SECTOR ASSESSMENT (SUMMARY): TRADE[1]

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. The economy of Papua New Guinea (PNG) depends heavily on trade. In 2009, exports accounted for about 60% of gross domestic product. Minerals, including gold, copper, and oil, accounted for about 77% of the total value of PNG's exports in 2009. Major agricultural products, which account for 17% of total exports, include palm oil, coffee, cocoa, copra, copra oil, vanilla, tea, and rubber. Forest product exports account for about 5% of the total, while marine resource exports account for about 1%.

2. Driven by exports, PNG's economy grew rapidly from 2004 until mid-2008 as a result of near-record world price levels for key commodities including oil, copper, gold, and agricultural products. Strong surpluses on goods trade were reflected in a series of substantial current account surpluses in most years from 2005 to 2008. However, the onset of the global economic crisis, a reduction in global demand, and corresponding drop in world prices for minerals and agricultural products led to the deterioration in the country's terms of trade, resulting in falling export revenues and slower growth. However, with signs of global economic recovery, world commodity prices have begun to rise again. Large investments in 2010–2012 in liquefied natural gas (LNG) development in PNG are also expected to significantly increase oil and gas exports.

3. Although the incomes of informal sector agricultural smallholders rose during the period of high commodity prices in 2003–2008 the majority of the poor did not benefit from PNG's strong export growth. PNG's economic structure remains narrowly based and highly dualistic, with the modern sector dominated by mining and affecting only about 15% of the population. The majority of the population remains in isolated rural areas, is engaged in subsistence agriculture, and has poor access to economic opportunities and social services. For example, it has been estimated that the welfare effect to the PNG economy is typically only one-third of export values from the mining sector, after discounting the returns that accrue to foreign capital and the purchase of intermediate imported inputs.[2] In the addition, despite a significant rise in government spending in recent years, funded largely by windfall gains during the commodity price boom, the majority of the population lacks access to quality basic services such as health and education.

4. PNG is close to Australia and Asia's dynamically developing economies, particularly Indonesia. It has fertile land and rich resources to support expanded export growth, particularly in agricultural products. However, basic infrastructure and an environment conducive to doing business—including efficient and effective policy and administrative practices, law and order, and a low-cost skilled labor force—are lacking. Expansion of PNG's export sector remains constrained by poor infrastructure, particularly the country's transport systems, which have been deteriorating badly in recent decades. This has prevented the effective distribution and marketing of agricultural produce. Agricultural producers also face constraints such as lack of access to credit and agricultural extension support. Inadequate border infrastructure impedes the movement of goods and people between the West Sepik and Western provinces of PNG with the West Papua province of Indonesia.

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[1] This summary is based on ADB. 2009. *Technical Assistance to Papua New Guinea for Preparing the Pilot Border Trade and Investment Project*. Manila.

[2] S. Chand and T. Levantis 2000. *Dutch Disease and the Crime Epidemic: An Investigation of the Mineral Boom in Papua New Guinea*. Australian Journal of Agricultural and Natural Resource Economics, 44(1), pp. 129–146.

5. The high costs of doing business in PNG also limit trade and investment. PNG ranked 102 of 183 countries in the *2010 Doing Business Survey*.[3] Factors that raise business costs in PNG include poor law and order, corruption, and government regulations and policies. An Investment Promotion Authority exists, the investment approval process has been simplified, and most sectors now are open to overseas investment. However, foreign investment is deterred by inefficient approval processes for investment licenses, visas, and work permits. In addition, input costs, such as electricity and labor, are high and quality is low compared with other countries in Asia and the Pacific. The national minimum wage for unskilled labor increased in 2009, which raised the costs of employing unskilled workers. As a result, foreign direct investment in PNG has been limited and remains concentrated in the high-risk, capital-intensive minerals sector, which has few links with the rest of the economy.

6. One of the main risks for the trade sector is the threat of "dutch disease,"[4] which would result in the absence of sound macroeconomic management, leading to a real exchange rate appreciation and causing a fall in the price of agricultural exports through a decline in relative returns to export crops (footnote 2). Another risk to improved trade performance is that investment in upgrading infrastructure, removing agricultural supply constraints, and improving the business environment will not be sufficient to support increased flows of trade and investment.

2. Government's Sector Strategy

7. PNG lacks a coherent trade strategy as a result of limited government capacity in this area. Efforts by the government to use trade policy to encourage industrialization have generally not been successful.[5] The government has entered into a number of trade agreements, and its exports have been granted duty-free market access to many countries including Australia and the European Union (EU).[6] Its major trading partners include Australia, the People's Republic of China, Japan, and the United States. PNG launched its Tariff Reform Program between 1999 and 2006, which set duty rates for most goods—except those produced or have the potential to be produced in PNG—set to zero. As a result, about three-quarters of PNG's imports enter the market duty-free.[7] Export tariffs are charged only on raw logs and crocodile skins. PNG's simple average import tariff is currently 5.1%, making it one of the least-restrictive trade regimes in the

[3] World Bank, 2009*. Doing Business 2010 Papua New Guinea*. Washington, DC.

[4] Dutch disease is a concept that purportedly explains the apparent relationship between the increase in exploitation of natural resources and a decline in other sectors of the economy. The theory is that an increase in revenues from natural resources will reduce the competitiveness of other sectors by raising the exchange rate.

[5] For example, in 1982, as part of a government plan to establish a national sugar industry, Ramu Sugar was created. In 1984, a ban on imported sugar was introduced, which has subsequently been replaced by prohibitive tariff levels to protect the local sugar industry from less expensive imports.

[6] PNG has been a member of the World Trade Organization since 1996. PNG has a bilateral trade agreement with Australia, which gives PNG's exports duty-free access to the Australian market. PNG has also recently signed an interim economic partnership agreement with the EU under the Contonou Agreement and its predecessor the Lome Accord, which provides duty-free and quota-free access to the EU market for African, Caribbean, and Pacific countries. The country is also part of the Pacific Island Countries Trade Agreement, which is a free trade agreement on trade in goods between Forum Island Countries. It is also part of the Melanesian Spearhead Group Trade Agreement with Fiji Islands, New Caledonia, Solomon Islands, and Vanuatu. Australia and New Zealand are also seeking to start negotiations with PNG and other Forum Island Countries under the Pacific Agreement on Closer Economic Relations. PNG is an official observer of the Association of Southeast Asian Nations (ASEAN) and is working toward achieving full membership.

[7] For goods that are produced or could potentially be produced in PNG, duty rates are classified according to three tariff bands: (i) intermediate (15%), applied to intermediate goods; (ii) protective rate (25%), applied to goods that are produced or can potentially be produced in PNG; and (iii) prohibitive (40%), applied to fruits, vegetables, alcohol, wood, and some luxury goods. Domestic sugar production is protected with a 70% tariff on an exceptional basis. In addition to excisable goods (alcohol, tobacco, fuel, certain luxury goods), a 30% excise rate applies to home electronics and between 0% and 110% for vehicles.

world. Further planned tariff reforms stalled in 2009 over fears of government revenue loss as a result of the global economic crisis. However, tariffs are no longer a significant source of revenue for the government, estimated to be 3% of total government revenue in 2009 compared with 17% in 1998.

8. The government has also introduced reforms to lower trade transaction costs in the country.[8] A customs modernization program was introduced, which has resulted in a steady upgrade in customs systems and procedures that have supported the country's accession to the Revised Kyoto Convention. The development of a comprehensive risk management system based on voluntary compliance measures, including the increased use of post-clearance audits, has allowed customs to clear an increasing proportion of goods immediately upon payment of duties and taxes.[9] However, lack of efficiency and coordination of procedures with other border management agencies such as the National Agriculture and Quarantine Services, which s required to inspect 100% of consignments containing agricultural goods, delays cargo clearance.

9. In recognition of the important role that cross-border trade could play promoting economic development in its poorer border provinces, the government created the Border Development Authority in 2008. The authority was created to emulate achievements of other regions, such as the Greater Mekong Subregion, in promoting subregional integration with neighboring countries. The main functions of the Border Development Authority are to coordinate planning and implementation of capital works, infrastructure, and socioeconomic activities in border provinces.

3. ADB Sector Experience

10. The Asian Development Bank (ADB) only recently began directly supporting activities to promote cross-border trade and investment with neighboring Indonesia. The PNG Pilot Border Trade and Investment Development Project[10] aims to remove infrastructure bottlenecks along the northern transport corridor connecting West Sepik with West Papua by constructing border facilities at Wutung Border Post, and to improve the investment environment in West Sepik to capture the trade opportunities for development. The ADB technical assistance for Capacity Strengthening and Institutional Development for Border Management and Trade and Tourism Development in the Pacific[11] will support enhanced subregional cooperation by strengthening the capacity of agencies responsible for border management, trade, tourism, and infrastructure in Timor-Leste and PNG. The technical assistance will promote the development of enhanced cross-border links with neighboring Indonesia to facilitate increased trade and travel between these countries.

11. Australia provides capacity building support to PNG in customs and quarantine management by providing advisers from the Australian Customs and Border Protection Services and the Quarantine and Inspection Service under programs including the Enhanced Cooperation

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[8] The World Bank in 2009 estimated that it takes about 29 days to complete necessary import procedures, including documents preparation (19 days), customs clearance (4 days), inland and transport handling (2 days), and ports and terminal handling (4 days). On the other hand, it takes 26 days to complete export procedures in PNG, including documents preparation (13 days), customs clearance (4 days), inland handling and transport (4 days), and ports and terminal handling (6 days). Source: World Bank. 2009. *Doing Business 2010*. Washington, DC.

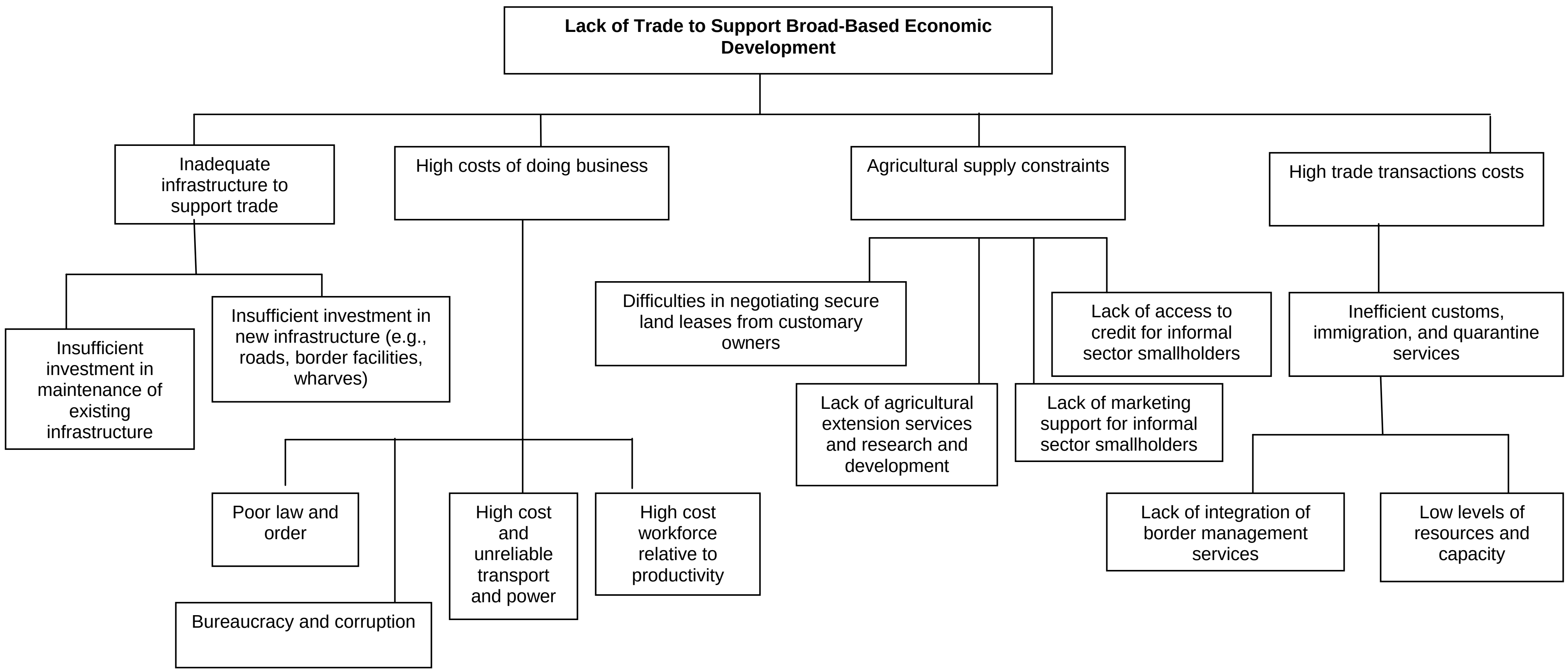
[9] Customs advised in 2010 that it is now clearing about 90% of goods through the “green lane” where cargo is cleared immediately once duties have been paid. Only 10% of goods fall into either “yellow lane” (goods held until all required documentation has been checked and found to be in place), or “red lane,” which requires the manual inspection of goods. For the latter two categories, goods are usually held from 2 to 7 days, and up to 21 days in extreme cases.

[10] ADB. 2010. *Loan Agreement (Special Operations) between the Independent State of PNG and the Asian Development Bank: Pilot Border Trade and Investment Development Project*. Manila (2591-PNG).

[11] ADB. 2010. *Regional Technical Assistance for Capacity Strengthening and Institutional Development for Border Management and Trade and Tourism Development in the Pacific*. Manila (7503-PNG).

Program, the PNG–Australia Quarantine Twinning Program, and the PNG–Australia Customs Twinning Program. The EU, under the Trade-Related Assistance Program, is providing €3.3 million to PNG to support capacity building in trade policy development, quality certification support, and private support for export promotion. There are a number of opportunities for ADB to partner with these donors on various trade facilitation activities.

Problem Tree for the Trade Sector



Source: Asian Development Bank

Sector Results Framework (Trade, 2011–2015)

Country Sector Outcome		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contributions	**Indicators with Targets and Baselines**	**Outputs with ADB Contributions**	**Indicators with Incremental Targets (Baselines Zero)**	**Planned and Ongoing ADB Interventions**	**Main Outputs Expected from ADB Contributions**
Export-driven economic growth supported by sectors that reflect Papua New Guinea's competitive advantage in the global marketplace	By 2015, increase by 10% the total amount of agriculture commercially produced and by 34% the amount of subsistence agriculture production By 2020, increase commercial use of land and natural resources through improvements in environmentally friendly technologies and methods of production, measured through agricultural exports as a percentage of all exports, and value of agricultural exports as a percentage of total gross domestic product	Efficient border management services developed and managed Border-related infrastructure constructed and maintained	Average border crossing clearance times at land borders reduced by 10% by 2015 Volume of over-land trade between Papua New Guinea and Indonesia increased by 10% by 2015	**Ongoing Projects with Approved Amounts** Pilot Border Trade and Investment Development Project ($25 million) Technical Assistance for Capacity Strengthening and Institutional Development Border Management and Trade and Tourism Development in the Pacific ($2.5 million, also includes Timor-Leste)	**Ongoing Projects** Border facilities at Wutung to be constructed and refurbished by 2014 At least 100 personnel trained successfully in border management and border services, including customs immigration quarantine security

Source: Asian Development Bank