation; and
- The judiciary to effectively adjudicate disputes between private parties and the government.

These tasks require a public service that is not only capable, but also immune from both public and private sector influence. This is no trivial requirement, even in advanced countries. In developing countries, these capabilities are only present in varying degrees. In PNG, there is widespread documentation of the breakdown in public services and the ineffectiveness or absence of the machinery of government in supplying public goods.

The government has acknowledged that severe governance problems exist in PNG and has made governance reform part of its medium-term development strategy. The task, however, is a significant one, and is complicated by the fact that the lower levels of the bureaucracy may not share the perceptions of the senior members of government regarding the need for reform. Until there is consensus on the need for fundamental change, PNG will remain a very challenging environment in which to do business.

Moreover, the private sector remains concerned about political stability and arbitrary and inconsistent policies, even though the past 5 years has seen continuity of government. A recent survey by the Institute of National Affairs highlights the concerns of the private sector in this area. Figure 5 shows the extent to which the private sector remains concerned over the stability of policies and rules. Though the survey was conducted after the 2007 elections, with government officials that had held office for 5 years being reelected, some 90% of business owners remained concerned about political stability. Similarly, about the same number expressed concern over the stability of rules governing business behavior and nearly 80% were concerned about retroactive changes to laws and regulations governing business. The protracted uncertainty over the license of a recent entry to the mobile phone market, which is discussed in the section on competition policy, can only have reinforced these perceptions.

The concerns over the impact of political uncertainty are clearly illustrated in Figure 6. Over 85% of those surveyed indicated that political uncertainty negatively impacted on their businesses. In addition, 75% feared that rule
changes would take place after a change in government.

Furthermore, the government’s process of consultation with the private sector is generally viewed as unsatisfactory. Figure 7 illustrates the perceptions of the private sector regarding the degree to which it feels as if it is consulted by the government, its confidence in policy announcements, and its overall perception of its relationship with the government. These are all negative. More than 70% believe that the relationship between private firms and the government is poor. Similarly, nearly 70% think that consultation by government is inadequate and that information regarding policy announcements is insufficient. About 45% indicated that they do not have confidence in the government’s policy announcements.

These perceptions are grounds for serious concern. It is impossible to know the degree to which confidence will increase as the period of political stability continues. The government has publicly announced its commitment to promoting the private sector. However, the survey results demonstrate that the private sector remains skeptical regarding the credibility of this commitment.

Although the economy’s rate of growth is accelerating as commodity prices continue to rise, sustained growth will still depend on a concomitant expansion of the private sector to cushion against the inevitable downturn in the prices of the primary sector’s output. Closer consultation and exchange of information between the government and the private sector, stable policies, and ensuring that the private sector is informed of the reasons for implementing policies that affect their businesses are necessary.

The National Working Group on the Impediments to Business is a forum designed to foster public–private dialogue on policy matters and regulations that impact the business community. We endorse the objectives of the Working Group, and strongly encourage it to become as proactive as possible in driving the reform process.
The Commercial Legal Framework

The commercial legal framework for business is the foundation for reliable long-term contracting. It determines
• how economic activity is organized, and the types of companies that are formed;
• the contracts in which investors, suppliers, producers, and consumers enter;
• how collateral is used to secure loans and how debts are treated when companies go bankrupt;
• the protections accorded to consumers with respect to the products they buy; and
• how contracts are enforced in the event of disputes.

The legal framework in PNG is not well suited for modern commercial practices. Many laws governing commerce are based on outdated legislation from other countries, where they have long been updated. For example, the Insolvency Act dates from 1951 and is based on an English act from the early 20th century. The Sale of Goods Act is similarly outmoded and adds to the costs of conducting business. The Companies Act is based on the New Zealand Companies Act of 1993. While this is not a seriously outdated law, it does not accommodate a number of organizational types needed in the country, particularly nonprofit and rural cooperatives. In addition, there is no provision for the inexpensive incorporation of women’s groups, a common form of organization in both urban and rural areas in PNG.

The Companies Act also requires annual audited accounts, unless a waiver is granted. However, to obtain a waiver, a lawyer is necessary. As a result, compliance among small- and medium-sized companies is weak. While a Business Groups Incorporation Act exists, it is difficult to use. The only independent land groups incorporated under the act are those in logging areas and those being mined. Lawyers in PNG report that they require a great deal of assistance to function effectively and often take several years to establish since they have to go through a special court established under the Act.

PNG will benefit from the modernization of its legal framework, which brings laws up-to-date, fills in gaps in legislation, and improves enforcement.

Property Rights in Fixed and Movable Property

The three types of property rights are rights in (i) fixed property (i.e., land and buildings); (ii) movable property (i.e., movable assets, such as machinery, inventory, accounts receivable, harvests, and herds of animals); and (iii) intellectual property (i.e., publications and inventions). This section will focus on fixed and movable property.

Property rights are the foundation of a modern economy. Societies where property rights are secure and ownership is widespread tend to have a more equitable distribution of income and wealth. Rights in both fixed and movable property have the legal system as their foundation. Effectively functioning laws provide for the establishment of ownership and records, and enforcement mechanisms to protect property rights.

7 Although it has been revised in New Zealand.
Land Rights

Many economic benefits result from well-defined and secure title to fixed property. Among them are greater incentives for the maintenance of and investment in property and the reduced probability of long-term environmental degradation. Secure rights tend to be associated with higher investment, more intensive farming, and stronger commitment to preserve the integrity of natural resources. The ability to use land as collateral enhances financial market development and promotes greater investment. In particular, titled land, which has secure registration, generally has a much higher market value. While this is not sufficient for a well-functioning financial system, insecure property rights unambiguously reduce financial system development.

Land ownership is predominately vested with the people of PNG. Traditional law mainly governs ownership, and only about 3% of the country’s land, or about 600,000 hectares (ha), lies outside this system. This land is almost entirely owned by the national government and generally referred to as alienated land. Most alienated land is in urban areas, but some plantations in rural areas occupy alienated land as well. Only 30,000 ha of alienated land are freehold, and 60,000 ha are used for public purposes. About 200,000 ha are leased to the private sector.

Under the Land (Ownership of Freehold) Act, no foreign investor or noncitizen is allowed to own freehold land. Leasehold land for specified purposes is, however, available for long-term tenure (usually for 99 years). Investors involved in manufacturing operations usually face little difficulties with land availability, but those involved in resource or agricultural projects have many problems with land use. While mobilizing land for investment if the traditional landowners are involved in all aspects of development is possible, this is, however, difficult and requires much persistence and patience.

Under the Land Act, the government has the authority to assist investors in large projects that are vital to the country’s economic growth. Nonetheless, the government is generally restricted to protecting traditional property rights, and investors are prohibited from negotiating directly with the local owners.

Control over virtually all rural land is vested in some 700 clans and tribal groups under customary land tenure systems. Clans and other traditional groups grant customary land rights to families and individuals. Most rural families have access to land to raise crops for subsistence and cash sales, and the system has provided remarkable security of tenure, social stability, and a degree of equity. Needless to say, Papua New Guineans have strong spiritual ties to land through ancestral belief systems.

But from the perspective of market-based systems, which permit unimpeded transfer of land from one owner to another and the use of leases, enabling land to be used as collateral, customary tenure is complex and poses major challenges to the mobilization of land for development purposes. Discussions on land ownership in PNG invoke strong emotions and can often lead to opposing claims. Where such claims involve land with significant economic value, these disputes can be protracted and violent.

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8 Farming investment typically requires a time horizon of 5–10 years, even for payback on fertilizer.
9 “Under no circumstances will a New Guinean ever consider that he has irrevocably sold or parted from his land. All he is allowed is a right to share in its usage. Land sold becomes land stolen. Land taken by conquest must be recovered, if necessary by violence” (Downs 1970).
Where, as in PNG, property rights are enshrined in a dynamic, culture-based land tenure system, enforcing ownership based on mere legal title is difficult and often impossible. Lack of enforceable property rights reduces incentives for private investment in land improvement as the benefits to investors cannot be ensured. As has been demonstrated on numerous occasions, a group of traditional landowners can remove a tenant regardless of legality. Traditional landholder groups are increasingly using this power to obtain compensation for granting access to land. In some cases, these claims are understandable, as when landholders demand a greater share of the benefits from large natural resource projects. But many claims for compensation appear inappropriate and unreasonably costly to the state.

The government is committed to improving land policy

The impact of these problems on private sector development is considerable and immediate—costs in terms of time and money are very large. However, the government is committed to improving land policy. In 2005, a national land summit was held to discuss reform and explore ways of making the system of landholdings more conducive to promoting economic development, while preserving traditional values. Since then, the National Land Development Task Force has held extensive discussions to develop a land program. Consultations were held throughout the country with interest groups, including politicians, government employees, private sector representatives, nongovernment organizations, and the general public. The process was a break from the past because it embodied the recognition that the government could not impose the current land policy if the exercise were to be successful.10

The task force made a wide range of recommendations designed to make the land tenure system more suitable for a modern economy. The most important of these were to

- Reform the Lands Group Incorporation Act (1974). This allowed incorporated land groups to serve as vehicles for development with management power over land development and the ability to both receive and control income from land. The reform also allows individuals to secure their own land, which would remain under the ownership of the incorporated land group.
- Bring land disputes under the jurisdiction of a single court or land tribunal.
- Make titles accessible to the public.
- Store files electronically to reduce the danger of their destruction.

The National Executive Council adopted the recommendations of the task force at the end of 2006. A land development program was established to implement the recommendations, with the Land Development Advisory Board reporting directly to the National Executive Council. There are reports of hostility to reform within the Department of Lands and Physical Planning. However, the minister for lands has stated publicly his strong support for the program. Following the elections in 2007, he not only retained his land portfolio, but also became deputy prime minister.

The outlook for further progress on land reform is therefore encouraging, although sustainable funding for the Land Development Advisory

10 See Fingleton 2004, which provides an extensive list of acts and ordinances related to land, dating back to the early 20th century.
Group is an outstanding issue. In the 2008 National Budget, K28 million was appropriated for land reform. The next phase of the program will be to generate consensus and support from political institutions, landowners, and other key stakeholders throughout the country.

It must also be remembered that PNG is home to as much as 5% of the world’s flora and fauna in a variety of diverse ecosystems. This is a heritage worthy of conservation. The principal threat to biodiversity comes from the unmanaged conversion of prime habitats into other uses. Majority of the population is dependent on the renewable resources sector (e.g., agriculture, fisheries, forestry, and hunting) for subsistence. These resources are renewable only if managed correctly, using appropriate harvesting practices. The scope for the development of ecologically sustainable industries is excellent. There are great prospects for biogenetic engineering, use of traditional medicines in the pharmaceutical industry, the development of other extractive industries, and ecotourism. Stronger land rights will strengthen preservation of this heritage.

Movable Property and Collateral

An essential part of financial market development and improving access to finance is a system that allows movable property—assets that are neither land nor buildings—to be used as collateral to ensure the repayment of debt. A system of effective movable property rights promotes access to finance and is the foundation of modern financial systems.

However, the legal framework for pledging movable property as security for loans, known as the secured transactions or personal property securities framework, has failed to promote lending and access to finance. Problems in every area have been preventing the secured transactions process from performing in a way that gives confidence to lenders that, in the event of default, they can seize the property and sell it to satisfy the debt.

Currently, collateral consisting of business assets can only be pledged under the Companies Act, or the leasing framework. However, the process is difficult and costly. Individuals can pledge property under the Sale of Goods Act, but this is also extremely difficult. Lawyers report that searching records is difficult, time consuming, and unreliable, if prior security interests have been registered over assets that are being pledged. As a result, collateral in the form of movable property is only used as secondary security. Lenders frequently require borrowers to pledge land and buildings and personal assets as security for loans.

Reform needs to encompass all stages of the secured transactions process. Reforming the personal property securities framework requires a new law, a new way in which to register security interests, a new way of enforcing repossession in the event of default, and the abrogation of clauses in other laws that could adversely affect the functioning of a secured transactions system. It is essential to bring about comprehensive reform. Partial reform will have little impact on improving access to credit because it will not provide lenders with confidence in the system. Complete reform requires drafting a comprehensive statute, accompanying regulations, and a filing system governing the entire process to ensure that parts of the old system do not overlap with those of the new one and will not create contradictions that
lead to confusion and uncertainty—the enemy of lenders seeking to secure loans with collateral.

**Competition**

Competition is an essential mechanism for promoting economic efficiency and unleashing innovation and entrepreneurship for the benefit of the consumer. The following section outlines the principles of competition and how they are being applied in PNG's key sectors.

**Competition maximizes the benefits of price signals**

**Efficient markets ensure that buyers get what they want at the lowest possible price**

**Principles of Competition**

Competition maximizes the benefits of price signals. Efficient markets ensure that buyers get what they want at the lowest possible price. At the same time, prices translate to profits or losses for producers. They signal where production needs to expand, and which activities should be discontinued. Inefficient producers are forced out of the market, while efficient producers expand production, which ensures that resources are put to their most productive use. Competition also improves quality and innovation. Producers need to ensure that their products meet standards that consumers demand, leading to innovation and greater productivity.

Competition among suppliers benefits consumers. Competition among employers benefits workers, reducing the possibility of exploitation. Competition reduces the potential for a firm or group of firms to dominate sectors of an economy. It redistributes wealth and reduces the concentration of economic power and the ability to control factors of production and the channels of distribution.

While essential for dynamism and efficiency, this process is painful for firms, especially for SOEs, which are frequently accustomed to the benefits of government-mandated monopolies. The discipline of competition requires constant and costly striving for improvement. In an attempt to avoid competition and maintain their market power, large companies, including SOEs, often lobby government for protection. Protection from competition often goes hand in hand with market incumbents supporting political parties, providing paid positions on boards to bureaucrats and politicians, or giving regulators or politicians lucrative directorships once they retire.

A useful way to examine issues on implementing competition policy is to distinguish between rules and behavior that limit business entry and pricing, and the rules that govern how businesses may carry out their activities with a view to correcting market failure. The former set of issues arise either because of anticompetitive behavior on the part of incumbents or because of government controls on entry. The latter arises because of externalities that businesses do not take into account when conducting their activities (e.g., information on the side effect of medications) or because they withhold information from consumers or workers (e.g., ensuring that workers have information with respect to the dangers of the work they are doing).

How these departures from competitive behavior and markets are dealt with is a function...
of circumstances. Price regulation might be necessary under circumstances where a monopolist or a very small number of suppliers supply a market. However, price regulation has no place in markets that have the potential to be reasonably competitive. Paradoxically, and revealingly, some of the most vocal supporters of price regulation in industries where a number of suppliers is substantial are the incumbents who benefit from the restrictions on new entrants.  

Principles of competition policy, therefore, require that

- price setting through regulation be limited to monopoly situations, or situations where a small number of firms have market power to set prices.
- there be no restriction on entry. Firms or individuals should be able to enter any market they wish. In addition, foreign investors should be treated as equally welcome as domestic investors.
- firms attempting to restrict entry by forming cartels be prosecuted vigorously.

Weak institutions benefit incumbents. If property rights are poorly protected, investors will be reluctant to enter markets even if they provide good business opportunities. If financing is difficult to obtain, incumbent firms will face less competition. The conclusion, therefore, is that effective reform of competition policy in countries where institutions are weak includes strengthening institutions more generally.

**Competition Policy in Papua New Guinea**

PNG has espoused the virtues of competition, and the government has made some positive steps toward promoting a competitive business environment. In particular, the enactment of the act establishing the ICCC was a major step in promoting a competitive business environment in the country. The ICCC, which is an independent competition watchdog and industry regulatory authority, has significantly impacted on the economy since its inception, most notably with the regulation of power, water, telecommunications, ports, and certain aspects of the postal services industry.

**Telecommunications**

In late 2006, the ICCC issued the first two private mobile telephony licenses to two new mobile operators to enter the PNG market. This action, while of major benefit to the economy, has been surrounded by controversy. One new licensee, Digicel, has rapidly expanded cellular access across the country, including remote areas where telephone communication had never been available.

Mobile phone rates have plummeted and service has improved dramatically. The number of mobile subscribers has risen sharply, from an estimated 160,000 at the beginning of 2007 to more than 500,000 at the end of the year, with most of the growth, which has continued into 2007, coming from the new provider (World Bank 2008). Equally important has been the improvement in the quality of service. Greater access to cellular phone services has also substantially benefited the economy. In his budget speech, the minister of finance pointed out that even though the new company had only been operating a short time, the improvement in mobile phone services and the employment that it provided had already increased GDP by 0.7%, over and above what growth would otherwise have been.  

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12 For example, in the United States between 1940 and 1980, interstate freight transport was heavily regulated. Entry to the industry required a permit, which was hard to obtain. The Interstate Commerce Commission, a federal agency, determined the prices, routes, and types of cargo that trucks could carry. Yet the trucking companies strongly opposed being deregulated. Unsurprisingly, studies revealed that regulation of the trucking industry increased costs significantly. Once it was eliminated, road freight charges fell by 10–20% on average, and in some cases by 40%. Service also improved, with a major benefit being that many industries could adopt just-in-time inventory holdings, which have led to substantial productivity improvements.

13 This is in line with research on the introduction of widespread cellular service in other countries. Contributions to GDP from improved communications have been uniformly positive and substantial.
Nevertheless, the government-owned incumbent, Telikom PNG, which also has a monopoly on fixed-line telecommunications, has attempted to protect its monopoly position in a number of ways. These include

- initiating court action to have Digicel’s license rescinded;
- stalling interconnection with the new mobile network;¹⁴ and
- demanding that all international calls be routed through the Telikom gateway.

Prior to the introduction of competition, Telikom provided service that was among the highest cost and lowest quality in the world.

In April, the legislature passed, an amendment to the law giving Telikom exclusive control over the international gateway for an indefinite period. Digicel has vowed to fight the legality of the amendment.

As a result, the introduction of competition to the mobile phone market has been fraught with conflict and, as of October 2008, is still in a state of flux. Several other factors are influencing developments in the market. The revised information and communication technology (ICT) policy commits to a phased competition, with the government concentrating on rehabilitating Telikom to enhance its ability to compete under open competition, the second phase of the ICT policy. The ICT policy has no specific timeline for open competition, except a commitment to review phase one in 12 months, with a view to establishing a timetable for the introduction of open competition.

Asking what the costs and benefits are of Telikom’s actions throws light on the value of competition in the telecommunications sector. Prior to the introduction of competition, Telikom provided service that was among the highest cost and lowest quality in the world. Improvement in Telikom’s service provides strong evidence of the benefits of competition. Landline service penetration, which remains a Telikom monopoly, has not improved. The number of subscribers has remained almost unchanged at about 70,000 for the past 5 years.

Besides improved service, the spread of mobile phone use has already impacted GDP positively. Furthermore, the 0.7% increase in GDP noted by the minister of finance amounts to some $40 million for only part of 2007. Since mobile phone penetration is continuing, it is reasonable to assume that the positive impact on GDP growth will increase and, over time, will amount to hundreds of millions of dollars.

Internet access is similarly channelled through one internet gateway, with the license being held by Tiare, a subsidiary of Telikom. Five private internet service providers (ISPs) distribute internet services throughout the country, but are not allowed to have their own international gateways. Internet penetration is limited by the availability and quality of the landline. Tiare also provides internet service in competition, which has solicited calls of anticompetitive behavior from some ISPs claiming that Tiare is exploiting its exclusive access to the gateway to undercut the competition. Facilities in the country are limited, as is growth. ISPs interviewed expressed the opinion that the Tiare monopoly is severely restricting the growth of the internet service industry in PNG. Service has

¹⁴ Interconnection for domestic calls was achieved with regulatory intervention in mid–2008.
been poor, with limited bandwidth available, long delays in obtaining leased lines, and a uniform pricing structure throughout the country that does not allow cost recovery in providing services to remote areas. As a result, internet costs are four to five times higher than those in the Fiji Islands, where service is of the lowest cost in the region. Put bluntly, the current monopoly arrangement for the provision of internet services is harming the development of the country. Opening up the gateway to competition has the same potential to benefit the country as opening up the mobile phone market.

**Airlines**

A study by the ICCC (2006) shows that international airfares to PNG appear to be substantially higher than they would be if there was more competition. Currently, Air Niugini, which is 100% government owned, serves most international routes. It has a code share arrangement with Qantas on the main routes to Australia. There is some competition from Airlines PNG, a small airline which flies the Port Moresby/Cairns and Port Moresby/Brisbane routes.

The ICCC reviewed the Air Niugini/Qantas code-sharing arrangement in the context of an application by both companies to extend code sharing, as the current agreement expired. A complicating factor is the substantial protection that the policy of the Government of Australia on air transport bilateral arrangements gives to Qantas, which impacts Air Niugini negatively on some routes to Australia. More open access policies to foreign airlines will improve the competitiveness of Air Niugini.

In its findings, the ICCC authorized a 2-year renewal of the code-sharing agreement, even though it has determined that the arrangement restricts competition and leads to higher prices. The code-sharing arrangement will expire on 31 December 2009. The ICCC has found that in spite of the anticompetitive aspects of the arrangement, a number of other considerations need to be taken into account, including employment issues, contributions to government revenue, and the potential that over a transition period air passenger service would be negatively affected. Its findings emphasize the importance of competition on the Cairns/Port Moresby routes. The ICCC ruling also requires a full-scale review of the code-sharing agreement before it can be further renewed.

**Shipping**

Fourteen coastal shipping companies currently serve the ports and islands of PNG. Many of the routes are not profitable, with the charges on those that are profitable subsidizing those that are not. Cabotage rules\(^\text{15}\) are relatively liberal compared with other countries.

The ICCC (2007) reviewed competition in the coastal shipping industry. The findings expressed serious concerns over the operation of the ports in PNG, even though PNG Ports, the governing authority, was found to have met the performance standards set in its regulatory contract. The ICCC suggested that these standards are inadequate and compromise the service standards for intracoastal shipping operations.

For a new company to enter the coastal shipping industry, the minister of transport, as advised by the Coastal Trading Committee (CTC), must issue an operating license. However, the majority of CTC members are executives of shipping companies that are already operating on these routes. The ICCC report has found that their objectivity in deciding whether to grant new licenses is therefore suspect. Furthermore, the report also indicates that shipping agents favor incumbent shipping companies with their business, further introducing

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\(^{15}\) Cabotage is the restriction or regulation of shipping operators on the extent to which they can service particular routes, the type of ships that must serve particular routes, and the extent to which they can pick up goods at one port and transport them to another.
anticompetitive elements to the process. As a result, market access is difficult for new entrants to obtain.

The ICCC suggests that it take over the licensing and regulation of coastal shipping. In this way, regulatory capture will be avoided. Another factor is that the CTC has little technical expertise to make its recommendations.

Conclusion

The preceding sections indicate the extent to which competition is restricted in PNG. In the key areas of telecommunications and transport, SOE monopolies and restrictions on access push up prices and reduce the quality of service. Business people in PNG indicate that the degree to which Telikom has improved its service since the advent of competition is striking. Restrictions on the internet gateway have seriously limited the spread of internet use and availability in the country. Both airlines and coastal shipping have powerful anticompetitive elements in their market structure. Although the ICCC has allowed continuation of the code-sharing arrangement between Qantas and Air Niugini, it is only until the end of 2009. The ICCC suggests that it should take over the regulation and granting of licenses for the coastal shipping industry. These are sensible suggestions.

Underlying many problems regarding lack of competition is the view that state-owned incumbents must be protected from competition by the provision of monopoly rights, so that these enterprises can continue to provide the much-needed community service obligations which the private sector would not deliver. This view is both flawed and damaging to all categories of consumers. First, without competition, consumers do not get the benefit of investment, innovation, downward pressure on prices, and quality improvements. Second, community service obligations can and are being provided by the private sector in the telecommunications and other sectors through robust contracts mandating their delivery. On both counts, therefore, competition is by far the best strategy for supporting long-term growth in the economy.

The controversy over mobile phone provision and competition has the additional effect of increasing risk and uncertainty in the economy and the investment environment. Investors observing that previous agreements were not sacrosanct and that attempts were made to change the conditions of a contractual obligation would naturally feel that in order to invest, estimated rates of return on a project would need to be higher to compensate for risk. In turn, this reduces the amount of investment that comes to PNG.

Access to Finance

By international comparison, PNG’s formal financial sector is small relative to the size of its economy as measured by the ratio of domestic credit extension to the private sector in relation to GDP. (See Figure 4, reproduced here for convenience as Figure 8).

At 21.4% in 2007, domestic credit extension to the private sector as a percentage of GDP was less than the average figure for low-income developing countries, despite rapid growth in credit supply over the last 2 years. The overall low credit penetration results from a financial system
III. Binding Constraints and Foundations for Growth

that is narrowly focused by geography, sector, and company size. Only five main urban centers are well serviced by banks. Little formal credit is extended to agriculture, which generates 26% of GDP and less to the semi-subsistence farming sector that provides livelihood for 85% of the population (World Bank 2005b).

While larger companies are well served—albeit sometimes on terms that they consider onerous—little credit extension is given to smaller companies in the formal sector. There is no general need in PNG to import capital to finance current investment levels or even significantly higher ones. The country has a satisfactory level of savings and can mobilize more. However, larger export-oriented mining and oil extraction projects often procure debt financing from external sources since, among other reasons, the loans are too large for domestic institutions to take on without breaching prudential limits, and the foreign currency needs of these companies are substantial.

The Structure of Financial Markets in Papua New Guinea

Commercial Banks. The commercial banks comprise the largest lending group. Commercial bank assets reached K10.7 billion at the end of 2007. The Bank of the South Pacific controls half of these assets, with the bulk of the rest owned by Westpac (PNG) and ANZ (PNG). Around 29% of the banks’ assets, or K3.1 billion, constitute loans to the private sector. Although lending to the private sector has grown strongly over the past 2–3 years (in response to increased economic activity and opportunities occasioned by high commodity prices), loans to the private sector remain low by international standards.

The existing bank lending is profitable, however. Return on average shareholders’ equity exceeded 50%. Some banks have managed to produce comparable returns in previous years.

At the end of 2007, weighted average lending rates were 12.1%, weighted average deposit rates were at 0.9%, and loan loss rates were at a low level, even compared to Australia and New Zealand. Anecdotal evidence from banks suggests that recent loan loss levels are comparable to those in Australia. The banks’ liquid assets are ample and do not constrain lending. At K4.6 billion at the end of 2007, liquid assets are double the minimum statutory requirement and exceed loans to the private sector by a substantial margin. Most liquid assets are placed in treasury bills and central bank bills. With a low average cost of funds, the banks’ liquid asset placement operations are profitable. Banks derive more than half of their net income from foreign exchange transactions, the only area where they are licensed to operate. Sellers and purchasers of foreign exchange are faced with bid-offer spreads that are large compared with those in mature foreign exchange markets. The banks’ average overall profitability is high by international standards.
Finance Companies. The size of the finance company sector (including merchant banks) is less than 5% of commercial banks in terms of total assets. The companies’ combined total assets reached K474 million at the end of 2007, while loans to the private sector totaled K304 million. The finance companies have a conservative capital structure, funding themselves with deposits and shareholders’ equity in roughly equal measures. They need to pay more for deposits than banks, but also charge higher lending rates. Despite their relatively modest size, finance companies play an important role in broadening access to credit. Their typical client company tends to be a second- or third-tier company in terms of size. They often extend credit to companies to which commercial banks will not lend, although with corresponding interest rates that are substantially higher than those charged by the banks.

Savings and Loan Societies. A total of 21 societies were active at the end of 2005, with a total membership of 152,800 persons. At the end of 2007, total funds under management reached K634 million, with loans to members at K166 million. In addition to its lending services, savings and loan societies perform a valuable economic function by offering deposits to many people who would otherwise not have access to this service. The savings and loan movement was very active in the decade after its start in 1961. About 320 societies were created during the period. The movement is now in a period of revitalization, having suffered financially after 1991 when societies started to engage in investments other than loans to members and experienced management problems.

Superannuation Funds. There is compulsory superannuation coverage in PNG for all employees in firms with more than 15 staff (reduced from 20 in May 2007). A defined contribution approach is used, with a lump-sum payout to contributors at retirement. Following financial problems with the former National Provident Fund in 2000, an appropriate legal and regulatory framework is now in place. BPNG now licenses 10 superannuation funds, with the two major funds—the Public Officers Superannuation Fund (primarily for government officers) and the National Superannuation Fund (primarily private sector contributors) accounting for some 90% of the K3.1 billion in superfunds at the end of 2007. Over the past 5 years, superfund assets have grown at an average rate of 19% per annum, and are now equivalent to around 30% of total assets of commercial banks.

Under BPNG prudential standards, superfund trustees have broad flexibility to establish and follow a defined investment strategy. Apart from meeting exchange control regulations, there is no restriction on offshore investment. To date, most funds have invested primarily within PNG in a mix of domestic loans, equities, commercial property, and government securities. Offshore investments remain low by international standards.
by the Public Officers Superannuation Fund and the National Superannuation Fund account for a modest 12% and 18% of their respective total assets. While these funds do not directly provide housing finance, there is provision for contributing members to withdraw a proportion of their contributions for housing. Such withdrawals are often packaged as a deposit on a house together with a bank-provided mortgage.

Microfinance

The provision of microfinance services in PNG, particularly in rural areas, is now largely addressed by two recently established microfinance institutions, PNG Microfinance Ltd. (PML) and Nationwide Microbank (NMB), together with the related activities of a number of smaller savings and loan societies. The state-owned development bank is also seen as a potential microcredit provider, but has not yet entered the market. The commercial banks and some finance companies provide small-scale personal and consumer finance, but this is confined to urban areas and to borrowers in formal employment. At the end of 2007, the assets of microfinance companies totaled K37 million, while loans to the private sector totaled K9 million.

PML was established in 2004 as a subsidiary of PNG Sustainable Development Program Ltd.16 The largest bank in the country, the Bank of the South Pacific, became a 40% shareholder in PML in 2005, with a K4 million investment, and additional equity investments and technical input now pending from the International Finance Corporation, European Investment Bank, and India’s microfinance provider, BASIX. PML’s operations have expanded from the initial focus in Western Province (based on the microfinance operation started by Ok Tedi Mining Ltd.) to a current nine branches as part of plans for expansion to national coverage. At the end of December 2006, PML had deposits of K17.6 million and loans of K5.9 million.

NMB was established in 2004 as a pilot project under the Microfinance and Employment Project, supported by the Asian Development Bank (ADB).17 The operation has since expanded to Lae and established operational links with several savings and loans societies. At the end of September 2006, NMB had total deposits of K5.2 million from 9,800 depositors, with 2,850 loans disbursed totaling K3.9 million. NMB recently graduated from its pilot status, with a capital increase to K1.5 million enabling it to become a licensed financial institution. While the government, funded by the ADB loan, is the founding owner of NMB, there is agreement for a potential sale of the government shareholding in 2009, following potential expansion through merger with several savings and loans societies.

PML and NMB have different origins and somewhat different business models, but they share many similarities:

- Deposit taking exceeds lending operations at each institution, reflecting the importance of access to saving facilities for rural people.

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16 The PNG Sustainable Development Program Ltd. was established in 2002 as a development fund by agreement between PNG and BHP Billiton to take over the latter’s interest in the Ok Tedi mine. It had net assets of $540 million at the end of 2006.

17 Microfinance and Employment Project (Loan No. 1768–PNG), approved in 2000.
There is an appropriate regulatory framework for deposit taking from the public: both are licensed financial institutions under the Banks and Financial Institutions Act 2000, and thereby fall under supervision of BPNG.

Each enjoys a strong capital base, and shareholders are supportive of the role of microfinance institutions.

Despite the liquidity generated from deposits, each microfinance institution is still in the development phase.

The microfinance institutions are seeking financial self-sufficiency by expanding the scale of operations with further branches planned through growth, and mergers with savings and loans societies.

While operating in a challenging business, the microfinance institutions face a broadly conducive policy environment: licensing and regulatory issues appear to be appropriate, there are no restrictions in setting lending interest rates, and training for staff of microfinance enterprises is provided through the ADB-supported Institute of Banking and Business Management.

A modern personal property securities framework will provide a foundation for future financial market deepening

The banking system has likewise been the principal provider of long-term housing mortgage finance in PNG. However, mortgages currently account for only 7.2% of total bank loans (or less than 3% of bank assets); hence banks currently have minimal concerns on maturity mismatch (financing long-term mortgages with predominantly short-term deposits). This will change with future growth in demand for housing so that mortgage finance will become a more significant component on bank balance sheets.

The lack of an effective collateral framework is hindering financial market development in PNG. Lenders have no simple inexpensive way with which to take pledges of movable property as security for loans. While reform of the system is not a panacea for financial market development, a modern personal property securities framework will provide a foundation for future financial market deepening.

Similarly, the lack of comprehensive credit information increases the risks of lending. As lenders have no way of judging the likelihood
of being repaid, they lend only to “blue chip” borrowers. Individuals and small firms find it difficult or impossible to obtain business loans. There is strong interest in promoting the availability of credit information, and the private banks are actively considering the establishment of a credit bureau.

The rapid spread of mobile phone use that has occurred through the introduction of competition in the market also provides the potential for phones to be used to execute payments. Kenya, the Philippines, and South Africa provide excellent models for this development. However, before this can happen, the laws and regulations governing PNG’s national payments system will have to be modernized. The expansion of mobile phone use could possibly be a primary vehicle for the spread of financial services, which are severely lacking in rural areas. Several banks intend to pilot mobile phone banking applications.

Security

An important component of a country’s business environment is security—in terms of personal safety and the absence of crime. As noted in numerous publications and in mission interviews, law and order problems in PNG are serious and perceived as the single most important constraint on investment. This is hardly surprising.

An alternative way to look at law and order issues is as a tax on turnover. The more spent on security, the higher the tax. Surveys show that firms pay 4.1% of their turnover for security and lose 4.6% of turnover from theft (Levantis and Manning 2002). This sizable 8.7% crime tax matches the average profit margin for many businesses. Crops, inventory, and cash are often stolen. Trucks on highways are hijacked and looted, imposing high additional indirect costs. Theft is often violent, adding to insecurity on the part of business. Shift work becomes impossible as employees refuse to travel after dark, reducing the productivity of assets. This environment is not conducive to local or foreign investment,18 and is a deterrent to all except the most adventurous tourists.19 While many in the country maintain that the threat to tourists is exaggerated, high crime rates inevitably influence the external perception of the country as a place to visit.

Figure 9 illustrates the seriousness of the impact of crime and security issues on investment and private sector development. More than 80% of those interviewed from various firms indicated that law and order issues negatively impact investment, compared with the still-substantial 42% who indicated that compliance with regulation negatively impacts investment.

An environment that is reasonably crime free is one of the more important public goods that the state should provide. If taxpayers feel that the state is falling short in this duty, they are less willing to pay taxes. In the case of PNG, firms have to pay out substantial amounts for private security.

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18 Insecure conditions also deter foreign investment because foreign firms find it difficult to induce their expatriate staff to work in PNG. Many companies do not allow the wives and children of male employees to live in PNG because of the danger from crime.

19 This discourages the private sector from expanding tourism, which can potentially be a significant employer and generator of foreign exchange.
Not only does this negatively impact investment, it also inflates GDP artificially. Crime in PNG imposes unambiguous deadweight losses and is a severe drag on private sector development.

**The price of electricity in PNG is one of the lowest in the region. Access and reliability, however, are a serious problem.**

**Infrastructure**

Poor quality infrastructure reduces productivity and economic activity. It contributes to the high cost of doing business and reduces the capacity of industries to compete internationally. Because of its challenging physical terrain, PNG faces particular problems in supplying good quality infrastructure in many areas of the country, with some parts experiencing virtual isolation. The arrival of the new phone carrier and the potential entry of a third one, however, have resulted in communications being available in parts of the country which previously had difficulties communicating with the outside world. Substantial potential productivity gains stand to be reaped through this new development.

**Electricity**

Dependable electricity is a critical business input for economic and private sector development. In recent years, the reliability of electricity has worsened, while PNG Power, the government-owned electricity provider, continues to operate from a precarious financial position, which has compromised its investment program. Electricity is available to about 60% of urban households. Availability ranges from 6% in traditional and makeshift houses to 83% in better-quality individual houses and almost 100% in apartments. The remaining households rely on kerosene for lighting and cooking. In rural areas, firewood and, to a lesser extent, kerosene meet the energy needs of most households.

The price of electricity in PNG is one of the lowest in the region. Reliability, however, is a serious problem. The ICCC reported that in the last 9 months of 2005, some 12,000 megawatt (MW) hours were lost because of power outages of various sorts, although outages fell in 2006. The requirement of many businesses to maintain backup generators adds substantially to the effective overall cost of providing electricity.

The electricity sector in PNG is highly regulated and dominated by state-owned PNG Power Ltd., which is regulated by the ICCC. Restrictions on competition in the electricity sector have recently been relaxed. In 2007, PNG Sustainable Energy Ltd. was issued a license to generate, transmit, distribute, and retail electricity. Nonetheless, existing legal and regulatory barriers will, in effect, limit the ability of private operators to invest in retail electricity on a purely arm’s-length, commercial basis. Importantly, PNG Power retains a monopoly on the retailing of electricity within a 10-kilometer radius of its existing network (although entry is allowed for the supply of 10 MW or greater to a single customer); and the government supports a uniform tariff for retail customers throughout the country.

A draft electricity industry policy paper20 has been prepared. It argues that a uniform tariff should be maintained on equity grounds, and the need to ensure that all Papua New Guineans have access to electricity at the same price, irrespective of where they reside. Affordability, the paper argues, is one key principle underpinning the electricity policy. The draft paper acknowledges that the policy on uniform tariffs will undermine the

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20 At the time of writing, the government’s electricity industry policy was still in draft form and the issues remained under discussion.
21 The initial capital cost of the power generation facility could be subsidized or, alternatively, the ongoing retail tariff could be subsidized.
commercial viability of electricity supply in rural areas, which is characterized by high costs and/or low customer density. The paper then promotes the need for a state subsidy21 to enable electricity providers to realize a commercial profit while meeting the confines of the uniform electricity pricing policy.

The policy paper suggests setting up the Electrification Trust Fund, funded from the budget, to be administered by the Electrification Management Committee, chaired by the Department of Petroleum and Energy. Majority of members will be appointed from various government departments, although there is an allowance for one private sector representative.

Implicit in the draft policy paper are two assumptions related to electricity generation and development:

- Rural inhabitants would be unable and unwilling to pay electricity prices that reflect full cost recovery.
- The cost of rural electrification should be subsidized because it is a priority in the development strategy.

Neither of these assumptions is necessarily correct, since the willingness of rural inhabitants to pay higher prices than those in urban areas has never been tested, and subsidized rural electrification is not identified as an expenditure priority in the medium-term development strategy. Furthermore, under the circumstances existing in rural PNG, the opportunities for private suppliers using small-scale generation is certainly available. Private rural suppliers operate effectively in other parts of the world, basing charges on such factors as the number of light bulbs used by consumers and the hours of the day that they are connected. However, the draft policy makes no provision for the free entry of small-scale suppliers on a commercial basis.

Although there are natural monopoly elements to the electricity industry, the ability of small-scale rural suppliers to charge monopoly prices would be limited by the threat of entry from a potential competitor and the availability of energy substitutes in the form of traditional sources, such as firewood and kerosene. If private sector power providers would identify market opportunities in rural areas, and are prepared to make the necessary investments, they should not be prevented by government regulations, such as a uniform pricing regime.

**Road infrastructure is the lifeline to trade and business, and their poor condition in PNG has been cited in surveys as a very serious impediment to doing business**

Roads

Road infrastructure is the lifeline to trade and business, and their poor condition in PNG has been cited in surveys as a very serious impediment to doing business (Levantis and Manning 2002). This imposes significant economic costs. Vehicle fleets, for example, depreciate more rapidly. The increased tire wear along the Highlands Highway adds an additional K100,000 per year in operating costs per truck. Marketing systems are also disrupted as the time required to transport products from farm to market increases—a costly outcome for marketers of perishable agricultural goods. The foregone economic value of poor roads is estimated at K200 million per year.

The lack of road development, including feeder roads, seriously impedes the development of rural agriculture and business, which has been pointed
out in numerous local and international evaluations of infrastructure in PNG. Bad roads mean high transport costs. As such, producers in rural areas find that their costs are too high to compete in urban markets and that the uncertainty is too great. The incentive to produce large quantities, if at all, is limited. As a result, many focus on food crop production for self-consumption with cash crop production viewed as a minor, subsidiary activity. For these reasons, the rehabilitation and maintenance of PNG’s transport infrastructure is a core expenditure priority under the government’s medium-term development strategy. This is crucial for private sector development, particularly in rural areas.

**Ports and Shipping**

For 14% of PNG’s population, water is the only means of transport. For others, water is the best form of transportation as about 30% of Papua New Guineans live near the coast. But, as with roads, high water transport costs stifle private sector development in remote areas.

PNG has 17 main public seaports, of which 11 are designated as official ports of entry. Lae, Port Moresby, and Rabaul are the main ports, and the only ones that have produced profits. Other public seaports receive cross subsidies through the Harbours Board, the public corporation responsible for their management and operation.

There are 120 secondary ports visited regularly by coastal trading vessels, and a number of jetties around the coastline and on the inland waterways. Provincial governments, village communities, commercial plantations, and logging companies are responsible for the maintenance of local wharves.

Unlike other infrastructure, ports do not appear to be in great need of widespread upgrading, although lack of capacity at Lae Port has resulted in a large-scale expansion program, which will receive significant funding support from ADB.22

**Telecommunications**

The benefits of a competitive telecommunications industry are profound. The minister of finance indicated that in only a few months, investment and competition in the mobile telephone sector had added 0.7% to GDP. These benefits will continue to accrue, especially if a third operator enters the market. Areas previously without access to communications now have cell-phone coverage. In the medium term, the cellular phone industry has the potential to join with the financial sector to extend financial services (i.e., deposit and payment systems) to those who, until then, will have to deal in cash. The future benefits will be enormous.

Nevertheless, problems remain. An amendment to the telecommunications law restricts the international gateway exclusively to Telikom. This makes little sense. The interests of all Papua New Guineans lie in having the lowest possible cost of access to the outside world. Currently, international charges levied by Telikom are significantly higher than those of the new entrant. All that the new rule achieves is to protect Telikom from competition. Its performance in the domestic market when faced with mobile phone competition improved markedly. There is no reason it should not also face competition on the international gateway.

Another factor holding back private sector development is the monopoly that a subsidiary of Telikom enjoys on internet provision. This simply raises the costs of doing business and harms the extent to which local internet service resellers can expand. If the object of policy is to foster growth in the economy, this monopoly should be eliminated without delay.

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22 Lae Port Development Project (Loan Nos. 2398–PNG and 2399–PNG), approved in 2007.
Conclusions

Provision of infrastructure in PNG is a serious binding constraint; Box 1 summarizes the private sectors views of regarding their perceptions of PNG as a place in which to do business. It is not positive.

As the next section will show, SOEs command a substantial portion of the economy’s assets, which appear not to be put to the most productive use. For infrastructure provision to improve, far greater use of the private sector is required. This does not necessarily have to be outright privatization. Use of public–private partnerships is an excellent vehicle for improving the use of resources for infrastructure and service delivery. Just as important, the introduction of competition to sectors where monopolies exist leads to lower prices, better service, and more investment. This is a road down which PNG must go if it is to at last realize its potential.

State-Owned Enterprises

The Government of PNG provides public services and infrastructure—power, water, telecommunications, ports, and air transport. It has shareholdings in various local companies, such as in banking and mining. The stated purpose of these holdings is to develop economic activity and to foster growth.

Following the 2002 national elections, the incoming administration reduced the emphasis on the privatization program and, as an alternative, opted for a strategy designed to improve the operational efficiency and effectiveness of SOEs under the stewardship of the Independent Public Business Corporation (IPBC). Accordingly, a decision was taken to consolidate holdings of a substantial portion of government assets into the Government Business Trust, which the IPBC would manage. An Act of Parliament established the Government Business Trust and the IPBC in 2002.

The aim of this move was to put management of SOEs on a sound commercial foundation to improve their service delivery and strengthen their financial position. To this end, the Government Business Trust was given the authority to borrow in order to provide investment funds to the various entities it owns. IPBC’s 2007 business plan estimates that the value of the more liquid portion of the portfolio it manages is more than K2.4 billion, and that it has an annual net income stream of some K100 million, of which more than K40 million is likely to have been derived from its 17.6% shareholding in Oil Search.

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SOEs command a substantial portion of the economy’s assets, which appear not to be put to the most productive use

The main shareholdings of IPBC are shown in Table 3. These were used as a basis for valuing the portfolio. However, the valuation methodology can only be described as suspect as it is based on a capitalization of maintainable earnings method, rather than discounted cash flows or returns on equity. Furthermore, the adjustment for risk is ad hoc, at best.

Nevertheless, the valuation calculations illustrate a glaring problem in determining values and evaluating performance of SOEs in PNG. The

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23 At the time, politicians expressed concern that privatization would lead to Papua New Guineans being denied access to public goods. However, their perception of public goods is incorrect. Public goods as defined by economists have two characteristics: non-excludability and non-rivalry. Non-excludability means that the cost of keeping non-payers from enjoying the benefits of the goods or services is prohibitive. Non-rivalry means that the consumption of the good or service by one person does not diminish the quantity available to others. Electricity or other outputs of SOEs meet neither of the criteria for being a public good.
information required to assess how well these entities are operating is not publicly available. This lack of transparency is unacceptable and, in some cases, belies a lack of capacity to maintain current accounting records, which in turn does not give management of these entities the appropriate tools to run their businesses.

A further problem is that there is ongoing political interference in the governing bodies of the SOEs, with government officials sitting on most boards. Conflict of interest between the overall development benefits to the economy and the management of the IPBC is also ongoing. The incentive relating to the latter is to maximize the value of the assets under its control, which it can best do by lobbying to maintain the monopoly positions of SOEs, and ensuring the competitive advantage of the listed companies in which it has a stake. By contrast, the long-term development prospects of the country are best served by vigorous competition and ownership that maximizes efficiency and productivity. There is no way to resolve this tension without the government’s adoption of a clear and credible policy that fosters competition, supported by concurrent SOE reforms and a strengthened role for the ICCC in prosecuting anticompetitive behavior.

**Agriculture and Access to Markets**

The preceding sections outline the problems that businesses face in improving productivity and expanding to markets. Some sectors of the economy, primarily agriculture, have limited access to markets. Agriculture forms a critical component of private sector activity, providing income, employment, and livelihood to more than 85% of PNG’s population and contributing 28% of its GDP, 40% of export revenues, and about 40% of formal private sector employment from 1984 to 1998. Past economic development and public investment policies have focused on the growth of modern enclave sectors, such as mining, petroleum, and commercial logging, and four major export crops—coffee, oil palm, coconut, and cocoa. Much less attention has been paid to improving the productivity and natural resource management of smallholder food crop, livestock, forestry, and fishery activities.

Subsistence food production is estimated to account for almost half the value of all crop production, although most is self-consumed or
used in barter exchange. Farming systems are highly diverse and closely adapted to a wide range of agroecological zones in PNG. The main agricultural export commodities are coffee, palm oil, cocoa, and copra oil. Other agricultural exports include tea, rubber, and copra. Coffee, cocoa, and coconuts have plantation sectors, but smallholders predominate, accounting for 70–85% of total production. Oil palm production is based on nucleus estates, with mills and associated smallholders producing about one third of the crop.

Yet in only 5 of the past 15 years has the annual growth of agriculture exceeded 5%, and in many of those years, growth was attributed to windfall gains from world market prices. Real agricultural growth averaged only 1.2% from 1994 to 2004 and saw great variability. However, with the rise in world prices of agricultural products, output in the sector is increasing, although reports indicate that so far, new investment is not taking place.

Development experience from several countries that have achieved high agricultural growth demonstrates the importance of increasing smallholder productivity and output as one of the most powerful and cost-effective drivers of private sector growth. Continuing efforts to accelerate smallholder-based agricultural growth, therefore, remains a key development objective. The potential for farmers to become involved in export crop production is one of the few opportunities for private sector development in PNG. Current arrangements for export crops draw on the strengths of the private sector, get around the weaknesses of the public sector, and promote a “user-pays” approach to extension services and inputs, thus avoiding problems brought about by insufficient government budgets and poorly targeted government programs. A strong smallholder export crop subsector brings cash incomes to the local economy and creates demand for more goods, which in turn promotes further investment opportunities in private farm and nonfarm activities. It is complemented by the efficient plantation and estate sector, which provides important production, marketing, and processing linkages to smallholders. Policies need to reflect the mutual interdependence of smallholders and plantations.

The transformation of the sector requires that it be characterized by a vibrant smallholder subsector coexisting with efficient commercial plantations producing for export to overseas niche markets. It would be more diversified, competitive, and sustainable than at present—exploiting the country’s agronomic suitability for the production of a wide variety of tropical, semitropical, and temperate climate crops, livestock, and fisheries.

Various taxes and levies provide the national government and industry boards with resources

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24 Due to the importance of the nonmarket component of agriculture (i.e., subsistence and barter exchange), the official data on agricultural GDP must be interpreted carefully. Many observers have argued that nonmarket agriculture has grown relatively strong in 1994–2004 due in large part to the depreciation of the kina, which has increased the relative prices of imported foods, such as rice. This growth may not have been reflected in the official data.
that contribute to the national budget while supporting industry-specific management, technical, and marketing services. Licensed operators in the private sector undertake commodity exporting except for copra, where the Copra Marketing Board retains a virtual monopoly. Research and extension services are carried out by crop-specific agencies funded by the respective industries and government and/or donor grants. While industry participants report that the Oil Palm Industry Corporation provides effective extension services, this is not the case with other crops, where the most common complaint is that funds are wasted.

The National Agricultural Development Plan 2007–2016 was released in 2007. The main features of the plan include

- More emphasis on agricultural research, extension information, and training;
- Food and horticultural crop development through the revival of the nucleus estate system to increase production, transfer skills, and improve quality;
- Tree and industrial crops development;
- Promoting livestock for import replacement, through the rehabilitation of breeding centers;
- Revitalizing the spice industry and improving processing and marketing systems;
- According a greater role to women;
- Improved regulatory and technical services; and
- Putting in place a plan to manage the National Agricultural Development Plan.

However, the plan has been criticized heavily for not focusing on the real issues facing the agricultural sector. The most important criticisms include

- Failure to address the issue of landholding, land tenure, and communal property issues;
- Failure to recognize transport issues as being central to the problems of bringing agricultural produce to the markets;
- Overreliance on the smallholder nucleus estate model which, in most industries (with palm oil being the exception), has fallen into disrepair as a result of land invasions and neglect;
- Failure to consult with the farmers themselves as to the problems they face; and
- Failure to point out how agricultural extension can be revived using a model that has been failing for many years.

The National Research Institute surveyed the rural, informal agricultural sector regarding constraints to production. Farmers see transport as being paramount—producing goods that cannot be transported to market is a futile exercise. “Poor transport is the key constraint to improving agricultural production in PNG. There is no point in anyone producing goods for market if they are unable to get them to market. Roads are all in very bad condition and the only difference is the degree of disrepair. There is no sea and air transport available for almost all provinces apart from a few major ports and provincial airports as well as some that are still maintained by missions” (Manning 2007).

Agriculture forms a critical component of private sector activity, providing income, employment, and livelihood to more than 85% of PNG’s population

25 See, for example, Manning 2007.
Another major constraint is law and order. Crops are stolen or destroyed (including during tribal disputes), and village store owners, tired of being continually robbed, have closed shop. Coffee plantations have shut down, and larger farms that remain are said to be producing products that they can protect, rather than those that obtain the highest prices.

Land issues are also a serious problem. Expansion of agriculture is constrained by the availability of land that can be developed securely under the communal system.

The state also continuously interferes in agriculture. The Coffee Industry Corporation recently banned all sales of cherry coffee, the justification being to avoid the theft of cherry coffee and to improve its quality. The reality as documented in recent studies of the coffee sector is that cherry coffee attracts a premium because exporters can control the quality of coffee when they purchase it. By banning sales, the state is effectively lowering the quality of coffee produced.

Other issues include access to finance and the need to improve institutions. Problems in the agriculture sector mirror those of the private sector. The sustainability of the benefits from the commodity boom, depending on reform, greatly applies also to the agriculture sector.

III. Binding Constraints and Foundations for Growth

The transformation of the sector requires that it be characterized by a vibrant smallholder subsector coexisting with efficient commercial plantations.
IV. Conclusion: Promoting Private Sector Development in Papua New Guinea

PNG’s poor growth record in the past 10 years has been reversed by the commodity boom, with a sharp expansion in GDP and improved prospects for the future. The theme of this paper, however, is for the windfall revenues from high commodity prices to be translated into sustained higher growth that contributes to poverty reduction, and for sustainable reform to be put in place. Typically, commodity booms do not translate into a significant amount of additional employment. PNG has a young and growing population that is looking for employment and income-earning opportunities that do not currently exist. In addition, most workers live in rural areas. As such, job creation and income-earning opportunities will need to take place in rural areas despite increased rural to urban migration. In a country as fragmented and poorly served by infrastructure as PNG, this is a monumental task. It will be a long and slow process that can only happen if more village-based activities are developed, and these are linked to a larger domestic and international economy.

This requires a transition from the informal sector—which operates mainly on a semi-subsistence and local level—to the formal sector. Such a transition is hampered by inadequate education, limited entrepreneurship, weak links with the world, and a challenging environment for the private sector.

The Role of the State

The government is not supplying the essential public goods that provide a foundation for private sector development. Well-functioning states provide secure property rights and basic services such as health, education, and law and order; keep transactions costs low; encourage access to finance; promote competition; provide adequate infrastructure, but do not own substantial productive assets; and keep the costs of doing business low.

The government has not yet fulfilled these criteria. The business environment is very challenging precisely because of the deficiencies in many of these areas. Furthermore, governance is still weak and capacity of the public sector is limited. The private and the public sectors have only limited contact, and an attitude of mutual distrust prevails. The first step must be to begin restoring contact and consultation. We recommend that this be done through the revival of the National Working Group on the Impediments to Business.

The Commercial Legal Framework

Examination of the commercial legal framework indicates that it is outmoded, and many laws are not suited to the demands of modern commerce. Furthermore, an improved framework for the incorporation of community, family, and tribal groups would make this model more viable. Work on these issues needs to begin soon.
Property Rights in Fixed and Movable Property

Property rights in PNG are not adequately defined and protected. However, in the area of land property rights, a long-term framework is being established. This is not a process that can be hurried, but neither is it one that can be delayed. The consultation framework is in place, although funding is not yet assured. We strongly recommend that some proceeds of the commodity boom be used to ensure that the Land Development Advisory Board has adequate funding to continue its task. It is important that the Advisory Board remains focused on the task at hand, and in achieving results against a carefully prepared work program.

In the area of movable property rights, the collateral framework for lending is weak and expensive. PNG does not have a system that allows for the pledging of movable property as collateral for lending. We recommend that the process of secured transactions reform begin without delay.

Competition

PNG has a modern framework for promoting competition. The ICCC is a major step forward in ensuring that markets are competitive. Its granting of licenses for new entrants to the mobile phone market has had a major positive impact on telecommunications, which has boosted GDP and promoted the welfare of rural communities.

However, the actions of Telikom, and the modification to telecommunications policy that has enshrined Telikom’s monopoly over the international telephone gateway for an indefinite period, have been major retrograde steps. The monopoly over the internet gateway raises costs and holds back the development of the economy.

We firmly believe that public welfare is enhanced through competition, rather than maintaining the value of SOEs through the misguided provision of monopolies. From the perspective of maximizing long-term growth, competition is a key factor, not enshrining the market power of incumbents.

Access to Finance

Access to finance is a significant problem in PNG. It is not, however, a shortage of funds that makes it difficult for businesses to borrow. Rather, it is the risk of lending. To this end, the need for reform of the collateral framework is central, as is the need for credit information through the establishment of a credit bureau. At the same time, reform of the payments system needs to go ahead without delay to prepare financial markets for the technological changes that are under way.

The experience of microfinance institutions demonstrates the great need for financial services. It appears that people want deposit-taking facilities as much as they want access to loans. The expansion of the cellular phone networks, combined with technological advances and facilities that have been successful in other countries, has the potential to transform access to finance. Modernization of payment systems and refinements to the regulatory environment are needed to further enable these developments.

Security

Various experts, on different occasions, have discussed the tax on businesses, agriculture, and the population that is imposed by the high level of crime. Without progress on the crime issue, businesses and PNG’s economy will, in general, be fighting an uphill battle. This is an issue that...
needs to be tackled urgently. It will also help that foreign governments stop issuing warnings to their citizens about the dangers of traveling to PNG.

**Infrastructure**

Infrastructure does not adequately support the private sector. Electricity generation is unreliable and covers only limited parts of the country. Transport infrastructure is costly and of low quality. Roads are inadequate and poorly maintained. One bright spot is telecommunications, which has spread in many areas, especially to those previously with no contact with the outside world. Yet, even here, there are problems. Telikom’s monopoly over landlines hinders access to the internet, which in itself is a monopoly as a result of restrictions on who may link to the outside world.

**State-Owned Enterprises**

Closely linked to the issue of infrastructure is that of SOEs. The state owns a significant portion of the country’s capital stock, which is generating low returns. Moreover, conflicts arise from IPBC management of SOEs to maximize value on the one hand and the need for competition, open markets, and the elimination of monopolies on the other. Since the current structure is enshrined by law, the only way this conflict can be resolved in favor of competition is through cabinet action.

**Agriculture and Access to Markets**

Rural areas and agriculture account for more than 85% of PNG’s population. Yet agriculture does not perform well, nor does it provide adequate income for those who engage in it. We point out that, unsurprisingly, the problems of agriculture are similar to the problems of the private sector.

**A Final Word**

The government has publicly committed itself to promoting private sector development. The fruits of the commodity boom give it an ideal window of opportunity to transform PNG from a country that has always been described as challenging to one that attains its potential and takes its place in the rank of middle-income countries. This analysis describes an extensive agenda of reform and action. The opportunity is there to be seized.
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International experience strongly suggests that resource booms often do not bring lasting benefits and prosperity unless they are supported by an effective institutional and legal framework for business to prosper. This private sector assessment suggests ways in which Papua New Guinea can consolidate and sustain its current commodities-based growth spurt by making improvements to the business environment that will encourage sustainable investment in the non-resource sectors of the economy, facilitate competition, create jobs, and bring prosperity throughout the nation.

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