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ECONOMIC POLICY MAKING IN PAPUA NEW GUINEA

by

Satish Chand and Charles Yala

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ACRONYMS

ANU	Australian National University
APEC	Asia Pacific Economic Cooperation
BPC	Budget Priorities Committee
BPNG	Bank of Papua New Guinea
CPC	Constitutional Planning Committee
CPO	Central Planning Officer
FAS	First Assistant Secretary
GDP	Gross Domestic Product
GFEP	General Financial Economic Policy
MSG	Melanesian Spearhead Group
NIDA	National Investment and Development Authority
NLDC	National Lands Development Commission
NPC	National Planning Committee
OLPGLLG	Organic Law on Provincial Governments and Local-level Governments
PICTA	Pacific Island Countries Trade Agreement
PNG	Papua New Guinea
PNGBC	Papua New Guinea Banking Corporation
SOE	State Owned Enterprise
VAT	Value Added Tax

Preface

Economic policy making in Papua New Guinea in the first fifteen years following independence was exemplary. It was characterised by fiscal discipline, a stable and convertible currency, low inflation, and responsible governance. This is remarkable, given the limited capacity at that time to achieve any of these goals. The about turn in responsible policy making that occurred in the 1990s is a puzzle. The solution to this turnaround should assist in expediting a return to an era of better policy making.

This discussion paper documents policy making from pre-independence to 2001, and offers suggestions to hasten the return to better policy making in Papua New Guinea.

Dr. Satish Chand ***Dr. Charles Yala***

Dr. Satish Chand is a Senior Lecturer and Director of Pacific Policy, Asia Pacific School of Economics and Government, the Australian National University.

Dr. Charles Yala is a Senior Research Fellow, Economic Studies Division, National Research Institute.

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CHAPTER 1: INTRODUCTION

From 1951 to 1973, the responsibility for economic policy making was shifted from Canberra to Port Moresby, and from expatriate Australians to the local authorities, at an accelerating pace. The Chief Minister and Prime Minister-in-Waiting, Michael Somare, noted that, 'after April 1972, the elected representatives in the House of Assembly believed that, in reality, they were, the government. We began to initiate policy' (Sir Michael Somare 2001: 16).

The period preceding self-rule, and the fifteen years following independence, saw responsible economic policy making. During this era of hope, policy makers were in control of the fiscal position, and were on track to see rapid development. However, this situation was not to last very long, with the State having lost control of its budget, prices, and the exchange rate by the early 1990s. Although some ground and control were recovered between late 1999 and 2001, a lot remains to be achieved.

The Legislative Councils of the Territories of Papua and New Guinea were combined in 1951, and of a total of 29 councillors, three were native Papua New Guineans. By 1961, twelve members of the expanded 37-member Legislative Council were Papua New Guineans. The 1964 General Elections were based on universal adult suffrage, and saw the House of Assembly, which replaced the Legislative Council, expand to 44 elected Papua New Guinean members, out of a total of 64.

Local parties were first formed in 1964, and by 1968 the election machinery and party politics were well-established in Papua New Guinea. Responsibility for economic policy making was rapidly transferred from Canberra to Port Moresby, such that, by 1972, the Chief Minister's Office, together with the Department of Finance, had almost full autonomy in charting the economic course for the nation.

Australia retained responsibility for defence and foreign policy, until independence. Well before attaining self-governance on 1 December 1973, the processes of law making and appropriation of money for public purposes in the Territories were undertaken locally by the House of Assembly, with the majority of members elected by the local population. Full independence was acquired on 16 September 1975, when Australia transferred its final responsibilities for defence and external relations. [1]

It is argued that:

- the preparation for independence was well under way by 1962, and the process was well managed by the colonial power;
- Australia achieved many of its goals, including that of a peaceful and amicable transfer of power and responsibility for policy making from Canberra to Port Moresby; and
- institutions that were created at independence achieved their desired goals of ensuring responsible economic policy making, which enabled the democratic processes to function properly.

However, the virtuous effects of good governance on responsible economic policy making began to unravel in the early 1990s — particularly following the Bougainville crisis, which led to repeated economic crises, until the instalment of the Morauta government in July

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[1] See World Bank (1965) and Garnaut (1981) for details, including the politics of this transition.

1999. Since then, some lost ground on macroeconomic management has been regained, but the revival of the development process, which had lain dormant for a decade, remains the immediate challenge. The catalyst for this revival, and the drivers of the process must be the focus of sound research.

Chapter 2 of this paper considers the transition of responsibility for policy making from Canberra to Port Moresby in the period leading up to independence. Chapter 3 highlights initial conditions at independence that had a major influence on future policy making. Chapter 4 provides an account of policy making at, and following, independence. Chapter 5 highlights major policy switches in the post-independence era. Chapter 6 highlights major policy voids, particularly in the context of the goals espoused in the Constitution, and Chapter 7 provides conclusions to the paper.

CHAPTER 2: TRANSFER OF POLICY-MAKING RESPONSIBILITIES FROM CANBERRA TO PORT MORESBY

The shift in responsibility for economic policy making, from Canberra to Port Moresby, was smooth as a result of good planning and methodical implementation by the then colonial administration. The transition was a success, with the timely handover of power and responsibility for policy making in a peaceful, amicable, and orderly fashion (World Bank 1978:5).

The options to increase autonomy for the Territories were aired by four distinguished academics from the Australian National University in a series of lectures which were subsequently published (Bettison, Fisk, West, and Crawford 1962). This report provides an excellent account of the thinking that was put into preparing Papua New Guinea for self-rule.[2]

Amongst the achievements in the early years of self-governance, there are two that stand out in terms of relevance for the current period:

- the conduct of the 1968 National General Elections; and
- the institutional arrangements that were put in place for fiscal prudence.

On the former achievement, the World Bank (1978: 22) noted in the context of the 1968 National General Elections that it was an 'organisational marvel, with voter registration being close to complete, with two-thirds of registered voters having voted'. On the latter achievement (*ibid.*), pressures for responsible budgeting were created following self-rule, via new institutions and procedures that were established for this very purpose.

The outcome was constant dialogue between the respective ministries and departments. Expenditure requests and program proposals by agency heads were channelled through the Central Planning Office (CPO), which acted as the secretariat, to a subcommittee of Cabinet — the National Planning Committee (NPC). These freshly established institutions and procedures, and the accompanying by-product of documents ensured that there was control over expenditures, and subsequently, the budget. This also served as the mechanism to inform and educate stakeholders on the nation's overall fiscal position, the linkages between programs, and the national policy goals of the Government. This demonstrates that institutions which were essential to ensure fiscal prudence, were successfully established and functional before independence.

Other features which characterised the initial conditions included a cadre of well-qualified graduates from the University of Papua New Guinea, who took the helm of political leadership during the transfer of responsibility for policy making from Canberra to Port Moresby. The churches, together with a significant number of senior expatriate administrative staff, provided much needed support during this transition. However,

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[2] ANU's active involvement with policy making in Papua New Guinea dates back to 1953 when Oskar Spate, Cyril Belshaw, and Trevor Swan were commissioned by the Australian Government to investigate the economic structure of the Territory, with a view to suggesting gaps in knowledge (Terrell 2000: 1). Since then, many ANU academics, including Sir John Crawford, Professor Peter Drysdale, Dr. Andrew Elek, Professor E. Fisk, Professor Ross Garnaut, and Dr. Ron May have been involved in the design and implementation of policy for the nation.

assessment by stating that, 'no-one can say how sturdy or fragile Papua New Guinea's policy or administration will prove to be, but the short-run record provides strong grounds for optimism and few for anxiety'.

At independence, Australia accounted for between 40 percent and 45 percent of the local budget, and some 45 percent to 50 percent of the foreign exchange requirements. The World Bank (*ibid.*:6) had 'reasonable grounds' to believe that this dependence on Australian grant 'might end entirely within the next 20 to 25 years'.

The state of public infrastructure and social service delivery at independence were good, relative to those of recent years, and in comparison to the state of the economy at independence. The pre-independence World Bank mission to Papua New Guinea, in 1975, observed that:

> 'the strikingly primitive state of much of the economy and society contrasts with the surprisingly well-developed status of the central government and many of its services. Education and health care and some of the country's infrastructure — harbours, electricity supply, telecommunications, and air services — are comparatively advanced' (*ibid.*: 5).

The recent sharp downturn in the fiscal position of the State, loss of budgetary control, and widespread allegations of misappropriation of public funds are shocking, and deserve closer scrutiny. It is amazing how such good preparatory work leading to an initial phase of responsible policy making could go haywire more than a decade later.[4]

[4] Garnaut (2000: 35) claims that, 'by 1999, Papua New Guinea had become a kleptocratic state' — a statement highlighting the damning state of governance (and policy making) in the country.

decision making rested fully within the hands of the local leaders. These achievements were no accidents, as they transpired and were consistent with a proposed, preferred strategy of preparing Papua New Guinea for independence:

> If, by a change of emphasis in policy, a Papuan elite were to be given every opportunity within the next ten years for education and experience, when the time came for Australia to transfer sovereignty, to hand over power to that Legislative Council the Minister has seen as the sovereign body, I think we would have every reason to be hopeful that an independent State would willingly establish a special relationship, in terms of defence, economic aid, and diplomatic representation, with Australia (West, in Bettison *et al.* 1962: 58).

Furthermore, the strategy was implemented with success, given that Papua New Guinea, in the period since independence, has maintained a special relationship on defence, economic aid, and diplomatic representation with Australia.

Papua New Guinea achieved initial successes in economic management through well-considered, responsible action by its leaders — many of whom remain active some thirty years later. For example, Garnaut (1981: 172) stated that the ideas which were important for the evolution of a satisfactory framework for economic policy making had been around for some time and had been discussed at length by Julius Chan, Mekere Morauta, and their advisers. Mekere Morauta took office as the first Papua New Guinean Secretary for Finance, in late 1973, and played a significant role in ensuring that fiscal discipline was maintained during the early years of self-governance (*ibid.*).

In those early years, the General Financial and Economic Policy (GFEP) Division, which was located within the Ministry of Finance and headed by a First Assistant Secretary (FAS), had a critical role in the formulation of economic policy.[3] A Budget Priorities Committee (BPC) established systems for the identification and enforcement of long-term priorities within the budgetary capacities of government. According to Garnaut (*ibid.*:172), by the second half of 1976, the major elements of an internally consistent macroeconomic strategy had fallen into place.

The World Bank (1978:5) was highly complimentary on policy making at independence, stating that:

> In the four years after its election, the Somare government showed an impressive ability to deal with the young country's financial, economic, and political problems. An effective set of institutions for economic and financial management has been created. This includes a strong Ministry of Finance that has developed; a tight system of budget controls, operating through a Budget Priorities Committee; a planning office; and a Central Bank that, with International Monetary Fund assistance, has organised a set of international accounts.

The World Bank (*ibid.*) also noted the successful introduction of the kina, the approval of a set of principles to govern development policy and foreign investment, and the publishing of investment priorities by the National Investment and Development Authority (NIDA). These achievements were remarkable, particularly as this was the inception of a new nation State, and there were limited resources. The World Bank (*ibid.*: 5) qualifies its highly favourable

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[3] Ross Garnaut took up the FAS position in April 1975.

CHAPTER 3: STATED GOALS AND BEACONS FOR ECONOMIC POLICY MAKING

In December 1972, the Somare government announced its development goals in the form of the eight aims of the national government (World Bank 1978: 66; Fitzpatrick 1985). These were to:

- raise the proportion of domestically generated income, either from value-adding, or via exploitation of natural resources, accruing to the locals — this was to be achieved via a program of localisation;
- ensure a more equitable distribution of income — localisation and decentralisation were to assist in achieving this objective;
- see greater decentralisation of economic activity and decision making in favour of the rural sector, and agriculture, in particular — this was to be pursued via provincial and local government reforms;
- increase the emphasis on small-scale industries — particularly those in control of the locals;
- increase self-reliance, which is defined as a reduction in dependence on imports;
- increase domestic capacity to meet budgetary obligations — this entailed broadening the bulk of the revenue base of the State;
- enhance women's participation in economic and social activities; and
- increase government control and involvement in the economy to assure 'the desired kinds of employment'.

These aims reflected the government's concerns for equitable and sustainable growth, the use of natural resources for the benefit of the wider community, and the protection of the environment. In its economic mission to Papua New Guinea in 1976, the World Bank proposed two further goals:

- to raise the country's fiscal viability[5]; and
- for a gradual reorientation of the economy to costs and standards that could be sustained, using the country's resources.

These latter two goals complement those for self-reliance in that they encompass notions of sustainability.

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[5] This was to be measured by a rise in self-reliance, with the last being defined as the proportion of the government's total budgetary expenditure financed from domestic resources and foreign loans.

CHAPTER 4: POLICIES AT INDEPENDENCE

Full independence was acquired on 16 September 1975, but the bulk of the responsibility for economic policy making was acquired well before then. The Papua New Guinean Constitution, which was developed locally through an extensive consultative process, set out the goals for policy making. The Final Report of the Constitutional Planning Committee (CPC), which was tabled in the House of Assembly in 1974, made the following observation:

> 'We see the planning of our own Constitution as a vital aspect of the process of self-determination. It is not just the matter of our people determining that they should govern themselves. We have the opportunity of determining how we shall govern ourselves. To answer this question, we must know what philosophy of life we wish to live by, what social and economic goals we wish to achieve, and what kind of society we wish Papua New Guinea to be' (*Final Report of the Constitutional Planning Committee*, 1974, Part 1, in Somare 2001:17).

The Third *National Goal and Directive Principle* within the Preamble of the Constitution (GoPNG 1975) states that:

> 'We declare our third goal to be for Papua New Guinea to be politically and economically independent, and our economy basically self-reliant' (page 3);

This goal encapsulates themes of localisation and national sovereignty. For example:

- subparagraph 4 stipulates that citizens and government bodies should have control of the bulk of economic enterprise and production;
- subparagraph 5 stipulates strict control of foreign investment;
- subparagraph 6 mandates the State to take effective measures to control and actively participate in the national economy, and in particular, to control major enterprises engaged in the exploitation of natural resources; and
- subparagraph 8 warns against entering into agreements concerning foreign assistance that imperil our self-reliance and self-respect, or expose the nation to dependence on, and/or influence of, any country, investor, lender, or donor (*ibid.*:4).

There was also a clear recognition that resource exploitation would form the core strategy for the nation's economic development. The architects of the Papua New Guinean Constitution were cognisant of the policy challenges posed by such a strategy. The Fourth *National Goal and Directive Principle,* within the Preamble of the Constitution (GoPNG 1975) states that:

> 'We declare our fourth goal to be for Papua New Guinea's natural resources and environment to be conserved and used for the collective benefit of us all, and be replenished for the benefit of future generations' (page 4).

Subparagraph 1 within the Fourth Goal calls for the 'wise use to be made of our natural resources and the environment in and on the land or seabed, in the sea, under the land, and in the air, in the interests of our development and in trust for future generations' *(ibid.)*. It is difficult to argue that policies which have been implemented since independence have delivered on the above-quoted goals.

The section in the Constitution concerning basic social obligations places heavy emphasis on safeguarding the national wealth, with the theme of sustainable development, in the interest of both present and future generations. Sustainable development appears to be strong, as the following declaration demonstrates:

> 'that all citizens have an obligation to themselves and their descendants, to each other and to the nation to use profits from economic activities in the advancement of our country and our people, and that the law may impose a similar obligation on non-citizens carrying on economic activities in or from our country' (GoPNG 1975: 7).

Further, Clause (d), which concerns these basic social obligations, states that a goal is 'to protect Papua New Guinea and to safeguard the national wealth, resources, and environment in the interests, not only of the present generation, but also of future generations' (*ibid.*).

The overriding concerns of the first Somare government were independence, national unity, and a politically cohesive national government (Garnaut 1981: 163). These concerns were addressed — with limited success — and therefore have remained high on the priorities of all subsequent governments. A combination of fiscal, monetary, trade, and incomes policies have been employed in economic management.

CHAPTER 5: CHANGES IN ECONOMIC POLICY MAKING SINCE INDEPENDENCE[6]

Fiscal Policy

The period from 1976 to 1990 was one of broad macroeconomic stability, with the budget deficit contained within five percent of GDP, the inflation rate low and stable, and nominal interest rates low, relative to those of the major trading partners. Fiscal stabilisation in the first 15 years of independence was achieved primarily through the setting of annual expenditure, which was in line with the long-term capacity of the economy to fund such outlays. Revenue relied on the long-term understanding with Australia concerning aid flows, the establishment of mechanisms to stabilise income from commodity exports, and the judicious use of public sector borrowing.

The formative years of economic policy making in Papua New Guinea were exemplary, and were characterised by fiscal discipline, stable prices, and responsible governance. This was a remarkable achievement, given the limited capacities to achieve any of the stated economic policy objectives. This achievement does not discount the challenges of overcoming barriers to internal trade, seeing a rapid monetisation of the economy, containing the emerging social and economic problems associated with rising urbanisation and unemployment, and ensuring greater access to basic services for the broader population. In terms of macroeconomic fundamentals, institutions, and social infrastructure, the initial conditions were favourable for development.

The deterioration in the budget deficit began in 1991 and continued to worsen until 1999, as did other macroeconomic aggregates such as inflation, interest rates, government debt, and foreign reserves. Mawuli (1995) states that the loss of fiscal discipline was the primary reason for poor growth performance. However, this claim deserves closer scrutiny in light of quantitative evidence on macroeconomic aggregates.

The Hard Kina Strategy

Until late 1994, the exchange rate — in particular the use of the so-called 'hard kina policy' — formed the principal instrument of monetary policy. The hard-currency policy maintained the external value of the kina, relative to major world currencies. This policy was used to gain international credibility — including ready convertibility — of the new currency. The same policy was subsequently used to contain the risks of imported inflation, thereby stabilising domestic prices and real outlays. The kina was launched in April 1975, and was pegged, at par, to the Australian dollar. The pegging to the Australian dollar was rationalised on two counts that:

- Australia was then, and was likely to continue to be, Papua New Guinea's major trading partner; and
- Australian banks comprised, by far, the majority of the financial institutions in the economy (World Bank 1978:115).

The kina was revalued by five percent in July 1976 in order to contain inflationary pressures emanating from rising international commodity prices. This revaluation was possible then, given the favourable foreign reserves position. The kina rose an additional 12.5 percent

[6] This chapter covers selected policies up to 2001.

against the Australian dollar, after the devaluation of the latter by 17.5 percent on 29 November 1976. However, it fell by 7.2 percent against other world currencies.

The hard kina policy was only sustainable in the context of mutually consistent fiscal, monetary, and income policies. Garnaut (1981: 171) stated that:

> 'the art of the hard kina strategy was to establish mutually consistent and sustainable trends in *real* government expenditure, *real* wages, and *real* aid level, and to coordinate changes in *money* levels of these variables with changes in the exchange rate and price level.'

In essence, the hard kina strategy was used to target price stability, with the stated real variables being the intermediate target.

The simultaneous achievement of three goals of macroeconomic policy – *full employment,* constituting internal balance; *external balance,* meaning a sustainable current account; and *price stability,* implying low inflation – necessitates the use of three independent instruments (Salter 1959).

Typically, internal balance is targeted through government spending, external balance is targeted via the nominal exchange rate, while attaining price stability remains in the realm of the monetary authority. The hard kina strategy, which targeted price stability, was atypical. Consequently, the responsibility for attaining an external balance rested principally on fiscal policy, given the large share of public expenditure accruing to imports, while price flexibility was used to achieve full employment.

Garnaut (2000: 32) rationalises that:

> 'A *hard currency strategy*, based on cautious expenditure policies, was designed to achieve low inflation, a convertible currency, and financial stability'.

According to Garnaut (*ibid.*), this strategy was implemented in the immediate post-independence period, with tight control over expenditure, which was funded through moderate levels of domestic and foreign borrowing. This strategy culminated in real per-capita public sector outlays, which declined, over time, until the Bougainville crisis in 1989.

The hard currency strategy was abandoned following the switch to a floating kina in 1994, in the face of continuing liquidity crises resulting from the loss of fiscal discipline. The floating of the kina provided an opportunity to achieve external balance. However, the float was botched. The effectiveness of the floating of the kina in aligning the exchange rate to the fundamentals of the economy was 'hampered by intrusive exchange controls' (*ibid.*: 33). The lack of wage flexibility did not allow the achievement of an internal balance, thereby making the hard kina policy unsustainable (Duncan *et al.* 1998). The combination of wage indexation, together with the hard kina in a climate of subdued productivity growth, led to rising unemployment, which undermined the achievement of an internal balance.

Trade Policy

Papua New Guinea has traditionally been favourably disposed to international trade. At independence, an open-economy policy was pursued and adopted, with a liberal stance towards the use of exchange controls, foreign investment, imports, and the employment of foreign labour. The price incentives that were provided by the market were allowed to direct resource allocation.

Policy makers acknowledged the positive contributions to development that were made by international trade and foreign direct investment. The policy environment has generally been supportive of foreign investment and the use of necessary expatriate labour. However, some activities, were reserved for Papua New Guineans, in accordance with the stipulation in the Constitution that, 'particular emphasis in our economic development to be placed on small-scale artisan, service, and business activity' (GoPNG 1975: 5).

The early 1980s saw some backsliding on free trade, as protectionist pressures grew, and the political system began to respond to lobbying by business interests (Garnaut 2000). The liquidity problems of the early 1990s increased the nation's dependence on import duties, as a source of public revenues. Reliance on multilateral agencies, including the World Bank, to rescue the economy from several liquidity crises, saw a reversal in the protectionist tendencies of policy making. The introduction of a value added tax (VAT) in 1999 reduced the dependence on import tariffs as a source of public revenues, and provided further support to the liberalisation of commodity trade.

The ongoing liberalisation of trade can be partly attributed to pressures arising from Papua New Guinea's membership of several multilateral organisations and the signing of trade agreements. The accelerating pace of the integration of the Papua New Guinean economy into the global economy may be seen as being in conflict with the Third *National Goal and Directive Principle* which cautions against 'dependence on imported skills and resources' (GoPNG 1975: 4, Clause 7). On this issue, the Papua New Guinean Constitution is in conflict with current economic thinking that an open trading regime is a critical ingredient for the growth of production (Wacziarg 2002).

Incomes Policy

Papua New Guinea has pursued an active incomes policy, via centralised wage-setting mechanisms. The Minimum Wages Board, together with the labour unions, played a significant role in setting wages, until the lapse of the Board in 1992. Nominal wages were fully indexed until 1992, so that any initial disequilibrium which existed in the market remained, until deregulation. As a consequence, in the 1972 to 1975 period, real wages were maintained at levels that were well above those necessary for achieving an internal balance.

Wages rose rapidly during this period, with the minimum weekly wage in Port Moresby rising from K8 (US$9) in 1971, to K25.80 (US$35), by late 1975. Also, the national minimum weekly wage rose from K5.30 (US$6) to K8.90 (US$12) for workers in primary industries, and to K10.75 (US$15) for other rural workers. Moreover, the urban minimum wage was raised substantially above the rural minimum, thus increasing the incentive for rural-to-urban migration. Garnaut and Baxter (1984), estimated that, as of 1980, real wages for adult workers in Port Moresby would have to fall by as much as 30 percent, if it was to return to the level that prevailed in 1971.

The need for growth in employment, and the potential for job growth through the removal of impediments to the operation of the labour and informal markets were recognised well before independence. Faber *et al.* (1973: 60) warned against the damaging effects of increases in rural wages, on employment, and argued strongly for 'a policy of minimum average wage per capita, and maximum employment of numbers of wage earners'.

Their report stated that the informal sector was 'fully indigenous' and argued for 'a liberalisation of protective restrictions limiting competition in the urban economy' (*ibid.*: 25), in order to increase opportunities for self-employment. The report also stated that 'given that wage employment cannot absorb the growth in the labour force, self-employment must be a major source of indigenous income' (*ibid.*). Faber *et al.* (*ibid.*) saw the informal sector as the springboard for entrepreneurs to enter into the formal sector. However, the policies that were implemented, from independence through 1992, were basically contradictory to the recommendations in the Faber Report.

During this period, the labour market was deregulated, after unemployment had risen considerably. Together with the associated social problems of urban squatter settlements and crime, the general investment climate also worsened. High, legislated minimum wages for unskilled labour, which implied levels above those that would have prevailed under competitive conditions, became entrenched through indexation. This situation fed the growing unemployment problem, until 1992.

The abolition of the urban minimum wage in 1992, by the Minimum Wages Board, was too late, as the conditions for investment had deteriorated to the stage that wage deregulation, on its own, was no longer sufficient to reinvigorate private investment. The wage distortion had contributed significantly to urban unemployment and social instability, which raised the costs of doing business in the country.

Levantis (2000) provided empirical evidence in support of increased formal sector employment, after the deregulation. Even though urban real wages fell significantly after the deregulation, this could not be expected to lead to a substantial increase in employment, given the host of other non-wage structural impediments to private sector development that had built up during the period of wage indexation.

State-Owned Enterprise Reform

Recent major microeconomic initiatives include the privatisation program. Subparagraph 4 of the Third *National Goal and Directive Principle* calls for 'citizens and governmental bodies to have control of the bulk of economic enterprise and production' (GoPNG 1975). This control was initially exercised by the State, through engaging in the active supply of utilities, transportation, banking services, and participation in manufacturing. This strategy was not sustainable given the poor profitability of state-owned enterprises (SOEs), the increasing demands for budgetary support for loss-making, and the widespread abuse of any proceeds from the SOEs.

By August 1999, the Papua New Guinean Government had accumulated a debt of K2.2 billion, with K1.3 billion of this being owed to the Central Bank. Debt repayments for 1999 amounted to K300 million, which was a significant drain on the budget of some K2 billion. Foreign reserves had fallen sharply over the previous six months, and as of mid-1999, the kina was at an all-time low of approximately US$0.27. The inflation rate on a year-on-year basis, as of December 1998, was 24 percent, which was a sharp climb from five percent for the corresponding period a year earlier (Bank of Papua New Guinea 1999). Interest rates were at a record high, with the 180-day, Treasury Bill rate in excess of 25 percent.

These rates were more than four times those prevailing in Australia at that time. The high interest rates constituted a significant drain on the budget, given the country's high debt levels, and were also stifling the growth of the private sector. Private sector credit growth was falling, while highly geared firms were facing liquidation. Continuing support for loss-making SOEs in this climate was no longer an option. Consequently, the State had to withdraw from running businesses.

In 1999, the incoming Morauta government announced a *'reconstruction and development strategy'*, of which privatisation and corporatisation of public enterprises formed the core.[7] A package of policies was announced to deregulate the markets in order to enable the private sector to take the lead role in business activities. The withdrawal of the public sector from commercial enterprise was rationalised, as part of a broader strategy to stabilise prices and facilitate sustainable growth.

The sale of SOEs was to have a positive (net) revenue impact on the budget, which would be used to reduce domestic debt under the policy announced by the Prime Minister, Sir Mekere Morauta. It was argued that this, in turn, would lead to an easing of interest rates, and the stabilisation of the exchange rate and other domestic prices. It was also argued that, in addition to helping achieve the short-term goal of stabilisation, privatisation — and more generally the restructuring of the economy — would lead to stable and sustained growth. It was further argued that the withdrawal of the public sector from private commercial ventures would reduce financial wastage, and enable a more effective use of resources for development.

As of January 2002, the ownership of one SOE — the Papua New Guinea Banking Corporation (PNGBC) — had been transferred to the private sector, while several other SOEs were in the process of being divested. By the end of 2001, the kina had stabilised, the foreign exchange reserves had recovered to a healthy level, and interest rates on government bonds, as well as inflation, had returned to single digit levels. On most counts, the announced privatisation policy was delivering, well ahead of its implementation.

It could be argued that the privatisation strategy is not consistent — at least in spirit — with the stipulation for 'citizens and government bodies to have control of the bulk of economic enterprise and production' (GoPNG:4, Goal 3, Clause 4). However, economic reality dictated such a strategy. The State may still exert control over all domestic production, by performing its tasks as the regulator of commerce, as the privatisation strategy assigns such a responsibility to the State.

Value Added Tax

A value added tax (VAT) was introduced on 1 July 1999 as part of a base-broadening exercise by the Government. The VAT was considered to be necessary in a climate of trade liberalisation, where tariff reductions would erode the revenue base.[8] As part of the rationalisation of the tax system, the sales tax which had previously been imposed by provincial governments was abolished, and a mining levy was introduced to offset the loss in tariff revenues from imports by the mineral sector (Levantis 2001).

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7 Corporatisation had been pursued since the early 1990s. The Morauta regime used the privatisation strategy as a means of accelerating and expanding the corporatisation program.

8 As of 1998, approximately 25 percent of total tax revenues of K1.6 billion were from import duties. However, this share fell to 15 percent and 7 percent by 1999 and 2000, respectively.

The Papua New Guinea Constitution obliges the public to fund the development of the nation, based on their ability to pay such dues. In the Preamble of the Constitution, Clause (g) of the *basic social obligations* states this as 'to contribute, as required by law, according to their means, to the revenues required for the advancement of the nation and the purposes of Papua New Guinea' (GoPNG 1975).

Given that the VAT is compulsory on every transaction within the formal sector, this compulsion may be viewed as being contrary to the spirit of the Constitution. Although, the bulk of the poor avoid paying the VAT, by remaining involved in the non-formal economy, economic pragmatism dictates that the revenue base should be broadened, consistent with the global push to liberalise trade (personal communication, Agogo Mawuli).

Provincial Government Reforms

The devolution of authority, from the centre to the local-level governments, has been an important part of Papua New Guinea's political landscape. Its foundation was set in the Constitution, in Clause 2 of the *Second National Goal and Directive Principle,* which calls for:

> 'the creation of political structures that will enable effective, meaningful participation by our people in that life, and in view of the rich cultural and ethnic diversity of our people for those structures to provide for substantial decentralisation of all forms of government activity' (GoPNG 1975).

The system of provincial government, which was adopted at independence, was replaced in 1995 by the Organic Law on Provincial Governments and Local-level Governments (OLPGLLG). The meaningful decentralisation of authority from the centre to local-level governments and provincial governments remains a contentious issue, as Members of Parliament are represented at all levels of government under the OLPGLLG. As the creation of an autonomous Bougainville Province begins to take effect, the debate on possible alternative structures of government will intensify. In this debate, the trade-off between devolution and economies of scale will need to be seriously taken into account.

CHAPTER 6: REMAINING POLICY VOID

Many of the development challenges that were highlighted prior to independence remain relevant today. With respect to what is now Papua New Guinea, it was stated that:

> 'Along the western border of Papua and New Guinea, from Daru in the south to Aitape and Wewak in the north, communication has been difficult, resources poor, and the people have remained isolated, difficult to introduce to a cash economy, and in the Highlands, undiscovered' (in Bettison *et al.* 1962.: 2).

The Highlands Region has been discovered, but communication difficulties, the problem of isolation, and the difficulty of introducing a cash economy still remain today. This scenario highlights the fact that Papua New Guinea is made up of several smaller economies, which have limited opportunities for trade.

The income disparity between regions persists because opportunities for commodity trade are limited by the high costs of transportation. Similarly, opportunities for internal migration, which could reduce the income disparity between regions, are hampered by the lack of secure, long-term access to land. The latter issue also hampers the mobilisation of credit for investment and growth of the rural economy.

These situations can be relieved through the expansion of infrastructure such as regional road networks, coastal shipping, and the telephone grid. These are essential factors for increasing internal trade, and constitute some of the necessary preconditions for development. Reductions in the monopoly powers of service providers in telecommunications, aviation, shipping, and ports would reduce costs, and consequently encourage trade. Access to competitively priced transport and communication services would increase the size of the market, which, in turn, would provide benefits from economies of scale.

Problems arising from the rapid growth of urban populations must be addressed. As a matter of urgency, the State must consider options for expanding water and sewerage systems in Port Moresby and Lae. The burgeoning squatter settlements must be contained to enable proper urban planning to occur. The State could assist in facilitating secure, long-term access to land for residential and commercial development within the urban centres, by acting as the intermediary between landowners and 'tenants'. Consideration may be given to the expansion and commercialisation of the functions of the National Housing Commission[9], in order to contain the growth of squatter settlements. The private sector could be gainfully involved in these provisions, with the public sector underwriting the security of property rights to land and contracts. Eda Ranu has recently made some progress in addressing this issue in the provision of water to Port Moresby.

More concerted efforts have to be made to create opportunities for productive employment. Also, the expansion of road infrastructure has to remain a long-term objective. In the context of investments that are necessary for road infrastructure development, to enable access to cost-effective transportation, Fisk (in Bettison *et al.* 1962: 39) stated that, 'the sheer magnitude of the investment problem involved in the provision of such infrastructure is frightening, but it must be faced'. Fisk *(ibid.)* stated that, 'in the absence of

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[9] This will be more akin to Fiji's Native Lands Development Commission (NLDC), rather than the Housing Authority of Fiji.

an unexpected bonanza, such as the discovery of rich oil fields, *there is no other path to a viable economy*' [emphasis as in original text]. However, even the discovery of rich oil fields has not been sufficient to achieve a viable economy.

In the immediate term, better returns may be derived from existing infrastructure by enabling migration to their locations. The State may consider facilitating secure, long-term access to land around the major roads by acting as the intermediary between the landowners and those 'tenants' who wish to access the land. The objective would be to move labour to the available infrastructure in order to create opportunities for gainful employment. Such an initiative would ameliorate some of the problems arising from fragmented and thin markets, together with those emanating from high transportation costs that have acted as a major impediment to internal trade and growth of output.

These actions will need to be progressively implemented, and be driven by demand, possibly starting off with the peripheries of Port Moresby and Lae, and extending to the other urban centres. The private sector should be encouraged to provide the real estate services, with the State facilitating such provisions through enabling access to secure property rights and public safety.

It has long been recognised that the rapid development of the rural agricultural cash economy is crucial, if Papua New Guinea is to develop a viable economy. Fisk (*ibid.*: 25) considered an economy to be viable, if it is, 'sufficiently independent to be able to refuse aid without catastrophic economic and social consequences, if the terms on which the aid is offered are politically unacceptable'. On this definition, Papua New Guinea was not a viable economy during the repeated liquidity crises of the 1990s.

According to Fisk (*ibid.*), self-determination and political independence would not be possible, without clear support from external aid — particularly for recurring expenditures, at a minimum. Crawford (in Bettison *et al.* 1962) considered political independence to be separate from economic viability, and argued that external assistance would be necessary for the latter. Crawford (*ibid.*: 61) asserted that, 'continued economic progress of New Guinea, along modern lines, will call for heavy external aid for a long time to come'. Crawford (*ibid.*) saw Papua New Guinea as requiring aid for development to at least the early 1980s with the then Australian leadership showing willingness to provide such support for as long as the people of Papua New Guinea wanted it.[10]

Both West and Crawford (in Bettison *et al.* 1962), in their lectures some thirteen years before independence, noted that 'the problem of promoting self-government in the Territory, as a whole, is one of substituting wider loyalties for local village ones'.

According to Crawford (*ibid.*: 63), the primary challenge for economic policy, is to change the economy from subsistence, 'with a fringe of European plantations and urban industries, to a modern agricultural and even industrial economy'. Crawford (*ibid.*) envisaged full self-government in 10 to 15 years, if the process of such a takeover was to be commenced then. Many of the challenges for economic policy making that were noted in 1962 by Bettison, Fisk, West, and Crawford still remain.

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[10] See the statement by Minister Hon. Paul Hasluck, as quoted in Crawford (1962: 65).

There was considerable success in addressing several of the initial concerns in the first ten years of independence. However, many of the problems have returned with a vengeance in the 1990s. Interestingly, the solutions for many of the current policy dilemmas lie in the successes of the past. The immediate challenge is to rediscover them, and incorporate new initiatives to complement the proven strategies. To document such a rediscovery is beyond the purview of this paper, but it is part of ongoing research.

CHAPTER 7: CONCLUSION

Early policy making in Papua New Guinea placed significant emphasis on equity in income distribution and access to social services, sometimes even with full realisation of the costs of such interventions to growth. One of the main assertions that were stated in the Preamble of the Papua New Guinean Constitution is 'that our national wealth, won by honest, hard work, be equitably shared by all' (GoPNG 1975).

The *Second National Goal and Directive Principle* states:

- under Clause 3, that 'every effort to be made to achieve an equitable distribution of incomes and other benefits of development among individuals and throughout the various parts of the country' (*ibid.*); and
- while Clause 4 calls for the 'equalisation of service in all parts of the country, and for every citizen to have equal access to legal processes and all services, governmental or otherwise, that are required for the fulfilment of his or her real needs and aspirations' (*ibid.*).

On these two counts, economic policy making has failed. Morauta (2000: 3) stated that, 'we have not made the most of our resources and our wealth. Our destiny remains unfulfilled'. This is a most telling statement on this front. However, much can be drawn from the successes of the past in the design of future economic policies.

The first Papua New Guinean Minister for Finance following independence, Sir Julius Chan, stated in his 1976-1977 budget speech that:

> 'Without stable revenue, a stable currency and a sound economy the positive work of development would be undermined from the start – a fate, I must add, which has overtaken many developing countries that began with the highest hopes' (in Garnaut 1981: 158).

Indeed, Papua New Guinea was also overtaken in its ability to maintain the preconditions for development, and Julius Chan was in the driver's seat during part of this period. Much of the policy making in Papua New Guinea has been to the neglect of targeting internal balance. Consequently, unemployment has received little attention. The large and rapidly growing pool of workers in search of formal employment is testimony that urgent attention is long overdue on this front.

The struggle in the latter part of 1999 to stabilise the currency and begin to place the fiscal position back on an even keel has continued, and will remain for the foreseeable future. The challenge of policy making for sustainable development in Papua New Guinea is more about rediscovering what worked in the past, rather than continually trying new initiatives.

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